IMPACT OF FOREIGN DIRECT INVESTMENTS ON THE GROWTH OF NIGERIAN ECONOMY

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BY

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BEING A DISSERTATION SUBMITTED TO THE DEPARTMENT OF ACCOUNTING, BANKING AND FINANCE,
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DECLARATION

I hereby declare that this dissertation is a product of my original ideas and has not been previously submitted either in part or in full to any institution for the award of any certificate or degree.

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CERTIFICATION

It is hereby certified that this dissertation which was written and submitted by Gilbert, Mofiezibe, Mourphy (PG/14/15/229826) of the Department of Banking and finance, Faculty of Management Science, Delta State University, is accepted in partial fulfilment of the requirements for the award of Masters (M.Sc.) degree in Banking and finance.

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DEDICATION

This research is dedicated to God Almighty for His love and grace, for His unending love, faithfulness, protection, provision, guidance and infinite mercy.

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ABSTRACT

The study analyzed the impact of foreign direct investment on the Nigerian economic growth over the period of 1972-2015. The data used in this study are secondary, sourced from various publication of the World Economic Outlook (WEO) and the Central Bank of Nigeria, such as: statistical bulletins, annual reports and statement of accounts. Regression analysis was adopted based on the OLS technique using the standard package for social sciences to determine the relationship between foreign direct investment and Nigerian economic growth. the findings shows that economic growth is directly related to inflow of foreign direct investment as all the hypotheses revealed below statistical significant at 5% level which implies that a good perform of the economy is a positive signal for inflow of foreign direct investment, this implies that foreign direct investment is an engine of an economic growth. The study therefore, recommends that government should liberalize the foreign sector in Nigeria so that all barriers to trade such as illogical tariffs, import/export duties and other levies should be reduced so as to encourage investors as well make policies that will ensure enabling environment for foreign investors to invest in the economy and Nigerian government should also ensure that the qualities of exportable commodities are improved upon to bring about international competitiveness of goods. Both the private and public sector goods in Nigeria should have high level value addition in such a manner that investors can tap into. This can be achieved through the development of the indigenous technology.

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CHAPTER ONE

INTRODUCTION

1.1 Background to the study

An Investment is well thought-out to be a Foreign Direct Investment (FDI) if non-resident entities or individuals hold 10% or more of the equity share in a resident entity, together with all levels of Fellow Enterprises and Direct Investments of even less than 10 percent of shareholding (Farkas, 2012).

Businesses that make up Foreign Direct Investment are often referred to as multinational enterprises (MNE). Sometimes FDI can provide better advantages for the MNE but not for the foreign country, and sometimes the other way. For a foreign multinational enterprise to find it profitable to enter a domestic market, some conditions need to be satisfied. This means that the profit needs to be higher than the costs, such as communications, transportation, stationing personnel abroad, barriers due to language and customs. It's critical to identify the advantages for the multinational enterprise under which direct investments will occur. Dilby. (2014) suggested three conditions that need to be present for a firm to find incentives for direct investment; He explains this as ownership, location and internalization (OLI).

In the face of insufficient resources to finance long-standing development in Africa and with poverty diminution looking increasingly bleak, attracting FDI has assumed a prominent place in the strategies of African countries. The experience of a minute number of fast-growing East Asian newly industrialized economies has strengthened the confidence that attracting FDI could bridge the resource gap of low-income countries and shun further build-up of debt at the same time directly tackling the causes of poverty (UNCTAD 2004). Despite the fact that FDI has been flowing to different regions of the world in growing magnitude, Africa has been receiving the least of global FDI inflows. African countries,

like many developing countries need a substantial inflow of external resources in order to make up for the savings and foreign exchange gaps associated with a rapid rate of capital accumulation. Africa also needs growth to overcome widespread poverty and Africa's development crisis is unique as it is the poorest region in the world and remains caught up in debt (Egbo O, 2010).

Since FDI can generate employment opportunity and operate as a vehicle of technology transfer, local firm's to gain access to international markets ,provide better-quality skills and administration techniques, aid and augment product diversity, FDI can hence be an mechanism of economic growth and development in Africa where its needs cannot be overemphasised (Umah, K.E, 2011.)

The proof on growth and poverty reduction is best approached by looking at two countries that has experience poverty reduction; China and India. A huge majority of the world's poor reside in these countries but both countries achieved considerable reductions in poverty during the 1980-2000 when they grew rapidly by opening up to foreign investment (Nwillima N. 2010).

Ugwuegbe S., Okore A.O and John O.O (2013) argues that Africa is actually suffering from poor governance (as in Zimbabwe) and prevailing war and violence (as in Angola, Congo, Liberia, Sierra Leone and Sudan). To overcome many of the constraints on productivity, Africa will require a sustained program of targeted investments. According to the *2005 World Development Report*, governments need to improve their country's investment climate in order to increase the opportunities and incentives for enterprises, both domestic and foreign, to invest productively.

1.2 Statement of the Problem

It is generally alleged that economic growth depends critically on both domestic and foreign investments. However, empirical studies on the influence of FDI on economic growth are concerned with either the general effect on growth (or net welfare) or with explicit aspects of the FDI influence on trade, employment, technology, , entrepreneurship and other areas of the economy, such as, health, infrastructures and education

Despite the plethora of studies on FDI and economic growth in Nigeria, the existing empirical indication on the underlying relationship between Foreign Direct Investment and economic growth and the associated benefits is very inconclusive. Despite the seemingly positive association between FDI and economic growth, the empirical literature has not reached a consensus on the trend of this impact, thus suggesting that Foreign Direct Investment can be either beneficial or harmful to economic growth. Moreover, in the framework of the developing countries like ours, little research has yet been done on the topic. The principal driving force for this work is that, for developing economies, and for Nigeria in particular, the issue of economic growth is an important one. These countries have been stimulating growth with the help of various techniques, including policies that would aim at foreign capital and technology transfer. It is thus, of interest to investigate whether the start of growth can be attributed to an increased inflow of FDI into the country over the period under review. It becomes natural therefore to ask: if the growth which has been experienced in the economy for the past years was as a result of the contribution of Foreign Direct Investment or if the country has already attained this growth level before attracting Foreign Direct Investment. The current theoretical developments in the area of economic growth propose that successful developing countries were able to grow in large part due to the "catch up" process in the level of technology, One of the major channels of the access to advanced technologies is Foreign Direct Investment.

Thus, an analysis of enhanced economic growth through the advancement in technology can be closely related with modelling the relationship between growth and Foreign Direct Investment. Again, current theoretical developments allow researchers to model and appraise not only the short-run, but also the long run impact of Foreign Direct Investment on economic growth. 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. thus, these studies essentially modelled the influence of natural resources on Nigeria's economic growth. Most of the other empirical research that has been undertaken in this area has used panel data for a number of countries to establish the causal relationships. The results of studies carried out on the linkage between FDI and economic growth in Nigeria are not unanimous in their submissions. Due to this reason, it therefore becomes difficult to ascertain the direction of FDI and economic growth relationship in Nigeria. There is therefore limited exhaustive country specific research studies to establish the causal relationship and interaction between Foreign Direct Investment and economic growth. Hence, Chowdhury and Mavrotas (2010) proposed that individual country studies be carried out to ascertain this causal relationship. This thus provides a major incentive for this study.

1.3 Research Questions

Research questions refer to the foremost questions to which the researcher seeks to offer answer to during the course of the investigation (Olannye, 2006). Given the hypothetical and critical evaluation of the research objectives. The following questions will accentuate the subject matter of the study.

i. Does foreign direct investment have any significant impact on GDP?

ii. Of what importance is interest rate in the determination of GDP in Nigerian?

iii. How does the rate of inflation affect GDP in the Nigerian economy?

iv. To what extend does exchange rate affect GDP in the Nigerian economy?

1.4 Objectives of the Study

The broad objective of this study is to assess the impact of Foreign Direct Investment on the Nigerian economy while the specific objectives are:

i. To determine how FDI has impacted on the GDP Nigerian economy.

ii. To ascertain how interest rate has affected GDP in Nigerian economy.

iii. To determine how the rate of inflation has affected GDP Nigerian economy

iv. To determine the impact of exchange rate on the GDP in Nigerian economy.

1.5 Statement of Hypotheses

Olannye (2006) theorizes that hypotheses are unsure statements about expected relationship(s) between independent and dependent variables. They are referred to as intelligent predicts, hunches, or conjectural statement between two or more variables which the researcher expresses to guide his research for solution to the problem.

For proper investigation and finding, the following hypotheses will be formulated f or testing.

i. **Ho₁**: There is no significant relationship between FDI and increase in GDP

ii. **Ho₂**: There is no significant relationship between interest rate and GDP in Nigerian

iii. **Ho₃**: inflation rate does not have any significant relationship with the GDP in Nigerian.

iv. **Ho₄**: There is no significant relationship between exchange rate and GDP in Nigeria.

1.6 Scope of the Study

This study covers a period of forty-one years, ranging from 1972-2015. The data for the study will be extracted from the World Bank statistics Online Data Base, World Economic Outlook, and the Central Bank of Nigeria Statistical Bulletin, and is limited to FDI, EXCH, INF and INTR, as the explanatory (independent variables) while gross domestic product (GDP) is the explained (dependent variable). The study employed time series data and the reasons for using it is because the study is only for Nigeria data and is collected over a period of time interval which is annual time series data.

1.7 Significance of the Study

It is imperative to point out that on completion of this work by the researcher, it would be of immense significance to the following:

I. The researcher confidently believes that the result of this research work will assist policy makers to enact appropriate policies that will inspire foreign investors to invest in the nation's economy so as to combat deficit balance of payment in the country.

II. The research study will be significant in a number of ways apart from achieving set objective, other researchers on the same or similar topic will find this work useful, as it will form a basis for review of related literature and also a stepping – stone for future researchers.

1.8 Limitations of the Study

Every research work faces one limitation or the other. In this research work, the researcher encountered some limitations in the course of carrying out this project, some of them are as follows:

I.   Data were gotten from different sources e.g. world economic outlooks, Central Bank of Nigerian statistical bulletin, etc, some of these sources show different figures and information from other sources on the same subject matter.

II. Model specification. The model specification for this research is not 100% accurate, however, despite these limitations the authenticity of this research is not jeopardized

1.9 Definition of Terms

Absorptive capacity: Absorptive capacity is a limit to the rate or quantity of scientific or technological information that a firm can absorb. If such limits exist they provide one explanation for firms to develop internal R&D capacities.

Capital Flight: The act of repatriating capital generated within one country say Nigeria, to other countries.

Capital formation: It is a measure of the net additions to the (physical) capital stock in an accounting period, or, a measure of the amount by which the total physical capital stock increased during an accounting period

Direct investment: More commonly referred to as foreign direct investment, refers to an **investment** in a business enterprise in a country other than the investor's country designed to acquire a controlling interest in the foreign business enterprise.

Gross Domestic Product (GDP): Is the total value of goods and services produced in a country over a period of time.

Interest Rate: Interest rate is the amount charged, expressed as a percentage of principal, by a lender to a borrower for the use of assets.

Merger and acquisition: This refers to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid, finance, or help a growing company in a given industry grow rapidly without having to create another business entity.

.**Portfolio investment**: The purchase of stocks, bonds, and money market instruments by foreigners for the purpose of realizing a financial return, which does not result in foreign management, ownership, or legal control. eg purchase of shares in a foreign company, purchase of bonds issued by a foreign government, acquisition of assets in a foreign country, and purchase of stocks in a foreign company.

Purchasing power parity (PPP): Is a postulation of long-term equilibrium exchange rates based on relative price levels of two countries. In other words, PPP is the amount of a certain basket of basic goods which can be bought in the given country with the money it produces.

1.10 Organization of the Study

This research work is arranged into five chapters. The logical organization of the work will gives the study its uniqueness, and makes it very simple and clear.

Chapter one: Deals with introduction and overview of the study. It also includes the statement of problem; objectives of the study, definition of major terms etc.

Chapter two: Focus on the review of related literature. In this chapter two we will emphasized the various conceptual models, theoretical reflections and empirical studies.

Chapter three: Pertains to the research methodology employed for carrying out the study.

Chapter four: Cover the presentation of data and analysis of the data used for study.

Chapter fiver: Is the last chapter of the work and it deal majorly with the discussion findings of this study in details, conclusion was drawn from the findings and recommendations was made as well.

1.11 Summary

In the chapter above, the various conditions, circumstances and thought process that led to the choice of the topic were expatiated upon. The basic foundation of this investigation was also explained. We went further to critically examine the problem of this investigation as well as significances. We bore in mind the various questions arising from the investigation as well as formulated some hypotheses for testing. This section concludes with the definition of major terms, if the work must be read and understood by everyone.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The main objective of this chapter two is to provide a comprehensive review of related literatures on the impact of foreign direct investment on the growth of the Nigerian economy. This chapter is however divided into three sections. Section 2.2 deals with the conceptual framework of the study Section 2.3 deals with the theoretical frame work of the study. Here different theories that are related to foreign direct investment and economic growth are reviewed.. The section following is section 2.4 which is concerned with the

empirical review of related literature on foreign direct investment and economic growth.2.5 Deals with filling the gap in knowledge

2.2 Conceptual Framework

World Bank 1996 in Ekperiwe (2011) theorized, foreign direct investment as an investment made to procure a long-term management of about 10% of voting stock in business operating in a nation other than that of the investor defined according to residency. The logic behind the FDI is that companies could be looking for lesser resources cost, pursuing market share as well as sales growth in overseas countries. It could be directed at exploiting assets of foreign firms or supplying the foreign firms with input resources as the case may be. According to (Shenkar, 2007). André (2008) Asserted that FDI is an investment made to acquire long-lasting interest in a business investment operating outside of the economy shorelines of the investor. He added that the domestic enterprise and a foreign affiliate together form a transnational or offshore corporation. In order to qualify as FDI, the investor must afford the parent enterprise control over its foreign affiliate and such control exist when the parent enterprise owns 10% or more of the ordinary shares or voting power of an incorporated firm or equivalent for an unincorporated firm, it is known as portfolio investment (André, 2008).

2.2.1 Gross capital formation

This captures all the real-value-added to the country's economy in real-asset-terms which will lead to additional augmentation of savings, investment and generation of more wealth in future. It is defined as an accumulation to stock of capital assets set aside for future productive endeavours in real sector which will lead to more growth in physical capital assets of the country. Gross Capital Formation is measured by the total value of a producers acquisitions, less disposals of fixed assets during the accounting period plus certain additions to the value of non-produced assets (such as subsoil assets or major improvement

in the quantity, quality or productivity of land) or realized by the productive activity of institutional units. It has a positive impact on private savings accumulation in the sense that increase in capital formation will lead to more savings. When savings accumulate it will lead to an increase in gross domestic investment (GDI) and income generated as a result of the investment projects made will, in turn, led to GDP growth (Anyanwu,1998).

2.2.2 Inflation rate - Inflation can simply be defined as a general and continuous rise in the prices of goods and services. The conservation of price stability is one of the principal objectives of macroeconomic management. In an inflationary economy, it is problematic for money to act as a medium of exchange and store of value without adverse effects on output, employment and real income. (CBN, 1998) Inflation can simply be said to mean an overall and continuous increase in the prices of goods and services.

2.2.3 Exchange rate- This is the rate at which one nation's currency is compared with the value of another country's currency. If one nations exchange is higher than the other, it affects the purchasing power of the lower exchange rate of a particular country. Example, Nigerian naira rate is lower compared to dollar of America therefore an American will have a higher purchasing power than a Nigerian. Currency devaluation measured by the exchange rate is likely to encourage inward FDI in the host country as it makes the host country's assets undervalued, reduces the unit cost of the host country's factor of production and increases the relative wealth position of foreign investors (Froot and Stein, 2011; Globerman and Shapiro, 2013; Ramirez, 2006). However, the counter argument also holds that as foreign investors might take a depreciating domestic currency as a signal of future depreciation and thus reduce investment (Globerman and Shapiro, 2013). Moreover, Ramirez (2006) also argues that the appreciation of the domestic currency might attract inward FDI as it enhances the foreign currency value of the remittances of profits and dividends back to the parent company. Empirical studies on developed countries reach

mixed conclusions about the effect of exchange rate on FDI. Four studies find a positive link, four studies find a negative link and four studies do not find a link between the two variables

2.2.4 Interest rate – This is the cost of borrowing, cash, bond, credit, stock, mortgage, government borrowing. Interest rate reaches a peak just before recession and fall through the recession. Increasing interest rate signal an expanding economy and when already high interest rate begins to rise even further and faster, that is a sure sign of the beginning of inflation.

2.2.5. *Macro-Economic Studies on the Overall FDI-Led Growth Hypothesis*

Macro-economic level studies confirm the effect of FDI on economic growth. These studies used aggregate FDI flows for a *cross-section of countries.* And they establish that FDI inflows contribute positively to economic growth in the host economy, relying on particular conditions, such as the level of income, human capital development, the degree of openness, financial development, infrastructure development, and institution development. For example, the impact of FDI may perhaps be higher in export promoting (EP) countries than in import substituting (IS) countries. Following Bhagwati (1978) as cited in Elboiashi, H, A (2011), investigated the role of FDI inflow in the economic growth process. This was for 46 developing countries and tested the hypothesis that outwardly and inwardly oriented trade policies have significant consequences in attracting FDI inflow and in the impact of FDI on economic growth. They found that the countries that adopt IS are likely to be less attractive to FDI inflow. And the impact of FDI on economic growth is not as great. In contrast the countries that adopted EP are probably highly attractive for FDI and the influences of FDI are larger than the effects of DI on economic growth. They point out that since openness is crucial in determining the effect of FDI on economic growth and efficiency, more honest countries benefit more. According to Alfaro et al. (2004), the

impact of FDI on economic growth is favourable for countries that have excellently developed financial markets. Another study by Alfaro (2003) argues that the effect of FDI on economic growth relies on the FDI operations. FDI contributes positively to economic growth, if FDI operates in the manufacturing sector, negatively in the primary sector and unclearly in the service sector. Razin (2013) argues that the effects of FDI on economic growth depend on the nature of foreign capital inflows into the host country, and the degree of development in the host country. Agosin and Mayer (2010) illustrate that FDI in the form of mergers and acquisitions (M & As) leads, in some way, to the transfer of the existing assets from domestic to foreign investors. FDI, therefore, has not contributed to the accumulation of capital formation, and subsequently to economic growth of the host economy for 78 developing countries, found that FDI has to be beneficial to high-income developing countries rather than low-income developing countries. Thus, the host country should have a certain threshold level of development to absorb the benefits of FDI.

A study by Borensztein *et al.* (2011), on one hand, tested the effect of FDI on economic growth for 69 developing countries over two periods (1970-1979 and 1980-1989), based on the endogenous growth model. The results show that FDI is economic growth enhancing if the country has a high level of human capital development exceeding a given threshold. They argue that the impact of FDI depends on the level of human capital development in the host country, and that FDI contributes relatively more to growth than DI. On the other hand, Makki and Somwaru (2010) found that FDI and the interaction of FDI with trade openness, made a positive impression on economic growth for 66 developing countries over three periods (1971-1980, 1981-1990, and 1991-2000). Certainly, cross-country techniques may be making the effects of FDI on economic growth different between studies, because the production functions, such as technological techniques, are absolutely different from one country to another. Statistically, cross-country

studies may suffer from serious endogeneity problems and unobserved heterogeneity. Theoretically, rapid economic growth usually produces higher demand and enhanced returns prospects for FDI.

The positive impact of FDI is outcome of positive correlation between them and may be accompanied by causality between growth and FDI (Nair-Reichert and Weinhold 2012). Other types of studies apply *traditional panel techniques*. Panel data techniques are used to escape the problems associated with cross-country studies, such as unobserved country specific effects. This is done by controlling the endogeneity problem by including lagged explanatory variables in regression equations, and allowing for testing the Granger causality (Herzer *et al*. 2010). For instance, Nair-Reichert and Weinhold (2012), for 24 developing countries over the period (1971-1995), found that FDI has had a positive impact on economic growth. Carkovic and Levine (2012), for 68 countries over seven 5-year periods (1960-1995), found that FDI does not exert a positive impact on economic growth. Changyuan (2011) examined the direct and indirect effects of FDI on economic growth in the 29 mainland provinces in China for the period 1987-2001, based on the neo-classical model.

The findings indicate that FDI and private investment have no direct effect on economic growth, but state-owned investment has a direct effect on economic growth. The findings also clarify that FDI significantly increases the total factor productivity (TFP) and both private and state-owned investment have no significant effect on TFP. In particular, FDI has a positive effect on economic growth not through its direct effects but through its indirect effects by affecting technological progress and DI. The problems associated with traditional panel data studies are that; the regression is subjected to the unrealistic homogeneity conditions on coefficients of the lagged dependent variables; the standard cross-country and panel studies on FDI and growth may restrict the relationship between

these variables to those in growth rates or first differences; and using first differences and/or growth rates without allowing for the level of relationship may lead to serious misspecification problems (Hansen and Rand 2013). According to cointegration panel studies, they used these techniques to avoid the criticisms of traditional panel data estimators. Panel cointegration techniques can allow for country level, time-fixed effects, and country-specific cointegration vectors (Herzer et al. 2010). Basu *et al.* (2013), for 23 developing countries over the period (1978-1996), found there is a cointegration relationship between FDI and economic growth. Also that there is a bi-directional causality between these two variables in the open economies, and uni-directional causality, mainly the causality runs from GDP to FDI in the closed economies. Their results imply that FDI and GDP are not reinforcing under restrictive trade regimes. Similarly, Hansen and Rand (2006), for 31 developing countries over the period (1970-2000), found that there is a cointegration relationship between FDI and GDP, and between the ratio of FDI to gross capital formation (DI) and GDP. Their findings indicate that FDI inflows have a positive impact on GDP, whereas GDP has no long-run effect on FDI. Additionally, the ratio of FDI to DI has positive consequences on GDP. Their results imply that FDI enhances economic growth through knowledge transfer and implementation of new technologies.

In spite of the advantages of modern panel cointegration techniques, the heterogeneity problems remain a serious concern. The refusal of the null hypothesis (that there is no panel cointegration) may be driven by a few cointegration relationships between variables. In addition, assuming the whole panel is cointegrated can create high risks if only a small fraction of the relationships in the panel are actually cointegrated (Herzer et al. 2010). Thus, applying cointegration techniques if there is a mix of cointegration and non-cointegration relationships between variables, may lead to serious prejudices in determining causality as well as the short-run and long-run coefficients. Eventually, in

order to avoid the problems associated with using modern panel cointegration techniques, numerous studies applied time series for individual countries. These studies usually apply *time series analysis or time series cointegration techniques* to illustrate the causality between FDI and economic growth for country-by-country studies (Ramirez 2006). For example, Bouoiyour (2013) examines the determining factors of FDI in Morocco, using annual data by applying an econometric model for the period from 1960 to 2003. He argues that the instability of Moroccan economy growth leads to obstacles in attracting FDI inflows. Adewumi (2016) examines the contribution of FDI to economic growth in Africa using annual series, by applying time series regression analysis for the period from 1970 to 2003. He finds that FDI contributes positively to economic growth in most of the countries but it is not of statistical significance. Adewumi (2016) Argue that the impact of FDI on economic growth is through its contributions to other factors in the economy; however, its impact cannot be measured directly. In addition, he expected that the negative impact of FDI on the economic growth was due to the methodology used with a low sample size. Additionally, FDI inflow to Africa is relatively small and this may lead to its contributions as being relatively slight. Besides, the impact of FDI on the economic growth may need a considerable time to be achieved. This is especially so if FDI operates in the non-oil sectors where the profits can take a considerable time to be obtained. Herzer *et al.* (2010) apply time series techniques over the period (1970-2003) for 28 developing countries (10 countries from Latin America; 9 countries from Asia; 9 countries from Africa). They find weak evidence that FDI enhances either long-run or short-run economic growth (GDP). Also their findings indicate that there is unclear evidence that the impact of FDI on growth (GDP) depends on the level of per capita income, the level of education, the degree of openness and the level of financial market development in the host country.

Despite these results, the majority of time series studies, applying modern cointegration techniques developed by Johansen (1988; 1991; 1995) and Johansen and Juselius (1990), may tend to falsely reject the null hypothesis of no cointegration in the small samples (Tang . 20013). Thus, the cointegration and the causality between variables are unsupported by the data. And the validity of the findings of these studies, which do not suffer from small samples, may be biased and this needs to be examined (Bouoiyour, J. 2013).

2.2.6. *Micro-Economic Studies on the Technology Advances in FDI Firms*

These types of studies used micro-economic data in the industry/sector level or at a firm level. These studies tested the hypothesis of FDI firms being technologically more advanced and more productive than domestic firms. Colen, L., Maertens, M. and Swinnen, J. 2010) . For example, Aitken and Harrison (2011) applied panel data on Venezuelan plants, finding that foreign equity participation is positively associated with plant productivity; yet, this relationship is only robust for small enterprises. Lall (2013) points out that some crucial factors need to be taken into account regarding findings that indicate that FDI firms are more efficient than domestic firms. For example, firm size, the technology used, and market conditions. Lall (2013) postulated this comment on the study by Vaitsos (1976) who found that FDI firms have higher labour productivity than domestic firms, because FDI firms use more advanced technology, scale economies or better management Lall (2013). A study by Smarzynska (2014), based on firm-level panel data from Lithuania, found that the productivity of domestic firms is positively correlated with the degree of potential contacts with multinational customers. But not correlated with the presence of FDI firms in the same industry or the existence of multinational suppliers of

intermediate inputs. Haddad and Harrison (2009), based on firm-level data from the Moroccan manufacturing sector, found that the hypothesis of a foreign presence accelerating productivity growth in domestic firms can be rejected. Aitken and Harrison (2011), Konings (2011), Gorg and Greenaway (2013), and Herzer et al. (2010) argue that FDI firms can affect domestic firms negatively through competition effect, which lead to reduce the productivity of domestic firms. MNCs have some firm-specific advantages over domestic firms that moves up the cost curve of domestic firms. And this change allows FDI firms to take away the demand from domestic firms forcing them to reduce or cut production. Konings (2011) applies firm-level panel data from Bulgaria, Romania and Poland. He investigates the effects of FDI on the productivity performance of domestic firms. Konings (2011) finds that FDI firms perform better than domestic firms for Poland without foreign partnership, but not for Romania and Bulgaria. He argues that it may take time for ownership effects to affect performance, due to lags in re-establishing. Moreover, Gorg and Greenaway (2003), argue that MNCs may also have firm specific knowledge advantages over domestic firms, and that domestic firms have underdeveloped production technology and low skill employees. Djankov and Hoekman (2010), based on firm-level panel data from the Czech Republic, find that domestic firms with foreign ownership have higher total factor productivity (TFP) growth and higher labour productivity. This indicates that FDI firms have a positive impact on TFP growth of recipient firms, because FDI firms may tend to invest in firms with above-average productivity. In addition, this reflects the fact that joint ventures have higher TFP growth than firms without foreign partnerships.

According to Blomstrom and Sjoholm (2014), based on firm-level Indonesian data, found that foreign establishments have comparably high levels of labour productivity and the level of labour productivity is unaffected by the degree of foreign ownership. This indicates that FDI firms have a wide range of technologies to choose from when they invest

abroad. And that they will match their technology transfer to the competitive situation and other conditions in the host economy.

2.2.7. The Indirect Impact of FDI on Economic Growth

Various developing economies have been offered special treatment by foreign enterprises. The rational is stemming from the belief that FDI creates externalities in the form of technology transfer (Aitken and Harrison, 2011). The countries that invited MNCs may understand the need to access technologies that cannot be produced by domestic firms. These benefits are confined to spillovers.

Notwithstanding that, the advantages of FDI do not accumulate automatically and evenly across countries, sectors and local communities (OECD 2002). FDI is particularly foremost because it is seen as a package of tangible (capital accumulation; physical and human, and technology advances) and intangible (technological augmentation, organizational arrangement, and skill acquisition and know-how) assets (Ajayi 2006). These assets may not only accelerate productivity and growth from within the newly-entered MNCs, but may additionally spillover to other firms in the host country. And furthermore cause welfare economic growth in these countries through indirect or spillovers effects (Colen et al. 2010). FDI is considered as the primary channel through which technological transfer occurs. The subsequent effect of FDI on domestic economic growth depends on the diffusion of best practice through the local economy at large (Ajayi 2006). There are different forms of spillover effects that can be produced by MNCs and different channels through which they take place. The one motivating force behind attracting MNCs and associated FDI on the host economy is the boost of the domestic firm's productivity. This is correlated to the concept of productivity or technology, which embodies the fact that foreign enterprises own intangible assets, that can passed on to domestic firms, improving

their productivity level. Thus, productivity distribution is an issue of externalities, which are often referred to as productivity spillovers, from established foreign producers to domestic producers (Proenca et al. 2012). Blomstrom and Kokko (1998) argue that when MNCs set up affiliates outside the home country, they are different from the existing firms in the host economy for two reasons. The first reason is that MNCs bring to the host economy some aggregate of their proprietary technology. This technology constitutes their firm-specific advantage and allows them to compete successfully with other existing domestic firms that presumably have superior knowledge of domestic markets, consumer preferences, and business practices. The second reason is that the entry and presence of MNCs affiliates disturbs the existing equilibrium in the market and forces domestic firms to take action to protect their market shares and profits. These reasons may generate different types of spillovers. One of these types is productivity spillovers. These take place when the entry of MNCs in the host economy leads to productivity or efficiency benefits in the domestic firms and the MNCs are not able to internalise the full value of these advantages. In addition, the productivity spillovers may take place when the entry of MNCs leads to more severe competition in the host economy, which forces domestic firms to use existing technology and resources more efficiently. This kind of spillover may take place if the entry of MNCs raises the competition that forces domestic firms to search for new and more efficient technologies (Blomstrom and Kokko 1998; Colen *et al.* 2010). Market access spillovers take place when the entry of MNCs in the host economy leads to improved access to export markets for domestic firms (Colen *et al.* 2010). MNCs have better organised management that allows them to manage international marketing, distribution, and overall production more effectively than domestic firms, particularly those in developing countries. MNCs can provide both knowledge of international market conditions and access to foreign marketing and distribution networks to domestic firms.

MNCs, also, are often larger than domestic firms and may be able to fund the high fixed costs for development of transport, communications, and financial services that are essential in encouraging export activities. Another type of spillover effects is horizontal spillovers. These take place when MNCs formulate horizontal direct investment to produce overseas the same lines of goods as they produce in the home economy. The entry of MNCs leads to increased productivity that promotes other firms within the same sector to recover their performance and competitiveness by adapting new technologies or by renting trained workers and managers from FDI firms. Therefore, horizontal spillover effects may occur when domestic firms are unable to catch up with the augmented performance of other firms within the same sector. This action may force domestic firms to reduce their market shares (Stancik 2012). MNCs are not likely to give the source of their competitive advantage away at zero cost. They will hence strive to limit horizontal spillovers (intra-industry) of productivity and market access advantages to compete with domestic firms. Although, technology and knowledge are characterised by imperfect markets or known as public goods, thus, spillover of technology and knowledge or trained labour to domestic competitors cannot be completely prevented (Colen et al. 2010).Ultimately, vertical spillovers (inter-industry) take place when MNCs formulate vertical direct investment to produce overseas a new good or with other inputs to their production process at host country as they produce at the home economy. Firms from sectors other than that of FDI firms might be affected by its presence also if they are in direct business contact with it through forward and backward linkages. This includes firms that supply or provide services for FDI firms, and firms that are supplied by FDI firms. In general, MNCs desire higher standards from their suppliers, and the higher standards are provided by FDI firms to domestic firms, which would improve the domestic firms' efficiency and performance (Stancik 2012). MNCs tend to prevent the transfer of technologies to host country competitors; they are

likely to optionally increase the efficiency of domestic suppliers or customers through vertical input-output linkages (Colen *et al.* 2010).

Markusen (2010) argues that horizontal FDI, which means the foreign production of products and services approximately similar to those the firm produces for its home market, is more vital quantitatively than vertical FDI. Vertical FDI means fragmenting the production process geographically, by stages of production. This is because most FDI in production facilities seems to be horizontal in the sense that most of the output of foreign production affiliates is sold in the foreign country. Similarly, Soreide (2011) points out that horizontal FDI is supposed to generate more positive spillovers than vertical FDI, especially when MNCs supply a local market in the host economy. The weaker vertical FDI spillovers are due to the aim of the MNCs to use cheap labour and export the goods. In addition, the outsourced production technology fits in with the existing capabilities of the local workers, instead of upgrading them. Rodriguez-Clare (2005) illustrates that MNCs would affect the host economy through three important channels, which are the transfer of technology, the training of workers and the generation of linkages. However, empirical literature has suffered from the lack of identification of a formal concept of linkages. He formulates the concept of backward and forward linkages. There is assumed to be a mixture of inputs in the production of final goods, where domestic firms must purchase all of their inputs locally, and that the inputs are produced with increasing returns to scale. Through increasing demand for inputs, final-good firm help to make apparent a greater variety of specialised inputs, thus generating positive spillovers to other final-good producers. Rodriguez-Clare (2005) postulates three assumptions in the context of generation of industrial linkages. First, a variety of specialised inputs enhances productivity; second, the proximity of supplier and user is necessary for the production of intermediate goods; third, the size of market limits the available variety of specialised inputs. Rodriguez-Clare shows

that a positive linkage effect is present in an increase of intermediate goods production, when the MNCs have a higher linkage effect contrasted to domestic firms. In contrast to a negative linkage effect that might be present in a decrease in the productivity of domestic firms and a resulting decrease in wage levels. UNCTAD (2001) report that the host country that seeks to reap the benefit of FDI in terms of sustainable economic development, would be able to create or improve production linkages between foreign affiliates and domestic firms. These linkages can take several forms, such as backward, forward or horizontal. Backward linkages take place when MNCs get hold of goods or services form domestic firms, and forward linkages when MNCs put to the market goods or services to domestic firms, while horizontal linkages are when MNCs interact with domestic firms engaged in competing activities. The report of UNCTAD (2001) also highlights the importance of backward linkages to domestic firms as well as foreign firms. The backward linkages of FDI are important for domestic firms because they can provide opportunities for production and employment by domestic suppliers. The importance of these linkages appears through the knowledge diffusion and skills that can assist in upgrading domestic suppliers, technological and managerial capabilities and market diversification, with spillover effects on the rest of the economy. However, these benefits depend on the markets in which MNCs operate, the incentives that they have, and on the capabilities of domestic firms. Furthermore, large MNCs can create risks for domestic suppliers in the form of anticompetitive practices, unequal bargaining positions and excessive dependence. Productivity and market-access spillovers are in general complicated to distinguish empirically as they are set up through comparable externalities channels (Colen et al. 2010). Colen *et al.*(2010), following, identify five channels through which spillover effects from FDI firms to domestic firms can take place. These spillovers can occur throughout imitation, acquisition of human capital, competition, crowding-in and export effects.

Imitation means the broadcast method for new products and processes by the copying of products, technologies and production process by domestic firms, regularly referred to as reverse-engineering, Colen et al. 2010). The imitation is dependent on the product or process complication in which FDI firms apply simple manufacturing products and processes. In addition, the managerial and organisational innovations might be easier to imitate. Yet, the advance technology applied by FDI firms might not be imitated if the domestic firms do not have a certain level of technical skills. Theimitation can result in horizontal productivity spillovers and growth advances for the economy (Colen et al. 2010). Gorg and Greenaway (2013), quotes that *Any upgrading to local technology deriving from imitation could result in a spillover, with consequent benefits for the productivity of local firms.*

FDI can contribute to human capital formation through demanding and supplying skills (Colen et al. 2010). MNCs tend to invest in low wages developing countries. They are, however, likely to have a higher demand for relatively skilled labour in the host economy if they do not crowd out local demand for employment. They are also characterized by more skill-incentives than domestic firms (Gorg and Greenaway 2013; Colen *et al*. 2010). MNCs may also affect the supply side of skills by investing in training and the development of human capital. MNCs would set up of research and development (R&D) or education centres to develop domestic skills for their high-tech industries or business education (Colen *et al*. 2010). MNCs, in general, will invest in training and it is unfeasible to secure such resources completely with the lack of bonded labour. This in turn will lead to generate productivity progress through the mobility of labour from FDI firms to domestic firms (Gorg and Greenaway 2013). Colen *et al*. (2010) demonstrate that the motives of FDIs are crucial in determining the importance of worker training. For example, Natural resource FDI is usually intensive and requires the training of only a small number

of high skilled labours. Efficiency seeking FDI is usually low-skilled, low-wage labour and the need of training is limited. Additionally, strategic-asset seeking FDI is very specific skills to relatively well-educated labour. Another type of motivation is market-seeking FDI, which would involve technological or marketing training of domestic labour to a limited extent. This type of spillovers from the labour training and education investment would be horizontal or vertical. Horizontal spillovers take place through externalities or labour turnover. Labour that receives training at institutions supported by MNCs, may carry with them knowledge of new technology or new management techniques to domestic firms. However, this type of spillover may appear after a long-time. In contrast, vertical spillover effects through acquiring human capital would be more immediate. MNCs provide training to their domestic suppliers; such training and learning by downstream suppliers and upstream buyers may result in an immediate productivity gain (Colen *et al*. 2010). Therefore, training can create spillover directly through complementary workers and indirectly through the workers that carry with them knowledge and skills that is achieved at support training by MNCs (Gorg and Greenaway 2013). Another channel of spillover is competition and crowding in effects. Domestic firms may experience competition spillovers from FDI at the time when MNCs set up their affiliates.

Domestic firms that faced new or greater competition from FDI firms may have incentives for faster adoption of new technologies (Balsvik 2013). Domestic firms would be under pressure to use existing technology efficiencies or to invest in human capital, even if they are unable to imitate the MNC's technology or production processes (Gorg and Greenaway 2013). Following Young (1993), Colen *et al*. (2010) argue that the innovations embodied in FDI would change and accumulations to old technologies, making domestic investment more productive. Additionally, the competition might increase the speed of adoption of new technology or the speed with which it is imitated (Gorg and Greenaway

2013). A recent study by Chang and Xu (2014) used annual industrial survey database between 1998 and 2005 from Chinese industrial firms, finding that both spillover and competition effects from various groups of firms, whether foreign or domestic firms, affect firms in other groups in China, and the competition effects are more likely to outweigh spillover effects in regional markets than they are in national markets. In addition, the findings indicate that the competition effects are more likely to outweigh spillover effects among firms of similar resource types than they are among firms with distinct resource profiles. Besides, greater competition may cause the crowding out of domestic firms and reduce domestic investment, resulting in reduced productivity of domestic firms. For instance, MNCs can reduce the market share of domestic firms by pushing up the average cost curves of domestic firms because MNCs have lower marginal costs due to some firm-specific advantages. This effect can offset the positive productivity spillover effects of increased competition. The crowding-in effects are commonly known as the hypothesis of *Crowding-out/in effect of FDI on DI.* The crowding in effects of FDI can take place when FDI by foreign firms builds up new investment in downstream or upstream production that would not have taken place in their absence, particularly, when investment is carried out in undeveloped sectors of the economy. Meanwhile, the crowding out effects of FDI take place when FDI firms distorts domestic firms and other foreign affiliates from undertaking investment by driving them out of business (Bende-Nabende and Slater 2012).

The entry of MNCs may create competition that forces domestic firms to crowd out. FDI might stimulate DI and lead to the crowding in of domestic firms (Colen et al. 2010). Similarly, Borensztein et al. (2011) argue that the effects of FDI on domestic investment can be different; competing in product and financial markets MNCs may crowd out domestic firms; FDI may support the expansion of domestic firms by complementarily in production or by increasing productivity through the spillover of advance technology. The

policy that offers special tax treatment and other incentives, such as export free zones and tax exemptions, to stimulate FDI inflows may introduce a distortion affecting domestic investment. This distortion could have a greater negative impact on domestic investment and limit growth spillover effects through crowding in effects of FDI (Borensztein *et al*. 2011; Colen *et al*. 2010). In addition, MNCs may affect domestic investment in host economies in two ways; directly through their own investment activities, and indirectly by affecting investment in the host economy firms (UNCTAD 1999). Herzer e*t al*. (2008) postulate that the positive knowledge spillovers, as endogenous growth theory argued, cannot run from FDI to DI, especially in developing countries. For example, Gorg and Greenaway (2013) report that there is a positive spillover running from FDI to DI only in developed countries, not in developing countries, for several of the firm-level studies as in Aitken and Harrison (1999) for Venezuela. Gorg and Greenaway (2013), Kim and Seo (2013) argue that MNCs may have also firm-specific knowledge over domestic firms, that domestic firms have underdeveloped production technology and low skill workers. In addition, domestic firms may be unable to absorb the technological spillovers that may be restricted by undeveloped domestic product and financial markets (Apergis *et al*. 2006). De Mello (2010) and Apergis *et al*. (2006) argue that FDI can affect DI through its effect on the profitability of domestic investors, which lead to crowding-out DI. FDI also can have an impact on the adjustment of the ownership structure of total investment in the host country and offers additional financial support for DI. This effect leads to crowding-in additional investment in the receiving countries. Additionally, Van Loo (1977) illustrates that FDI may affect domestic investment in the host economy through forward and backward linkages. For example, FDI firms might buy some product inputs from domestic firms that leads to an increase in the rate of return in this industry, and thus lead to an increase in investment in that industry. In contrast, FDI firms might induce production by

providing lower cost inputs. Agosin and Meyer (2011) demonstrate that backward and forward linkages are necessary for crowding in effects but not a sufficient factor. For example, the presence of these linkages cannot prevent crowding out of domestic firms, particularly in the case where FDI firms simply displace existing firms. Also FDI can affect domestic investment indirectly through expenditure by means of the accelerator theory of investment. For instance, the changes in the relationship of expenditure to capacity generates changes in total investment, thus any changes that FDI causes in the level of expenditure produces changes in domestic investment, which creates indirect effects on domestic investment. The important assessment of the relationship between FDI and DI derives from several views.

For example, a Schumpeterian view of FDI-related innovation as creative destruction through substitution may overlook the scope for complementarity between FDI and DI (De Mello 2010). In addition, the endogenous growth theory view of FDI-led growth that FDI inflows have permanents effects on economic growth under constant returns to DI. This is because the increase in the stock of foreign-owned capital leads to a temporary increase in the output growth rate if diminishing returns prevail in the aggregate (Meyer 2013). Moreover, Dunning's eclectic paradigm view of OLI (ownership, location and internalisation); creative monopoly power and the competitive advantages of MNCs force domestic firms to exit the industries that FDI replaces DI (De Mello 2010).

Speaking generally, the positive contribution of FDI to economic growth through DI requires that FDI crowds-in DI. FDI can decrease DI when FDI takes away investment opportunity of DI through licenses, skilled, credit facilities, which reflect the superiority of FDI over DI (Herzer *et al.* 2008). However, there have been some studies on this relation concluded that there was a strong relationship between FDI inflows and DI over time (Lipsey 2000). FDI usually increases competition and this reduces market power, especially

if the MNCs have established Greenfield projects in a non-tradable goods sector. In a sector of tradable goods, the openness of the trade regime may be sufficient to generate competition. Acquisition entry does not increase competition, but it may affect the pattern of interaction between the competitors. The increased competition by foreign investors seems to push domestic firms toward the best practice limit in industries with low levels of technology, or goods that requires least advanced technologies (Meyer 2013). Similarly, foreign firms are theoretically expected to increase the efficiency of domestic firms via productivity spillovers (De Mello 2010). However, the effect of entry foreign firms on the domestic firms, in the same industry, depends on the industry structure. The entry of foreign firms in the host country market may increase competition and force inefficient indigenous firms to use existing technology more efficiently, or look for new technology, while the least efficient firms may be driven out of the market. The competition effect of FDI can lead to an increase and an update in the capital stock of DI, especially if the foreign investment operates in an underdeveloped sector or a sector where DI does not exist (De Mello 1999). In addition, the domestic firms should be aware of adopting advance technology to increase productivity as FDI may be able to increase the cost of production such as wages and the prices of local input supplies (Apergis *et al.* 2006). In contrast, if domestic firms are weak, foreign entry may improve their efficiency and motivate technological upgrading (Meyer 2010). Besides, foreign firms may come to dominate the domestic industry, especially if the technological gap between them and the domestic competitors is large. In other words, the imperfect competition can lead to reduced market share of domestic firms, especially if the technological gap is large and the labour force is not sufficiently qualified. In addition, employees may lose their industry-specific investment (negative spillovers effects) notable if domestic firms are crowding out or are forced to cut production (leading to oligopolistic market). Foreign investment, therefore,

may lead to reduced plant productivity, especially in the short-run (Aitken and Harrison 2011; Herzer *et al.* 2010), although FDI entry can create labour income and a new demand for local inputs (Apergis *et al.* 2006). Furthermore, DI can affect FDI in several ways. For example, increased investment in the physical and human infrastructure can lead to increased FDI profitability and then further enhancing FDI efficiency (Apergis *et al.* 2006). In addition, DI can act as a signal about the state of the investment climate, if the information is unavailable or incomplete in the host country (Apergis *et al.* 2006). In addition, Driffield and Love (2003) examine the assumption that foreign firms investing in the host country are able to capture spillover effects from domestic firms. They looked at the possibility of spillover effects from domestic firms to foreign firms by applying a panel of UK manufacturing industries. They found that technology generated by the domestic sector drifts out to foreign multinational enterprises, yet that this effect is limited to relatively research and development (R&D) concentrated sectors. There is also evidence that these spillover effects are affected by the spatial concentration of industry, and that learning-by-doing effects are restricted to sectors in which technology sourcing is unlikely to be a motivating influence.

The indirect channel of productivity spillover effects would be passing through export effects. FDI, in general, tends to generate positive spillover to the host economy and then improve the export performance of domestic firms (Nguyen 2008). Also the export spillover effects are dependent on the characteristics of domestic firms, industries and the host economy. These characteristics are known as absorptive capacity such as human capital, financial market development and technology gap (Nguyen 2008).

The presence of FDI firms may promote export activities of domestic firms in the same industry, and then generate positive spillovers to the host economy through horizontal linkages. FDI would also affect export activities of domestic firms in upstream and

downstream industries via vertical linkages, which are assumed to be a more important source for export spillover from FDI (Nguyen 2008). Aitken, Hanson and Harrison (2010) point out that the export spillover effects can take place when MNCs link domestic suppliers and sub-contractors to foreign markets through improved transportation infrastructure or improved access to information about which goods are preferred amongst foreign consumers. Therefore, MNCs can generate export spillovers to the host economy through the fact that FDI firms have a multi-market presence, thus MNCs are a natural channel for transferring information about foreign markets, foreign consumers and foreign technology to domestic firms, and they provide channels through which domestic firms would distribute their products. Aitken *et al.* (2010) illustrate that the export activities of MNCs often produce externalities from spillovers to domestic firms, enhancing the export prospects of these firms. Aitken, Hanson and Harrison (2010) applied panel data on 2104 Mexican manufacturing plants for the period 1986-1990. They found that MNCs tend to generate positive export spillover effects to domestic firms but not from general export activity. This suggests that export spillovers are limited to MNCs activity. Using panel firm level data in the UK, Greenaway *et al.* (2004) found that MNCs exporting has a positive effect on domestic firms' productivity for current exports. Girma *et al.* (2015) found that there is no evidence on the positive productivity spillovers from MNCs in the same industries (horizontal spillovers), upstream or downstream industries towards either exporting or non-exporting firms by using panel firm-level data from UK manufacturing industries from 1992 to 1999. In addition, the results show evidence for negative vertical spillovers for domestic non-exporters.

2.2.8 Determinants of Foreign Direct Investment

The unpredictability of autonomous FDI flows, in both scale and direction, has generated a substantial research effort to identify their major determinants. An extensive literature

based generally on three approaches – aggregate econometric analysis, survey appraisal of foreign investors' opinion, and economic study at industry level – has failed to arrive at a consensus. This can be partly attributed to the lack of reliable data, particularly at the sectoral level, and to the fact that most empirical work has analysed FDI determinants by polling of countries that may be structurally diverse. This section concerns itself with examining the factors influencing the destination of the investment: host country determinants, rather than industry specific factors.

1) Size of the market

Economic studies comprising a cross section of countries indicate a well established correction between FDI and the size of the market (proxied by the size of the GDP) as well as some of its characteristics (for example, average income levels and growth rate). Some studies found GDP growth rate to be a significant explanatory variable, while GDP was not, probably indicating that where the current size of national income is very small, increments may have less relevance to FDI decisions than growth performance, as an indicator of market potential.

There is no doubt that the size of China's market explains, in large part, the massive FDI flows it has attracted since the early 1980s. Though Bhattacharya et al (1998) identified GDP growth as a major factor of attraction of FDI in sub-Saharan Africa, small market size need not be a constraint in the case of resource-endowed, export oriented economies. In fact extractive industries in the low-income African countries continue to attract foreign investors as they have always done. In contrast, India, Pakistan and, to a certain extent, Bangladesh, have large markets but receive proportionately relatively small (below 1%) FDI flows in 1986-1995. Some analysts interpret this as evidence of high potential for increased FDI flows in the future, others stress that constraints are still restraining the channelling of foreign investment to these countries.

For the majority of low-income countries which fail to attract large FDI flows, their small domestic market are often cited as the main deterrent. Given other economic and political shortcomings, most investors are doubtful about the value of installing a factory unless they can achieve a "critical mass" for their products. Regional integration is often perceived as a positive means of compensating for small national markets. There is currently no clear evidence of the degree of this influence on FDI flows.

2) Openness

Whilst access to specific markets – judged by their size and growth – is important, domestic market factors are predictably much less relevant in export-oriented foreign firms. A range of research suggests a widespread perception that "open" economies encourage more foreign investment. One indicator of openness is the relatively size of the export sector. Singh and Jun's (1995) study indicates that exports, particularly manufacturing exports, are a significant determinant of FDI flows and that tests show that there is strong evidence that exports precede FDI flows. China, in particular, has attracted much foreign investment into the export sector. In Bangladesh, on the other hand, foreign investments have been attracted to the manufacturing sector by its lack of growth for textiles and clothing exports to the European Union and US markets.

3).Low cost of Productivity

Empirical research has also found relative labour costs to be statistically significant, particularly for foreign investment in labour-intensive industries and for export-oriented subsidiaries. The decision to invest in China, for example, has been heavily influenced by the prevailing low wage rate. The rapid growth in FDI in Vietnam has also been attributed primarily to the availability of low-cost labour. In India, in contrast, labour market rigidities and relatively high wage in the formal sector have been reported as deterring any significant

inflows into the export sector in particular. However, when the cost of labour is relatively insignificant (when wage rates vary little from country to country), the skills of the labour force are expected to have an impact on decision about FDI location. Productivity levels in sub-Saharan Africa are generally lower than in low-income Asian countries, and attempts to redress the skill shortage by importing foreign workers have usually been frustrated by restrictions and delays in obtaining work permits. The lack of engineers and technical staff in these countries is reported as holding back potential foreign investment, especially in manufacturing; it lessens the attractive of investing in productive sectors.

4) Political Risk

The ranking of political risk among FDI determinants remains somewhat unclear. Where the host country possesses abundant natural resources, no further incentives may be required, as is seen in politically unstable countries such as Nigeria and Angola, where high returns in attractive industries, seem to compensate for political instability. In general, so long as the foreign country is confident of being able to operate profitably without undue risk to its capital and personnel, it will continue to invest.

5) Infrastructure

Poor infrastructure can be seen, however as both an obstacle and an opportunity for foreign investment. For the majority of low-income countries, it is often cited as one of the major constraints. But foreign investors also point to the potential for attracting significant FDI if host governments permit more substantial foreign participation in the infrastructure sector.

6) Incentives and operating Conditions

Most of the empirical evidence supports the motion that specific incentives such as lower taxes have no major impact on FDI, particularly when they are seen as compensation for

continuing comparative disadvantages. On the other hand, removing restrictions and providing good business operating conditions are generally believed to have a positive effect. In China, the "open-door" policy and enhanced incentives for investing in the special economic zones contributed to the initial influx of FDI.

7) Privatization

Though privatization has attracted some foreign investments flows in recent years (e.g. Nigeria in 1993, Ghana in 1995), progress is still slow in the majority of low-income counties, particularly because the divestment of state assets is a highly political issue.

8) Trade Barrier and Trade Openness

FDI might be undertaken to gain access to the market in the host country because of trade barriers. So high trade barriers in the host country provide a disincentive for exports and an incentive for inward FDI. Therefore, FDI is viewed as a substitute for trade and open economies should receive fewer inward FDI (Moosa, 2002).

However, more recent studies believe that trade openness might lead to a better business climate through enhanced expectations of economic growth prospects, whereby open economies may encourage more inward FDI (Lim, 2011). However, only some empirical study on developed countries supports the above hypothesis, while other studies on developed countries do not find any significant relationship. Filippaios*et al.* (2013) argue that the negative link between trade openness and inward FDI indicates that inward FDI is used to cater for the local market in the host countries, while Yang *et al.* (2000) argue that inward FDI is a substitute for trade and it is used to avoid trade barriers.

2.2.9 The Origin and Development of FDI in Nigeria

The origin and development of FDI in Nigeria can be traced to the activities of the Royal Niger Company (RNC) which was granted Charter in 1886 to ship palm oil from Nigeria

to Liverpool and importing the processed palm oil back into the country in form of soap. This company merged with African and Eastern Trading Corporation to later form the United African Trading Company (UAC) a subsidiary of Unilever in Nigeria. Other firms which made significant impacts in the development of the FDI in Nigeria are Shell BP in the oil sector exporting its first oil in 1958. This follows by gulf oil (now Chevron), Mobil, ELF, Agip, Texaco to mention a few. Other sector includes John Holts, UTC, Julius Bergers, SCOA, etc (Baridam, 1990).

The post civil war period in Nigeria witnessed the advent of oil companies and the period (1973-79) saw the influx of FDI giving the country its greatest revenue in history with annual revenue of about $7.5 billion. Based on this level of revenue, Nigeria was reckoned as the wealthiest black African country. The third National Development plan (1975-1980) was considered as the testing ground for assessment of Nigeria with expenditure of N30 billion or N50 billion quotes. This level of expenditure became a fertile ground for investors both foreign and indigenous. The first ever international trade fair held in 1977 attracted 57 foreign countries and 300 Nigerian companies. In all there were 6000 exhibitions. Following this event, there were explosions of FDI in Nigeria including IBM, Dupon, Chase Mahathan, ITT, Ford Motors etc.

In the banking sector, the nationalization of two British banks, Barclays Bank (now Union Bank of Nigeria Plc) and standard Bank (now First Bank of Nigeria Plc) was seen as a healthy development in the economy in the light of nationalism. Direct investments in Nigeria dominated the economy until 1972 when the Nigerian Enterprise Promotion decree came into effect to check the activities of FDI in Nigeria. The upsurge of FDI was finally constrained by the Indigenization decree of 1977 which tried to make Nigerians shareholders of most of these FDI (The union Bank of Nigeria Plc, 1995) The decline of oil revenue in the early 80s resulted in a nose-dive of the economy in the mid 80s and

necessitated the introduction of Structural Adjustment Programme and other measures to revamp the economy.

These measures have been mentioned earlier in this study.

These foreign direct investments have positively contributed however, to the economy and Nigeria national development. These can be seen in the filling gap theory. Here it is believed that the FDI fill the gap exiting between what is needed to launch an economy into development take-off and what is available in the domestic economy. FDI contribute to rural development through their operations. Example is the rural banking scheme of 1977-1980. FDI engage in projects that support self-sufficiency according to federal government directive. Example is the Guinness Nigeria plc 4500 hecters of farm land at Kuru in Niger State. Standard of living is enhanced by the FDI in improved wages paid by them. They support manpower development through their scholarship programmes for Nigerians (Nnedu, E 2011). FDI, however, fail to reinvest most of their profit in the country thereby aiding capital flight out of the country. Even when FDI established manufacturing facilities in Nigeria, they still engage in substantial importation of intermediate products; a practice that helps to deplete foreign exchange reserve of the country.

According to Amy (1998), FDI rather than transfer technology often transfer the product of technology. FDI bring in capital but also take away capital. The important issue here is Net capital flow. In fact, in his analysis conducted between 1971 – 1988 showed that Nigeria was clearly financing the developed countries. The FDI mostly concentrate on few sectors of the economy especially oil sector. According to Pigato. (2010) oil industry has few backward linkages and virtually all the forward were external thereby exacerbating the disarticulation of the Nigerian economy.

2.2.10 Sectoral Analysis of FDI Inflow in Nigeria

Although there has been some diversification into manufacturing sector in recent years FDI has traditionally been concentrated in the extractive industries. Sectoral composition of FDI in Nigeria from 1992 – 2008. Agriculture, Forestry and Fisheries; Transport and Communications; and Building and Construction remained the least attractive hosts of FDI in Nigeria. Data reveal a diminishing attention to Agriculture, Forestry and Fisheries which had no contribution in 1996. Its highest contribution to FDI inflow was in 1992 with 1.9%. Manufacturing and Processing and Mining and Quarrying were the most contributory sectors. While Manufacturing peaked at 47.5% in 1992, Mining and Quarrying peaked at 41.5% in 1993 and their least contributions being 19.3 in 1992 and 22.0 in 2006 respectively. Nigeria is currently described as the fastest growing mobile phone market in the world since 2001, when the mobile telecommunication operators were licensed, the rate of subscription has gone up and does not show any sign of abating, hence corroborating the CBN report on privatization programme (CBN 2004:72) that telecommunication sector seem to have succeeded in attracting the interest of foreign investors. This is evidenced in the increase in its contribution from 0.6% in 2001 to 2.0% in 2008.

2.2.11 Major Sources and Destinations of FDI

Not surprisingly, the major sources of FDI are the high-income developed nations.

These countries accounted for over 90 percent of out flowing FDI in the years1987-1992 and for more than 85 percent in the period 1993-1998. The main recipients of FDI also turn out to be the advanced nations, which in the years1988-1998 received over 70 percent of inflowing FDI. But even though it is clear that the developed countries are the main destinations for FDI, an interesting fact is that ten developing countries make up two-thirds of the total FDI inflow to all developing countries. Among these, China received 30.6 percent. From 1988 to 1997, China experienced a fourfold increase of FDI during the years 1988-1992, the country received 2.9 % of the total FDI in the world, which can be compared

to over 12 percent during the years 1993-1997 (Brakman et. al., 2010). The development of the country has boomed and the growth rate is continuously increasing at a rate that economic history has never seen before. This clearly distinguishes China from other developing economies. According to the study done by (Agrawal, 2011) on economic impact of Foreign Direct Investment in South Asia by undertaking time-series, cross-section analysis of panel data from five South Asian countries; India, Pakistan, Bangladesh, Sri Lanka and Nepal, that there exist complementarily and linkage effects between foreign and national investment. Further he argues that, the impact of FDI inflows on GDP growth rate is depressing aforementioned to 1980, mildly optimistic for early eighties and strongly affirmative over the late eighties and early nineties. mainly South Asian countries followed the import substitution policies and had high import tariffs in the 1960s and 1970s. These policies progressively changed over the 1980s, and by the early 1990s, most countries had mainly abandoned the import substitution strategy in support of more open international trade and generally, market oriented policies (Agrawal, 2011). Carkovic and Levine (2012) also asserted in their econometric study on FDI and GDP growth that the exogenous component of FDI do not exert a strong, independent influence on growth. However, no consensus has yet been reached on the steady state as well as dynamic effects of FDI on growth. whereas some studies argue that the impact of FDI on growth is highly heterogeneous across countries with comparatively open economies presentation statistically significant results, the other studies maintain that the direction of causality between the two variables depends on the beneficiary country's trade regime. However, most research don't pay any grave attention to the prospect of a bi-directional association between the two variables in reference. Current research interest in FDI stems from the alteration of perspectives among policy makers from "hostility" to "conscious encouragement", especially among developing countries. FDI had been seen as "parasitic"

and retarding the growth and development of domestic industries for export promotion until recently. However, Caves (2012) observed that the underlying principle for increased efforts to attract more FDI stems from the confidence that FDI has several positive effects. Among these are, technology transfers, productivity gains, introduction of new processes, managerial skills and know-how in the domestic market, employee training, international production networks, and access to markets. Borensztein *et al.* (2011) see FDI as an important vehicle for the transfer of technology, contributing to growth in larger measure than domestic investment. Findlay (2010) postulates that FDI increases the rate of technical progress in the host country through a "contagion effect" from the more advanced technology, management practices, etc., used by foreign firms. On the basis of these assertions, governments have often provided special incentives to foreign firms to set up companies in their countries. Carkovic and Levine (2012) noted that the economic rationale for offering special incentives to attract FDI frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and spillovers. Curiously, the empirical evidence of these benefits both at the firm level and at the national level remains ambiguous. De Gregorio (2003), while contributing to the debate on the importance of FDI, notes that FDI may allow a country to bring in technologies and knowledge that are not readily available to domestic investors, and in this way increases productivity growth throughout the economy. FDI may also bring in expertise that the country does not possess, and foreign investors may have access to global markets. In fact, he found that increasing aggregate investment by 1 percentage point of GDP increased economic growth of Latin American countries by 0.1% to 0.2% a year, but increasing FDI by the same amount increased growth by approximately 0.6% a year during the period 1950–1985, thus indicating that FDI is three times more efficient than domestic investment. A lot of research interest has been shown on the relationship between FDI and economic

growth, although most of such work is not situated in Africa. The focus of the research work on FDI and economic growth can be broadly classified into two. First, FDI is considered to have direct impact on trade through which the growth process is assured (Markussen and Vernables, 2009). Second, FDI is assumed to augment domestic capital thereby stimulating the productivity of domestic investments (Borensztein *et al.,* 2011; Driffield, 2009). These two arguments are in conformity with endogenous growth theories (Romer, 1990) and cross country models on industrialization (Chenery *et al*., 1986) in which both the quantity and quality of factors of production as well as the transformation of the production processes are ingredients in developing a competitive advantage. Moreover, FDI has empirically been found to stimulate economic growth by a number of researchers (Borensztein et al., 2009; Glass and Saggi, 2013). Dees(1998) submits that FDI has been important in explaining China's economic growth, while (De Mello, 2009) presents a positive correlation for selected Latin American countries. Inflows of foreign capital are assumed to boost investment levels. Blomstrom *et al*. (2014) report that FDI exerts a positive effect on economic growth, but that there seems to be a threshold level of income above which FDI has positive effect on economic growth and below which it does not. The explanation was that only those countries that have reached a certain income level can absorb new technologies and benefit from technology diffusion, and thus reap the extra advantages that FDI can offer. Previous works suggest human capital as one of the reasons for the differential response to FDI at different levels of income. This is because it takes a well-educated population to understand and spread the benefits of new innovations to the whole economy.

Borensztein *et al*. (2011) also found that the interaction of FDI and human capital had important effect on economic growth, and suggest that the differences in the technological absorptive ability may explain the variation in growth effects of FDI across countries. They

suggest further that countries may need a minimum threshold stock of human capital in order to experience positive effects of FDI.

Balasubramanyan *et al.* (2013) report positive interaction between human capital and FDI. They had earlier found significant results supporting the assumption that FDI is more important for economic growth in export-promoting than import substituting countries. This implies that the impact of FDI varies across countries and that trade policy can affect the role of FDI in economic growth. In summary,(UNCTAD, 1999) submits that FDI has either a positive or negative impact on output depending on the variables that are entered alongside it in the test equation. These variables include the initial per capita GDP, education attainment, domestic investment ratio, political instability, terms of trade, black market exchange rate premiums, and the state of financial development. Examining other variables that could explain the interaction between FDI and growth, (Olofsdotter, 2013) submits that the beneficiary effects of FDI are stronger in those countries with a higher level of institutional capability. He therefore emphasized the importance of bureaucratic efficiency in enabling FDI effects. The neoclassical economists argue that FDI influences economic growth by increasing the amount of capital per person. However, because of diminishing returns to capital, it does not influence long-run economic growth. Bengos and Sanchez-Robles (2003) asserts that even though FDI is positively correlated with economic growth, host countries require minimum human capital, economic stability and liberalized markets in order to benefit from long-term FDI inflows.

Interestingly, (Bende-Nabende *et al.,* 2012) found that direct long-term impact of FDI on output is significant and positive for comparatively economically less advanced Philippines and Thailand, but negative in the more economically advanced Japan and Taiwan. Hence, the level of economic development may not be the main enabling factor in FDI growth nexus. On the other hand, the endogenous school of thought opines that FDI also influences

long-run variables such as research and development (R&D) and human capital (Romer, 2010; Lucas, 2011). FDI could be beneficial in the short term but not in the long term. Durham(2004), for example, failed to establish a positive relationship between FDI and growth, but instead suggests that the effects of FDI are contingent on the "absorptive capability" of host countries. Obwona (2011) notes in his study of the determinants of FDI and their impact on growth in Uganda that macro economic and political stability and policy consistency are important parameters determining the flow of FDI into Uganda and that FDI affects growth positively but insignificantly. Ekpo (2014) reports that political regime, real income per capita, rate of inflation, world interest rate, credit rating and debt service explain the variance of FDI in Nigeria. For non-oil FDI, however, Nigeria's credit rating is very important in drawing the needed FDI into the country. Furthermore, spillover effects could be observed in the labour markets through learning and its impact on the productivity of domestic investment (Sjoholm, 2010). Sjoholm suggests that through technology transfer to their affiliates and technological spillovers to unaffiliated firms in host economy, transnational corporations (TNCs) can speed up development of new intermediate product varieties, raise the quality of the product, facilitate international collaboration on R&D, and introduce new forms of human capital. FDI also contributes to economic growth via technology transfer. TNCs can transfer technology either directly(internally) to their foreign owned enterprises (FOE) or indirectly (externally) to domestically owned and controlled firms in the host country (Blomstrom et al., 2014; UNCTAD, 2000). Spillovers of advanced technology from foreign own enterprises to domestically owned enterprises can take any of four ways: vertical linkages between affiliates and domestic suppliers and consumers; horizontal linkages between the affiliates and firms in the same industry in the host country(Lim, 2001; Smarzynska, 2012); labour turnover from affiliates to domestic firms; and internationalization of R&D (Hanson, 2001;

Blomstrom and Kokko, 2014).The pace of technological change in the economy as a whole will depend on the innovative and social capabilities of the host country, together with the absorptive capacity of other enterprises in the country (Carkovic and Levine, 2012).Other than the capital augmenting element, some economists see FDI as having a direct impact on trade in goods and services (Markussen and Vernables, 2009).Trade theory expects FDI inflows to result in improved competitiveness of host countries' exports (Blomstrom and Kokko, 2009). TNCs can have a negative impact on the direct transfer of technology to the FOEs, however, and thereby reduce the spillover from FDI in the host country in several ways. They can provide their affiliate with too few or the wrong kind of technological capabilities, or even limit access to the technology of the parent company. The transfer of technology can be prevented if it is not consistent with the TNC's profit maximizing objective and if the cost of preventing the transfer is low. Consequently, the production of its affiliates could be restricted to low- level activities and the scope for technical change and technological learning within the affiliate reduced. This would be by limiting downstream producers to low value intermediate products, and in some cases "crowding out" local producers to eliminate competition. They may also limit exports to competitors and confine production to the needs of the TNCs. These may ultimately result in a decline in the overall growth rate of the "host country and worsened balance of payment situation" (Blomstrom and Kokko, 2010).

2.2.12 Impact of FDI on Economic Growth in Nigeria

Nigeria is one of the few countries that have time after time benefited from FDI inflow to Africa. Nigeria's share of FDI inflow to Africa averaged around 10%, from 24.19% in 1990 to a low level of 5.88% in 2001 up to 11.65% in 2002. The UNCTAD (2003) showed Nigeria as the continent's second apex FDI recipient after Angola in 2001 and 2002. The cumulative FDI inflow ranged from N20.5 million in 1992 to N122.6 million in 1996. This

was an increase in real terms from the decline of the 1980s. FDI forms a small percentage of the nation's gross domestic product (GDP), however, making up of 7.56% in 1992, increased to 41.74% in 1996, decreased to 37.38% in 2003 and subsequently moved up from 2004 to 2007 when it peaked at 87.11%. On the whole, it formed about 46.10% of the GDP over the whole period of analysis (1992- 2015).

2.2.13 Factors That Influence FDI Decision Making

It is rational to suggest that the process of careful planning precedes the final decision making about FDI activity on the top level of transnational corporations (MNCs). According to economic theory and empirical proof, financial flows take place from the low-profit to higher-profit regions, making the future profit anticipation (profit-seeking) one of the key motivation for undertaking investment activity (Carbaugh, 2000). Although an important one, the expectation of high future profits is not the only factor that is taken into account. Other factors that influence the decision to invest into a foreign country may be conditionally divided into two large groups of factors – "company-specific" and "country-specific" factors. Company-specific factors are the factors that differ among foreign companies of the same or similar industry with regards to a specific country. These factors include but are not limited to demand and cost factors.

By demand factors it is understood that a company may view FDI activity as a means of its market expansion (de Mello, 1997). Whenever foreign demand for a product of a particular firm is strong, and whenever it is more profitable to produce goods in that country rather than export them, a company may undertake Foreign Direct Investment into that country. Another demand reason for FDI is eliminating foreign competition by acquiring a control package in a foreign firm, the processes of globalisation makes firms expand their market and operate overseas. Clearly, such factors will vary firms belonging to different sectors of economy, but may be similar for firms in one particular field. Cost factors are concerned

with the firm's struggle to increase profits by means of decreasing costs. Whenever the costs of labour and costs of resources and final goods transportation are comparatively low in a foreign country, the parent company may shift a part or even the whole production to that country (Carbaugh, 2000). Other cost factors include economies of scale considerations, relative factor prices, and the use of capital in a recipient country. Country specific factors have a similar impact on decision-making of foreign companies operating in any sector, with regard to a specific country. To start with, such factors include institutional features of the recipient economy (De Mello, 1997). These are political stability, the development of democracy, a sound legislation base regulating FDI and enforcing contracts, the status of intellectual property rights, the degree of government intervention into economy, bureaucratic procedures, the system of taxation and tax incentives. In addition, factors associated with economic stability and economic performance of a country is important, such as the degree of openness, availability of tax rebates, and import and export regulations. De Mello (2010) also points to such scale factors as balance of payment constraints, the size of the domestic market, all of which he refers to as the absorptive capacity of the economy. According to some studies of FDI in transitional economies, (Hirvensalo, 2001) indicates that according to the national investment promotion agencies in these economies, one of the main reason why investors undertake investment activity in these economies is because of the prospect of economic growth itself. This is followed by proximity to Western markets, favourable investment climate, political stability, highly educated and productive workforce, well developed sectors of telecommunication and infrastructure. In addition, moving ahead with market oriented reforms, introducing inflation-stabilisation policies, and adopting sound monetary and fiscal policies, are factors that are thought to reduce macroeconomic risks and stimulate capital inflows in many Eastern European countries (Calvo *et al,* 1996). Other factors that

have been spurring FDI inflows into economies in transition are the processes of privatisation, with immense opportunities for foreign countries to acquire a controlling interest in newly privatised companies.

2.1.14 The Role of FDI: Positive and Negative Aspect

In addition to the benefits that FDI brings to investors, the interest in studying FDI lies in the area of the effects flowing from FDI. Although it seems to have become publicly accepted wisdom that FDI is beneficial rather than harmful in enhancing economic growth, empirical literature has not reached a consensus on whether FDI has a positive impact on economic growth. Since FDI represents a composite bundle of capital stock, technology, management, and know-how, it is believed to have multidimensional impact on the recipient economy. There are several ways in which FDI can stimulate economic growth. First, through capital accumulation, FDI is expected to be growth enhancing in that more new inputs are incorporated into production (Buckley, 2012). Economic growth may additionally result from a wider range of intermediate goods in FDI-related production Second, FDI is considered to be an important source of technological change and human capital augmentation (Buckley et al, 2011). Technological change occurs simultaneously through the process of capital deepening, as new varieties of knowledge-based capital goods are introduced, and through the human capital augmentation, as productivity increasing labour training; new skills acquisition, alternative advanced management practices and organisational innovations take place. More importantly, FDI leads to what is called "technology diffusion" – the transmission of ideas and new technologies, productivity spillovers, sharing and implementation of know-how, knowledge transfer all of which are important factors of economic development. Technological change occurs not only within the FDI- recipient firm, but also in the overall economy, due to the spillover effects such as positive externalities, are enhanced by FDI. Furthermore, FDI is believed to

improve efficiency of the locally owned firms. Broadly speaking, the efficiency of firms in the host economy is supposed to be increased in direct and indirect ways. Though by the direct effect it meant that FDI will contribute to the productivity of the sector in which a foreign firm operates. (Schoors *et al,* 2010) find that whenever firms in open sector are owned domestically, productivity is not very high. They use cheap labour force as a source of comparative advantage. This is in contrast to the foreign-owned firms in the same sectors, which hire more expensive labour, but benefit from higher productivity. On the other hand, cross-sector, or indirect, effects are also present whenever labour and knowledge are moving from sector to sector, technology diffusion occurs. In addition, more productive foreign firms stimulate healthy competition in the domestic market. In addition to the reasons mentioned above, FDI is believed to be especially important for economies in transition because these countries have much potential human capital, but lack the technology and capital necessary for development and growth. FDI is seen as serving as a stimulus for capital accumulation and technology transfer in these economies.

Moreover, as is widely known and understood, transitional economies lack capital and financial means, and they have to rely on foreign assistance. During the transition period, a country is faced with reorienting its production and consumption structures and rebuilding its capital stock as a whole, since the capital stock inherited from the past is old and inadequate for the new market situation. Consequently, the speed of the transition may be related to the ability of a country to stimulate capital inflows.

The experience of transition economies, however, suggests that such sources of external help as foreign aid and credits have proven themselves to not always be beneficial for the recipient countries, since much of the aid is being stolen or used ineffectively, whereas credits require interest payments. In this light, Foreign Direct Investment plays an important role as an outward factor that can and does represent a real working financial

injection into transitional economies. Another reason why transition economies may be interested in attracting FDI, in words of (Balatsky,2010) is the ability of a foreign-owned sector to lead the economy out of a temporary shock or a short-run recession, provided it is not very deep in order not to affect domestic producers. Furthermore, (Calvo *et al*., 2011) suggest that a large shift in capital flows to one or more large (or more developed) countries in the region (such as Hungary, Czech Republic, and Russia), may generate externalities for the neighbouring countries, by means of making investors more familiar with the emerging markets and more willing to invest into countries with similar economic prospects.

Finally, other important outcomes of FDI include increase in consumer choice, enabling household to smooth consumption over time, provision of support for pension funds and retirement accounts (Calvo *et al*.,2011), improving tax collection on the local and state levels as well as possible increase in domestic investment stemming from increased competition (De mello, 1997). It is important to note, however, that not all researchers are so sanguine with regard to the impact of FDI on the host economy. For example, with respect to the spillover effects, some authors (Schoors *et al*, 2010; Blomstrom *et al,* 2012) draw attention to the fact that the initial stages of the development and/or transition to the market economies, FDI may have a negative impact on the recipient economy. This fact is referred to as a "market stealing" effect, when domestic firms are so unproductive compared to the foreign ones, that foreign owned firms drive domestic producers out of the market. Schoors et al., (2010), however, find that the positive effect outweighs the negative one. They also find that cross-section, or intersectional, spillover effects are more important than the spillover effects diffused within the sector into which FDI was injected. This happens because foreign-owned firms that operate on domestic markets usually come into contact with firms of other sectors, suppliers and consumers of these firm's products. And,

as suggested by (Blomstrom *et al.*, 2012), since the foreign owned firms is producing a high-quality output, it requires its partners to comply with this quality, driving up production standards of the firms from different sectors of the economy. Nevertheless, it is not clear whether results obtained by (Schoors *et al.*, 2010) can be extended to other transitional economies, with which domestic production is still at the initial stages of development. And it is therefore, not unequivocal that FDI can be viewed as a remedy for unemployment since not only workers may be hired by foreign-owned firms, but also workers may be fired by domestically-owned firms that cannot compete. Similarly, it is not clear whether FDI can strengthen domestic competition in the short-run. Other ambiguous consequences of FDI inflows are pointed out by (Calvo *et al.*,2011), who suggest that whenever capital inflows are large, they may have less desirable macroeconomic effects, such as " rapid monetary expansion, inflationary pressures, real exchange rate appreciation and widening current account deficits". They also warn that FDI movements tend to possess some cyclical components. In the case of developing countries, FDI may lead to "booms and busts in capital inflows", and, consequently, to economic upswings and downswings in the host country. Therefore, they suggest that developing capital importing countries may be quite vulnerable to cyclically based FDI decisions, and special policies should be implemented to reduce such vulnerability. Not surprising, (de Mello, 2013), concludes that "whether FDI can be deemed to be a catalyst for economic growth, capital accumulation, and technological progress seems to be a less controversial hypothesis in theory than in practice" and (Campos, 2002) points out that "a closer examination of the attendant empirical evidence disappoints all but the most fervent believer". Therefore, different opinions presented in the literature, as well as evolving macroeconomic situation in transitional economies stimulate further elaboration on the problem of FDI and economic growth interrelation.

2.2.15 Role of Affiliate or MNE's Strategies on Host Country

 While the MNE directly influences the economy by transferring its O-specific advantages to the affiliate, the combination of O-specific advantages and the strategy of the MNE also have important implications at the level of the industry. MNEs may influence the productivity and growth of local firms, and they may change the nature and evolution of concentration. They may alter financing, marketing, and technological and managerial practices in the industries that they enter (Blomstrom, 2014). However, whether these advantages diffuse through to local firms or not may depend on the strategic response of the MNE.

Hirschman (2010) introduced the concept of "exit" and "voice" to explain the responses of firms and States to threats to their economic autonomy. Under the rubric of hierarchical capitalism firms mostly react to market failure by adopting "exit" rather than "voice" type strategies. A firm chooses to 'exit' where the response is to replace the market through hierarchical internalization, for instance, when the firm chooses to use intra-firm sources of inputs. Alternatively, a firm adopts a "voice" strategy where the response is to work with the market, for example, working with existing suppliers or purchasers to reduce or eliminate market failure (Dunning, 2012). This kind of strategy has the potential to have a very positive effect on local development. In general three strategic responses can be distinguished (Scott-Kennel, 2001). First, when the MNE bounds its affiliate to source inputs within the MNE, in turn, the affiliate uses very few locally produced inputs. In this case the extent to local sourcing and opportunities for spillovers will be limited, hence, very few advantages can be expected to be passed on to local firms. Second, as a strategic response, the affiliate is forced to import when the technological capability of the host country is not sufficient to produce competitive and reliable input. A third strategic response may be that the affiliate recognises the potential for local sourcing (in the longer

term) and works with local firms. The affiliate's willingness to commit to local suppliers, sub-contractors and the like, to bring them up to speed, to improve supply capability and to enforce high standards, may be the most effective means of local upgrading. UNCTAD (1994) states that empirical evidence suggests that foreign affiliate's that follow simple-integration, rather than complex-integration strategies, are less likely to establish linkages in the local industry since they tend to rely on imported inputs and create few local supply linkages. For instance, Buckley (2014) notes that although many of the foreign software firms that entered the Irish software industry in the 1990s are involved in higher end development activities, these have failed to develop any significant linkages with local firms mainly because high level research and development activities generally take place in the home country with lower level production operations. This instance illustrates the case of information- and knowledge-intensive industries which generate considerable knowledge that is better protected and more profitable when applied within the organisation (Enderwick, 2009; Fernández, 2001; Kundu, Kumar & Peters, 2008). MNEs pursue different strategies, which are usually closely related to their motive of investment in the host country. For instance, in the past, MNEs operating in relatively closed local markets often developed substantial supplier linkages, not only because quality requirements were less rigid and economies of scale less relevant, but also because host countries often imposed lo cal-content requirements. By comparison, investors seeking resources or focused on export-oriented industries created relatively few linkages, but these linkages with local suppliers were more competitive and sustainable (UNCTAD, 2000). However, agreements within the WTO framework, such as TRIPs, TRIMs and SCM, have limited the potential for developing countries to use traditional policy instruments that encourage MNEs to adopt strategies that lead to a greater level of embeddedness in the host economy. However, it is not always the case that firms choose to either "exit" or "voice" the market

in order to reduce market failure. On this respect, the literature fails to consider that a firm may adopt either of these strategies even in the absence of market failure. Moreover, market failure could also be remedied by attracting new firms (such as other MNE affiliates) to the local market as suppliers, rather than working with existing firms. This oversight has considerable implications for local development, and has received very little attention in the empirical literature (Scott-Kennel, 2001). In sum, the nature of the MNE's and affiliate's strategy toward local involvement and the internalization of its advantages it is expected to impact on the extent and nature of local upgrading.

Motive for investment - Dunning and Narula (2012) classifies the purposes of FDI into resource-based, market-seeking, efficiency-seeking, and strategic asset-seeking. These can be broadly divided into two types. The first three motives are primarily asset-exploiting in nature, which means that the MNE's primary objective is to generate profits through the use of its existing O-specific advantages. The last motive refers to the case where the MNE aims to add to its existing assets (Narula& Dunning, 2012). Each type of investment is associated with a certain set of O-, L-, and I-specific advantages and activities. Hence, it is expected that the OLI configuration associated with each type of investment affects the extent to which the MNE's affiliate will link with the local industry.

Resource-seeking FDI- refers to investment that seeks natural resources or cheap labour in the host country. This type of investment tends to require few local inputs. For instance, foreign affiliates in manufacturing tend to be more embedded in the local industry than resource-based FDI in terms of local sourcing (Mortimore et al., 2011). However, foreign affiliates in primary industries may get involved in local industry through forward linkages. Williams (2009) states that resource and market-seeking investments are likely to concentrate on low value-added activities and rely on parent firm know-how since both are driven by the need to access low-cost resources and new markets. However, forward

linkages may be formed when foreign affiliates perceive that more benefits arise when local firms are made responsible for marketing and distribution activities. Also, backward linkages will occur if the affiliate incorporates manufacturing with

market-seeking investment= Market-seeking FDI, in terms of foreign affiliates engaged in the production of products for the local market, relies on local sourcing because such production tends to require local inputs (Kiyota, Matsuura, Urata, & Wei, 2009; Barkley & McNamara, 2014), in turn; strong linkages with local firms are likely to be formed. In the case of service MNEs, they tend to go overseas in search of new markets and to follow existing clients who have moved overseas (Grosse, 2000; UNCTAD, 2004;) thus services FDI usually focuses on serving the local market (Enderwick, 1989). This type of FDI has the potential to get involved in the host economy through forward linkages. Services are generally intangible and depend to some extent on the interaction between the buyer and the seller for their provision (Fernández, 2011), thus they involve some kind of assistance to the client firm (Grosse, 2000). In contrast, foreign affiliates involved in export-oriented activities seeking to service foreign markets tend to form few linkages with local firms.

Efficiency-seeking FDI= refers to investment that seeks to increase productive efficiency through globalized operations, including exploiting economies of scale, economies of scope, or simply international division of labour which implies that foreign affiliates are likely to establish linkages with local firms in order to acquire cost-effective quality inputs (Mortimore *et al.,* 2001). Strategic asset-seeking FDI is a catch-all term referring to investment that links with foreign strategic assets. That is, foreign affiliates engage in collaborative agreements with local firms when the latter possess firm-specific assets that complement the O-specific resources of the affiliate. This kind of FDI results in high-quality linkages (Chen & Chen, 2010). Nonetheless, if the foreign affiliate chooses to acquire the firm possessing complementary assets, this move results in full internalization

of local O-specific advantages, in turn; the impact is on the new firm rather than on the industry.

Other factors –

Besides the MNE's strategy and motive for investment, the extant empirical literature suggests a range of variables that may also help to explain the level of embeddedness of the foreign affiliate in the local industry – which eventually leads to changes in the OLI configuration. The share of equity of the foreign affiliates held by the parent firm – or level of autonomy of the foreign affiliate – is expected to have a negative impact on local sourcing. Foreign affiliates under tight control of the parent firm tend to rely heavily on the parent firm for procurement of inputs, output sales, personnel, and other factors. Indeed, the parent firm has an incentive to increase supply or sales of inputs to its subsidiaries in order to maintain its business at home (Kiyota, Matsuura, Urata, & Wei, 2014). That is, the evidence suggests that higher levels of autonomy allowed to the affiliate are related to higher local involvement. In addition, greater specialisation of the foreign affiliate into higher value-added activities implies lower levels of autonomy, in turn, fewer local linkages are formed. The mode of entry also influences the extent of linkages. Greenfield investments typically involves an increase in local linkage formation while acquisitions of local firms may involve a decrease in existing linkages as the foreign affiliate may source from parent and related affiliate firms offshore (Barkley & McNamara, 2014).

2.3 Theoretical Framework

Over time, literatures have strained to the launch driving force of Foreign Direct Investment, its impact on the economy as well as the goal which multinational cooperatives seek to establish their branches outside the home countries. According to Saskia and Morgan (1998), dependency, modernization and integrative schools have theorized on FDI.

The dependency school focuses on the fact that influence of foreign direct investment in developed countries is adjudged to be positive by the proponent. The modernization school reflects FDI as a prerequisite and reagent for sustainable growth and development, and finally, the integrative school airs at the FDI from the perspective of its causes and effect at home countries. These are fundamentally the institutional or bureaucratic structures, structural bottlenecks and reforms, improvement and administration theories surrounding FDI school of thought. Shenkar (2007) acknowledged some analysis as the current theories of FDI which include:

2.3.1. Exogenous Growth Theory

The exogenous growth theory, commonly known as the neo-classical growth model or Solow-Swan growth model, was pioneered by Solow (1956). This theory assumes that economic growth is generated through exogenous factors of production functions such as the stock of capital accumulation and labour. Barro and Sala-I-Martin (1995) demonstrate that there is a positive relationship between economic growth and capital accumulation over time.

According to this theory, an increase in the stock of investment accumulation will result in an increase in growth assuming that the amount of labour and the level of technology remain constant (Barro and Sala-I-Martin 1995; De Jager 2004) as cited in Elboiashi, H,A. (2011) , economic growth is affected only in the short-run, determined by the stock of capital accumulation, which is determined by the saving rate and the rate of capital depreciation. On the other hand, economic growth is determined by exogenous factors such as technological progress, which takes the form of labour augmentation, in the long-run (Barro and Sala-I-Martin 1995) as cited in Elboiashi, H,A. (2011). So, the growth of the economy depends on the stock of capital accumulation and the augmentation of

labour force by technological progress. As a result, if new FDI introduced technology leads to increased labour and capital stock productivity this will lead further to more consistent returns of investment, and labour will grow exogenously (De Jager 2004). In general, this theory argues that FDI enhances the capital stock in the host country. And then promotes economic growth towards a new steady state by this accumulation of capital formation. The argument of exogenous growth theory is that FDI affects economic growth in the short-run through diminishing returns to capital; hence FDI promotes economic growth through raising domestic investment (DI) (Herzer et al. 2010). The main limitations of this theory are that it considers labour as human capital or knowledge.

Economically, labour is a human capital because knowledge accumulates within a firm and is stored within the system of firms. Additionally, this theory does not sufficiently explain production and the diffusion of technology, knowledge and the information that becomes gradually apparent in economic analysis (Ho et al. 2010). Also this theory does not provide the economic explanation about long-run growth and technological progress. It does however include a time trend to reflect technical progress in the long-run rate of economic growth (Barro and Sala-I-Martin 1995; De Jager 2004) as cited in Elboiashi, H,A. (2011)

2.3.2. Endogenous Growth Theory

In the mid-1980s, the exogenous growth theory became theoretically unsatisfactory in explaining the determinants of long-run growth (Barro and Sala-I-Martin 1995). as cited in Elboiashi, H,A. (2011) Therefore, endogenous growth theory was pioneered by Romer in his 1986's article, which concentrated on two factors. Economic growth is derived from the stock of human capital and then from technological changes. The mechanism of this theory regarding the stock of human capital is that labour grows as a share of population. This means that growth is promoted exogenously at constant rate. Afterward, this growth

is stimulated by a labour augmenting technology multiplier, which means that this growth is promoted endogenously through labour augmenting technological change. However, the main feature of this theory is the absence of diminishing returns to capital (Ho et al. 2010). Therefore, technological progress in the form of the generation of new ideas is a crucial factor in passing to diminishing returns to capital in the long-run. The theory argues that technological progress is improved endogenously by taking knowledge from research and development (as an example) (R&D) and that the development of this knowledge can create positive externalities and positive growth spillover effects (Barro and Sala-I-Martin 1995; Ho et al. 2007) as cited in Elboiashi, H,A. (2011). As a result, R&D, human capital accumulation and spillovers are considered as determinants of long-run economic growth (Meyer 2003). Spillover effects occur as knowledge generated by R&D in one country creates positive effects in other countries (De Mello 1997).Endogenous growth theory identifies economic growth as promoted in the long- run by the introduction of new technological production processes in the host country, and that the FDI is assumed to be more productive than DI (De Mello 1999; Herzer et al. 2008). Thus, FDI enhances economic growth through technological spillovers. These offset the diminishing capital return effects by boosting the present stock of knowledge through labour mobility, training and skills, and through managerial skills and organizational arrangements (Romer 1990; Barro and Sala-I-Martin 1995; De Jager 2004) as cited in Elboiashi, H,A. (2011) Moreover, FDI is expected to enhance the existing stock of knowledge in the recipient economy, through labour training and skill acquisition and technology diffusion; and also through the introduction of alternative management practices and organisational arrangements. Overall, the existence of various form of externality prevents the unrestrained decline of the marginal productivity of capital. As a result, foreign investors may increase productivity in the host economy and then FDI can be considered as a catalyst of DI and technological

progress. Also, the most important mechanism through which FDI promotes growth in the host country is expected to be the FDI's externality effect's great potential . Thus, economic growth can increase unlimitedly over time (De Jager 2004). Although, the greatest limitation of this theory is that its invalid predictive ability in growth convergence to allow for the heterogeneity of economies and their different growth patterns (Ho et al. 2010). Theoretically, FDI can promote economic growth in several ways (Herzer et al. 2010). Some investigators argue that the effects of FDI on economic growth are expected to be two fold. Firstly, FDI can affect economic growth through capital accumulation by introducing new goods and foreign technology. This view comes from exogenous growth theory view. Secondly, FDI can enhance economic growth through augmenting a stock of knowledge in the host country by knowledge transfer. This view comes from the viewpoint of endogenous growth theory. Therefore, FDI, theoretically, can play a crucial role in economic growth through raising capital accumulation and technological spillovers or progress (Herzer et al. 2010).

2.3.3 The Electic paradigm Theory

This involves the combination of some vital factor on FDI theories, namely ownership-specific (O), Location-specific (L) and internalization (I). The theory considers the three elements as important in determining the level and arrays of FDI. According to Sean-Leigh (2007), ownership advantage must be present in a host country which is sufficient enough to counter disadvantage of competing with firms in their home country. He said that the advantages are effective production and marketing and at the same time having international competitive power over local firms. Similarly Shenkar (2007) identified natural resources endowments, manpower and capital, technology and information, managerial and marketing skills and organization systems to constitute ownership advantage. Talking about location advantage, Wall and Ress (2004) opined that there must

be increased profitability from exploiting a firm's ownership advantage in different locations than its domestic market which could result from either economic, market or cultural prospects benefits. With internalization, firms have opportunities to fully exploit the ownership advantage which emanate from the knowledge of marketing a commodity or providing a service and also confer opportunity to keep that particular information secure in as much as he considers it to be core of their competitiveness (Sean-Leigh, 2004).

2.3.4. Dependency Theory

According to Aremu (2010), dependency theory maintains that, unindustrialized countries are poor because they have been steadily exploited through imperial neglect; overdependence upon primary products as exports to developed countries, foreign investors' laxity, particularly through transfer of price mechanism, foreign firm control of key economic sectors with crowding-out effect of domestic firms, implantation of inappropriate technology in developing countries, introduction of international division of labour to the disadvantage of developing Countries, prevention of independent development strategy fashioned around domestic technology and indigenous investors, distortion of the domestic labour force through discriminatory remuneration, and reliance on foreign capital in form of aid that usually aggravated corruption and dependency syndrome (Amin, 1976).

In the same vein, the dependency theorists have also focused on how FDI of multinational corporations distort developing nation economy. In the view of these scholars, distortions include the crowding out of national firms, rising unemployment related to the use of capital-intensive technology, and a marked loss of political sovereignty (Umah:2007). It is also argued that FDIs are exploitative and imperialistic in nature, thus ensuring that the host country absolutely depends on the home country and her capital. (Anyanwu: 1993). From the forgoing, dependency theories believe that the participation of

developed countries into developing nations via their FDI or any other means cannot be expected to produce beneficial result on the developing economies.

2.4 Empirical Review of Literature

Empirically, the relationship between FDI and economic growth has been severally well-known in both developed and developing countries with variable degrees of causal relationship which have been associated with macro economic factors as well as political conditions of the economy in question.

Bende-Nabende (2002) in Oyatoye, Arogundade, Adebisi and Oluwakayode (2011) recognized a direct long term influence of foreign direct investment on output and equally found out that substantial and positive relationship exist for comparatively economically less advanced Philippines and Thailand but adverse in the more advanced Japan and Taiwan.

In Ekperiware (2011), positive correlation was established between the variables of foreign Direct Investment and economic growth in Nigeria but he came to the deduction that the rate at which individual sector or variables of FDI affects economic growth varies as the way economic endowment will attract FDI from the rest of the world will be different. That is, sectors such as service, manufacturing, Agriculture etc. will attract the inflow of FDI at different degrees.

Onu (2012) used the econometric modelling of multiple linear regression to determine the impact of FDI on economic growth in Nigeria using the data for the period 1986 - 2010 and came up with affirmative relationship of FDI on GDP for Nigeria within the period of study. He rationalized that the rise in national savings and investment is a fundamental approach for economic growth and that FDI is an engine for economic growth.

Olokoyo, (2012) examined the effects of Foreign Direct Investment (FDI) on the development of Nigerian economy. The paper tried to answer the question: what are the FDI determinants in Nigeria and how do they affect the Nigerian economy? The study employed the use of Ordinary Least Square (OLS) regression technique to test the time series data from 1970 – 2007. The Cochrane-Orcutt iterative method was also used to correct for autocorrelation. The model used hypothesizes that there is a functional relationship between the economy development of Nigeria using the real gross domestic product (RGDP) and Foreign Direct Investment. The regression analysis results evidently do not provide much support for the view of a robust link between FDI and economic growth in Nigeria as suggested by extant previous literatures. Though the result does not imply that FDI is unimportant, the model analysis reduces the confidence in the belief that FDI has exerted an independent growth effect in Nigeria.

Saibu and Keke (2014) examined the impact of Foreign Private Investment on economic growth using annual time series data from Nigerian economy. The paper employed Co-integration and Error Correction Mechanism (ECM) techniques to empirically analyze the relationship between foreign private investment and economic growth and to draw policy inferences on the observed relationship. The study revealed that there was a substantial feedback of 116% and 78% from previous disequilibria between long-run economic growth and foreign private investment respectively. The findings also indicated that a substantial proportion of capital inflow were not productively invested however the relatively small proportion (22%) of net capital inflows invested, contributed significantly to economic growth in the Nigerian economy. The political environment was found to be unfavorable and overwhelmed the positive impact of foreign private investment.

Eravwoke and Imide (2013) analyzed corruption, foreign direct investment and its impact on exchange of the Nigerian economy. The ultimate objective of this study centers on an

empirical investigation of the impact of corruption, foreign direct investment and its impact on exchange rate of the Nigerian economy. In order to achieve these objectives the study used the ordinary least squares regression analyses, augmented dickey fuller unit root test and the co-integration test. The unit root test revealed that all the variables were stationary at first difference and the short run result revealed that corruption is very high in Nigeria and that have help to depreciate the currency of the country with regards its exchange to other currencies.

The insinuation of the conclusion reached by Onu (2012) is that for a long term growth to be attained or persistent in Nigeria, investment in human capital has to be taken more seriously in the form of training and reward for labour. This is dependable with the popular believe which streamlined that the motivation associated with Udoji salary award and the subsequent spread to private sector also contributed to productivity enhancement during the period. For FDI to be advantageous to human capital development even when there are evidences of resilient impact on economic growth, the host countries must be capable to address the badly-behaved labour market failures such as information lopsidedness and the need to have proficient workforce that will be capable to compete positively well in the global labour markets. According to Velde t (2001), governments need to launch investment promotion agencies to address information related market letdowns for investors to have information needed for investment.

In dissimilarity to all these optimistic suppositions, Otepola (2012) formulated a model that investigates the impact of FDI on economic growth when investment returns may be repatriated. She states that after the opening up to FDI, local firms will be replaced by foreign firms in the R&D sector. This may shrink domestic welfare due to the transfer of capital revenues to foreign firms. In this model, the effects of FDI on economic growth depend on the comparative strength of the interest rate effects. If the world interest rate is

greater than domestic interest rate, FDI has a adverse effect on growth, while if the world interest rate is lower than domestic interest rate, FDI has a positive effect on growth. Also, Firebaugh (1992) lists out several additional reasons why FDI inflows may be less profitable than domestic investment and may even be detrimental. The country may gain less from FDI inflows than domestic investment since conglomerates are less likely to contribute to government revenue; FDI is less likely to boost local entrepreneurship; conglomerates are less likely to reinvest profits; they are less likely to develop relationships with domestic firms; and are more likely to use inappropriately capital-intensive techniques.

In conclusion, the extant views about foreign direct investments polarize. While many scholars see foreign direct investments as advantageous and extremely desirable especially in developing nations where capital insufficiencies for investment is the norm rather than the exception, there are other academics who claim that these investments race with local investors and crowd out local entrepreneurs from the investing space and as such deteriorate the local economy in its place of building it.This work endeavour to find the praxis by probing the impact of foreign direct investments on economic growth in Nigeria.

2.5 Gap in Knowledge

Several studies has come to the conclusion that foreign direct investment contribute drastically to the growth of an economy and that open economy grows faster than closed economy, these studies did not put into consideration the negative impact of foreign direct investment. It is therefore necessary to study both the positive and negative impact of foreign direct investment to the growth of Nigeria economy.

Most studies on the impact of foreign direct investment and the growth of an economy takes into account few variable as the major determinant of economic growth,

this to an extend could not give a conclusive result that can be used to explain the performance and growth rate of the whole economy. It is therefore necessary to use more variable to study and explain the performance of the whole economy and make economic policies that will improve the growth of the economy.

Previous studies on the impact of the Foreign Direct Investment takes into account of few years. However, this study analysis and studies the impact of Foreign Direct Investment for the period of 1972 – 2015 (42years) which was long enough to draw possible conclusion on the impact of Foreign Direct Investment on the growth of Nigerian economy.

2.6 Summary of the Chapter

This chapter gives an insight of review of relevant literatures and empirical consideration of authors in this field of study.

Various justifications of the authors for foreign direct investment and its impact on economic growth were deeply looked into. We tried to match their views with this work and were necessary we try to disagree with one of such view.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

Research methodology is an the overall strategy used by the researcher in collecting and analyzing data for the purpose of investigation of problems, the method to be used by any researcher depends on the purpose of the study, the nature of the problem to be investigated. (Osuala, 1987)

In this section of the study the researcher present the method of study breakdown in a bid to extend the practical evidence in the case of Nigeria. This section of the study defines the indices of study and outlines the sources of data compilation and analysis. The major headings includes: the Research Design, population of the study, the sample size of the study' description of the instrument and technique for data collection etc.

3.2 Research Design

Onwumere, (2005). Define research design as a kind of scheme or blue-print that guides the researcher in a study; a layout which the researcher employs in order to thoroughly apply the scientific scheme in the examination of the problem.

This research employed analytical research design since they are helpful for assessing huge and minute populations mainly where a minute population is to be derived from a huge one. It relied on past data which have a common characteristic of an ex post-factor research. It aims at shaping and measuring the relationship between one variable and another or the impact of one variable on another, in which the variables concerned are not manipulated by the research,

3.3 Nature and Sources of Data

The data used in this study are Secondary data they include the aggregate annual time series at current prices for gross domestic product, GDP,INTR,INFLR,EXR, and total net inflows for Foreign Direct Investment, FDI covering the period 1972-2015. Data was extracted from the Central Bank of Nigeria and world economic outlook(WEO). For this study, aggregate time series data were used because of its steadily nature and characteristics.

3.4 Population of the Study

A population is the aggregate of all cases that conform to designated set of specifications. A set of condition is made to enable statements that are generalized to be people and object (Baridam, 2001). population of the study is the whole Nigerian economy and the data will be drawn from world economic outlook, CBN annual report and statistical bulletin for the year 1972 to 2015.

3.5 Sample and sampling technique of the Study

A sample is a part or unit of the population. It is a subset of the population interest, usually it is difficult to study every object or elements of the study population, a small part or fraction of the population is selected and studied and the study is generalized to the entire population (Olannye, 2006).for the purpose of this the few economic indices will be used to study the impact of foreign direct invest on the growth of the economy. These indices include GDP, FDI,EXCR INTR and INFLR for the period of forty one years.(1972-2015)

3.6 Method Of Data Analysis

The study is mainly quantitative along with existing research studies and methodologies. In this study, the researcher used some methods to test the hypothesis on the various relationships between Foreign Direct Investment and economic growth. The statistical methods used are the Ordinary Least Squares

Method (OLS), ORDINARY LEAST SQUARES METHOD

The ordinary least squares technique is one of the most popular and extensively used Technique for regression analysis. The technique was developed by Carl Friedrich Gauss (1821) and has subsequently evolved to become the Classical Linear Regression Model (CLRM). It is principally used to ascertain whether one variable is dependent on another or a mixture of other variables. It involves establishing the coefficient(s) of regression for a model and then building inference on the population.

Model Specification

GDP= F (FDI + INTR +INF +EXCH + Ut)……………………. ………………(1)

This equation can be transformed into a linear function thus:

GDP=b0 + b1FDI+ b2INTR + b3INFL + b4EXR + Ut......................................(2)

Theoretically, the coefficients of equation (2) are expected to take these signs:

b1 <0, b2>0, b3>0, b4 >0

Meanwhile, we introduced log in the equation to improve the linearity of the equation.

IN-GDPIt=b0+b1IN-FDIt+b2IN-INTRt+b3IN-INFLt+b4IN-EXRt+Ut................ (3)

Where:

GDP = Gross Domestic Product

FDI = Foreign Direct Investment

EXR = Exchange Rate

INTR = Interest Rate

b0 = the constant

b1- b4 = the coefficients of the explanatory variables

Ut = Error term

3.7 validity and Reliability of Data

Assessing the reliability of the data is important before making any statistical analysis. Reliability is concerned with accuracy and precision of a measurement procedure. While validity is represented in the agreement between two attempts to measure the same trait through maximally different methods, reliability is agreement between two efforts to measure the same trait through maximally similar methods.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Presentation of Data

Table 1: **Various Macroeconomic Indicators Data Generated For the Statistical Analysis**

YEAR	GDP (Nm)	FDI (Nm)	EXR(N/$)	INFL(%)	INTR
1972	4892.8	297.8	0.6579	3.46	3.99
1973	5310	186.3	0.6579	5.40	1.57
1974	15919.7	181.6	0.6299	12.67	-25.67
1975	37172	253	0.6159	33.96	-13.97
1976	29146.5	212.5	0.6265	24.30	-6.87
1977	96,100	717.3	0.6466	15.4	-4.26
1978	89,000	664.7	0.606	16.6	-6.29
1979	91,200	704	0.5957	11.8	-3.32
1980	96,200	786.4	0.5464	9.9	3.2
1981	70,400	584.9	0.61	20.9	3.2
1982	70,200	2,193.40	0.6729	7.7	1.9
1983	66,400	1,673.60	0.7241	23.2	2,6
1984	63,000	1,385.30	0.7649	39.6	2
1985	68,900	1,423.50	0.8938	5.5	0.3
1986	71,100	4,024.00	2.0206	5.4	0.7
1987	70,700	5,110.80	4.0179	10.2	0.9
1988	77,800	6,236.70	7.3916	38.3	3.7
1989	83,500	4,692.70	7.3916	40.9	5.8
1990	90,300	10,450.20	8.0378	7.5	5.5
1991	96,600	5,610.20	9.9095	13	5.1
1992	97,000	11,730.70	17.2984	44.5	6.7
1993	100,000	42,624.90	22.0511	57.2	8.4
1994	101,300	7,825.50	21.8861	57	7.4
1995	103,500	55,999.30	21.8861	72.8	6.7
1996	107,000	5,672.90	21.8861	29.3	6.8
1997	110,400	10,004.00	21.8861	8.5	10.6
1998	113,000	32,434.50	21.8861	10	8.1
1999	117, 000	4, 035.50	92.693	6.6	7.5
2000	121, 000	16,453.60	102.105	6.9	9.6
2001	126, 000	4,937.00	111.943	18.9	8,2
2002	131, 000	8,988.50	120.970	12.9	8.1
2003	136, 000	13,531.20	129.356	14	6.5
2004	145, 400	20,064.40	133.500	15	5.5
2005	156, 004	26,083.70	131.661	11.6	7.4
2006	169, 304	41,734.00	128.651	8.2	7.2
2007	634, 656	4,324,86	134.054	8.2	6.7
2008	674, 888	4,659.156	132.372	5.4	3.5
2009	716, 949	3,810.251	132.601	11.5	5.1
2010	801, 700	3,810.25	128.270	13.7	11.1
2011	90I, 300	5,304.112	146.680	10.2	13
2012	261, 855	3,199.89	150,20	12.30	12.25
2013	285,655	6,7400.00	156.00	11.6	13
2014	568.5154	73120.00	128.6516	8.06	12.
2015	90019.12	1213.98	196.5	10.8	10.03

Source: *(World Economic Outlook, Central Bank of Nigeria Statistical Bulletin, 2015)*

4.2   Data Analysis

Table 1 above shows gross domestic product (GDP), data from the table reveals that the gross domestic product of Nigeria increase tremendously throughout the study period. For instance the gross domestic product (GDP) of Nigeria was ₦48928 in the year 1972, it increase to ₦15919.7 in the 1974. It further increased to ₦117,000 in the year 1999 accounting for about 635 percent increase in it value. It rose further to ₦169,304 in the year 2006 recording 45 percent increase. However, it rose continuously through the remaining part of the period of an analysis, that is, through the years 2007, 2008, 2009, 2010, 2011, 2012, 2013 and by 2014 it stood at ₦568.5154

Data from the table 1 also reveal that foreign direct investment (FDI) increase remarkably throughout the study period (1972- 2015).For instance the FDI inflow to Nigeria was ₦297.8 in the year 1972 and fall to ₦186.3 in the year 1973.It further increased to ₦10,004.00 in the year 1997,it continue to increases from N3810.25 in the year 2010 to N1213.98 in 2015 accounting for about 1113.98.percent increase in it value. This was as a result of change political administration which led to change in government policy on FDI to own up to 60% and the proposed enterprise must earn up to ₦500,000 ($760,000).

Data from the table 1 reveals that the exchange rate was the same for the first two years under study, that is 1972 (0.6579) and 1973(0.6579) and continue to decrease from 0.6299 in the year   1974   to   1976.   The   rate   of   exchange   has   been   fluctuating   from 1975 till 1988, after which the exchange rate has been on continues increase for the entire study period,

Data from the table 1 shows that throughout the study period (1972-2015) inflation rate has been fluctuation from 3.46% to 72.8% For instance the inflation rate for the 1972 is 3.46%, this rate continues to increase till the year 1978,after which the rate fall down to 11.8% in 1979. in the year 1981, it increased to 20.1,the inflation rate has been fluctuation for the entire study period, the lowest rate of inflation during the study period was the 1972,(3.48),1978(7.7),1985(5.5),1999(6.9) and 2008(5.4).while the highest level of inflation was during the year 1984(39.6).1989(40.9),1992(44.5) to,199(72.8)

Table 1 also shows the data for the value of interest rate, it reveal that interest rate has not been stable for the entire study period (1972-2015).For instance the interest rate in Nigeria was 3.99 in the year 1972,in 1972 it was 1.57, It decreased to -25.67 in the year 1974. It further decreased to -3.33 in the year 1979 accounting for about -103.33% percent decrease in it value. It continue to decrease to 0.3 in 1997 rose further to 10.6% in the year 1997 after which the rate continue to decrease until the year 2009 when the rate got to 5.1,the Rate of interest continues to fluctuate for the rest of the remaining period under study

4.3 Test of hypothesis

Decision: Accept the null hypothesis (Ho) if the t-statistics is significant and reject the null hypothesis if it is significant.

Significant level is at 0.05

Table 2.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.431[a]	.186	.102	14322.16913	1.023

a. Predictors: (Constant), INTR, INFR, FDI, EXCR

b. Dependent Variable: GDP

Table 3.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-327.906	4394.113		-.075	.941
	FDI	-.028	.203	-.021	-.139	.890
	EXCR	117.817	44.541	.496	2.645	.012
	INFR	118.759	147.369	.125	.806	.425
	INTR	-991.336	376.249	-.471	-2.635	.012

a. Dependent Variable: GDP

Hypothesis one

Table 2. shows positive correlation between the independent variables exchange rate, interest rate, inflation rate, foreign direct investment, and the dependent variable gross domestic product.

The table revealed that the coefficient of correlation (R) is 0. .431 which indicates a positive relationship between the independent variables and the dependent variable. The coefficient of determination R^2 is 0. 186 which shows that the model is perfect and fit for prediction at 17%. The $AdjR^2$ is 0.102 which means that about 10.2 of the dependent variable is accounted for by the independent variables and the remaining 89.8% is not accounted for due to financial policies and financial errors. The DW is 1.023 which shows that there is no serial autocorrelation and it is significant and good model for prediction.

Table 3 which is the coefficients table, it shows the level of significance for the four independent variables, the p-values of the t-statistics are INTR 0. 012< 0.05 level of

significance, EXR 0. 012< 0.05 level of significance, INFR 0. 425 < 0.05 level of significance and FDI 0.890 > 0.05 level of significance

4.4 Discussion of Finding

Hypothesis One

From the test of result in hypothesis one, it was revealed that a positive relationship exist between FDI and economic growth, the level of significant/p-value revealed more than 5% and less than 95% confidence level. This however, means that FDI does not contribute positively to the economic growth of Nigeria. This findings disagree with that of (Onu, 2012).He used the econometric modelling of multiple linear regression to determine the impact of FDI on economic growth in Nigeria using the data for the period 1986 - 2010 and came up with affirmative relationship of FDI on GDP for Nigeria within the period of study. He rationalized that the rise in national savings and investment is a fundamental approach for economic growth and that FDI is an engine for economic growth.

However the findings agrees with that of Adewumi (2016).He examines the contribution of FDI to economic growth in Africa using annual series time data, by applying time series regression analysis for the period from 1970 to 2003. He finds that FDI contributes positively to economic growth in most of the countries but it is not of statistical significance. Adewumi (2016) Argue that the impact of FDI on economic growth is through its contributions to other factors in the economy; however, its impact cannot be measured directly. In addition, he expected that the non significant impact of FDI on the economic growth was due to the methodology used with a low sample size. Additionally, FDI inflow to Africa is relatively small and this may lead to its contributions as being relatively slight. Besides, the impact of FDI on the economic growth may need a considerable time to be achieved. This is especially so if FDI operates in the non-oil sectors where the profits can take a considerable time to be obtained. Herzer *et al.* (2010) apply

time series techniques over the period (1970-2003) for 28 developing countries (10 countries from Latin America; 9 countries from Asia; 9 countries from Africa). They find weak evidence that FDI enhances either long-run or short-run economic growth (GDP). Also their findings indicate that there is unclear evidence that the impact of FDI on growth (GDP) depends on the level of per capita income, the level of education, the degree of openness and the level of financial market development in the host country.

Hypothesis Two

Hypothesis two revealed a positive significant relationship between interest rate and GDP as the level of significant/p-value is 0.012.which is 1% level of significant. This means 99% confidence interval, which is less than 5% significant level and more than 95% confidence interval, the null hypothesis was rejected and the alternate was accepted, the result of this hypothesis is in line with the conclusion reached by (Otepola, 2012).

Hypothesis Three

The null hypothesis was accepted because the level of significant /p-value is 0.43,which means Inflation rate does not have significant impact on the growth of the economy

Hypothesis Four

The result above shows a positive correlation between exchange rate and gross domestic product. Also the table shows the value of (R) coefficient of correlation to be 0.496 which indicate a positive relationship between exchange rate and gross domestic product while the coefficient of determination (r^2) is 0.2199 which means that about 22% of the dependent variable is accounted for by the independent variable and the remaining 78% is accounted for by other variable. Also in the table, the regression coefficient is 0.117.8 and the level of significance/p-value is 0.012; this is 1% level of significant. That means 99% confidence interval which means it is significant because it is more than 95%

confidence interval and less than 5% significant level. Therefore, the null hypotheses is not true, as the simple regression analysis shows a significance impact of exchange rate on gross domestic product, we therefore reject the null hypothesis and accept the alternate.

CHAPTER FIVE

SUMMARY, CONCLUSIONS & RECOMMENDATIONS

5.1   Summary

The research work focuses on the examination of the impact of Foreign Direct Investment on the growth of Nigerian economy. The researcher began with providing a background

review of foreign direct investment in Nigerian economy. It was stated that foreign direct investment plays a crucial role in the economy by promoting economic activity in terms of creating employment opportunities, technology transfer, provide better-quality skills and management techniques, aid local firm's to gain access to international markets and increase product diversity,. Despite the inflow of foreign direct investment in africa, it was opined by Ugwuegbe s *et al* (2013) that Africa is actually suffering from poor governance (as in Zimbabwe) and widespread war and violence (as in Angola, Congo, Liberia, Sierra Leone and Sudan). To overcome many of the constraints on productivity, Africa will require a sustained program of targeted investments. According to the *2005 World Development Report*, governments need to improve their country's investment climate in order to increase the opportunities and incentives for enterprises, both domestic and foreign, to invest productively.

The main problem that necessitated this research work was deduced from past studies with the aim of finding out the current state of things and also to see the position as it upholds in Nigeria. The study vitally identify the impact of foreign direct investment on the growth of Nigerian economy from 1972-2015 and ascertained the relationship that exists between FDI and the growth of Nigerian economy. The main significance of this study lies in the fact that the study serves as an update on the work done on developed and developing economies. Nigerian economy is the main focus of this study. Therefore, this study add to the body of knowledge by investigating the deficiencies in the findings of previous researchers on the impact of tax revenue on Nigerian economic growth.

Various literatures were reviewed and a lot of findings were revealed. Foreign direct investment was said to be a veritable tools for economic growth, it is as certain as death. However, it is still debatable in the literature that foreign direct investment does not only

contribute to the growth of the Nigerian economy but also harmful to the growth of the economy by causing capital flight. To progress further, the literature review looked into the origin and development of FDI in Nigeria. The researcher also made frantic efforts to discuss some economic indices that form the independent variables of this research work. The researcher concluded the review of literatures by looking into some theories relating to foreign direct and its relationship to economic growth

Efforts were made to describe different tools or techniques that were employed in analyzing the result of the functional test carried out on the hypotheses. The study adopted the standard package for social sciences (SPSS) for data analysis and data were sourced from various publication of World Economic Outlook(WEO) and the Central Bank of Nigeria, such as statistical bulletins, Annual report and statement of account, method of data analysis were discussed, data used to empirically investigate the impact of FDI on the growth of Nigerian economy were presented, time series data was used to capture the trends FDI in Nigeria, and its contribution to GDP, the result of the data analysis were discussed.

5.2   Conclusion

From the data above, it can be concluded that foreign direct investment is a key element of economic growth in Nigeria. This clarifies why different government's administration in Nigeria had made strenuous efforts to source for foreign investors into the country. This view has educated the drive among many serving political officers to lookout for foreign investors from all over the world. During President Obasanjo's first tenure in office (1999 – 2003), he toured to many countries with strong economic outlooks and met Presidents with a view to attract foreign investment to Nigeria. The desirability of foreign direct

investments to Nigeria has also been a key objective of virtually all state governments in Nigeria. As an emerging economy, Nigeria is labour abundant and desires capital to syndicate with land and labour resources to advance its employment and production output. This can be enhanced through foreign direct investments. In addition foreign direct investments can upturn access to knowledge transfers. In fact, Nigeria is a mono-product economy. This main product is managed by foreign direct investors especially the upstream activities. If foreign investors are fortified into other sectors, the economy may grow quicker. To attract foreign investors to Nigeria, the problem of insecurity, scandal, corruption, multiple taxations, the developing culture of minimum work for maximum pay, a theft between output and earnings are real problems that government must minimize through efficient policies. These problems looks difficult to surpass because some of these problems have deep roots and are informed by societal institutions but perhaps with re-orientation, positive results may be achieved.

Archeologically, foreign direct investments flow to nations with raw material base, high populace and markets, domestic excess capacity, governmental and economic firmness, plus stable wage policies (Tamuno & Otto, 2006). These factors enhance planning and encourage returns for the foreign investor which is a major objective of foreign investors but FDI involvement can augment local economic activity, employment and in the end lead to mutual benefits. Some of the essential factors are available locally. Government should encourage the presence of the missing factors.

5.3 Recommendations

The following recommendations are necessary for this study.

i. There should be strenuous efforts to increase the performance of the non-oil sector in Nigeria through more investment by directing appropriate authorities in the country to channel resources via long term loans to encourage more participation

by investors in the agricultural industrial sectors which will make the growth of the economy spread across other sectors and in turn encourage foreign investment in the economy.

ii. The government's fiscal discipline should ensure that prices do not rise illogically in the economy. This could be attained through supporting industrial inputs and at the same time develop other sectors to reduce overhead costs. This will go a long way to reducing the level of inflation and investors' overhead costs.

iii. Power supply should be made to be stable through public – private partnership for efficiencies. This will make both public and private investors to mobilize their resources for investment.

iv. When efforts at liberalizing the economy is being pushed without making effort to improve on the technical qualities of the tradable resources, the benefit will only accrue more to the countries with superior technology.

v. Nigerian government should ensure that the qualities of exportable commodities are improved upon to bring about international competitiveness of goods. Both the private and public sector goods in Nigeria should have high level value addition in such a manner that investors can tap into. This can be achieved through the development of the indigenous technology.

v. The fight against corruption should be strengthened and be seen to be rigorous and transparent, efforts should be made to reduce costs of doing business in Nigeria which are among the highest in the world; and the federal government should warrant that all incentive, regulatory and institutional frameworks, put in place, in aid of investors and entrepreneurs are working effectively and efficiently.

5.4 Contribution to Knowledge

The following contributions to knowledge emerged from the study based on the findings and conclusions of this study.

i.   This study has contributed to the knowledge by filling a time gap through the extension of this study to 2015

ii.   The study also employed more variables which were modelled to get the true picture of FDI in the Nigeria economy and also investigated the deficiency in the findings of previous researchers on the impact of FDI and the growth Nigerian economy.

iii.   The study also revealed that foreign direct investment can be harmful and beneficial to economic growth.

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APPENDIX

Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
1	INTR, INFR, FDI, EXCR[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: GDP

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.431[a]	.186	.102	14322.16913	1.023

a. Predictors: (Constant), INTR, INFR, FDI, EXCR

b. Dependent Variable: GDP

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.827E9	4	4.567E8	2.227	.084[a]
	Residual	8.000E9	39	2.051E8		
	Total	9.827E9	43			

a. Predictors: (Constant), INTR, INFR, FDI, EXCR

b. Dependent Variable: GDP

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-327.906	4394.113		-.075	.941
	FDI	-.028	.203	-.021	-.139	.890
	EXCR	117.817	44.541	.496	2.645	.012
	INFR	118.759	147.369	.125	.806	.425
	INTR	-991.336	376.249	-.471	-2.635	.012

a. Dependent Variable: GDP