IMPACT OF FOREIGN PRIVATE INVESTMENT (FIP) ON THE NIGERIA MANUFACTURING SECTOR

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Abstract

This reason study evaluated empirically the impact of foreign private investment on the Nigeria manufacturing sector within the period 1974-2004. The quest for development and lack of local fund necessitated the need for foreign private investment which in turn can lead to industrialization. Correlation coefficient was used to analyze the data collected. It was discovered that exchange rate in the country is directly and positively related to foreign private investment. It was therefore recommended that the government in attempt to attract more foreign private investment to boost the economy should maintain a stable exchange rate.

Introduction

The quest for development is one of the fundamental attributes of any modern society. The actualization of the basic macro economic objectives, such as full employment, sustainable growth, low level of inflation and balance of payment equilibrium has been a significant issue in political, socio-economic discussions and critics alike have suggested diversification of the economy as regards capacity utilization of human and material resources available to it.

The state of our national economy today has become a source of worry to all Nigerians. Despite the various structural economic policy reforms that have been put in place to strengthen and straighten the economy, to bring about growth and development, have only helped in deepening the problem, with persistent balance of payment deficits, inflation has continued to rise, the real sector (Manufacturing and Agricultural) remains almost dormant while oil sector continues to dominate our export earnings.

Babalola, (2005) wrote that the manufacturing sector has continued to record a lackluster performance. Despite government's effort to revamp the sector through various incentives and policy palliatives, industries continue to be bedeviled by weak infrastructural base, particularly public power supply.

To crown it all, exchange rate and interest rate keep moving in an upward direction over the years. The need for industrialization by developing countries such as Nigeria can be seen in the light of experiences of other countries particularly in Europe from the 18^{th} and 19^{th} centuries and lately, the Asian tigers' such as Indonesia, Malaysia, Singapore, and others. It has been observed by tracing the industrial history of these countries that industrialization does propel growth and quicken the structural transformation of the economy. Through industrialization therefore, with more emphasis on the manufacturing sector and the effect of foreign private investment (FPI), a country should be able to raise the standard of living of its citizens. The above can be achieved by converting the excess of the agricultural sector into finished product for export and in the process create employment, earn foreign exchange with which other sectors of the economy are meant to be furnished.

According to Obadan, (2004) foreign private investment may take the form of portfolio investment or foreign direct investment (FDI). The former consists of the acquisition of assets by a foreign national or company in domestic stock or money market by the national of some other countries while the later is a form of lending in the area of equity participation.

Objective of Study

The objective of this project is to study the motivating factors, determinants, performance and effects of foreign private investment (FPI) in Nigeria with a particular reference to the manufacturing sector assessing its contribution to economic development of Nigeria within the period (1974-2004).

Key Issues Affecting the Flow of FDI to Nigeria

Ihonvbere, (2008), posited that it is often quite easy for people to forget how wet the rain made them, especially once they get dry. In Nigeria, some of us appear to find it very difficult to learn from the past, build on the present and make scarifies for the future – partly due to the distortion in our history, people have tended to take "business as usual" as a sort of religion, corruption, waste, fiscal indiscipline and the arrogance of power have come to be seen as normal, especially for those who are not at the receiving end. We have over the years come to designate merit, subvert due process, contaminate integrity, and worship negative democratic institutions and values. In 1999, this country was almost on the precipice of collapse, to put it mildly.

These keys issues are so germane and crucial to our survival as a people and as a nation, so said Chief R.F. Giwa, chairman and managing Director of Unilever Nigeria plc. Some other key issues as put forward by him are:

Inflation and its impact on industrial relations; this is a situation where price are increasing at rate much faster than income of the average worker in the country. The resultant effects manifest by way of workers strike and unhealthy industrial relations atmosphere.

ii. Exchange and interest rates

These issues have led to high level of inflation in the economy which had in the past resulted to a lot of speculative activities that tend to create artificial scarcity in some sectors of the economy. He also suggested, in his statement by proposing that the country should make deliberate efforts to increase non-oil export in other to meet the ever-increasing demand for foreign exchange.

Ekhator (2004), was of the opinion that noticeable problem in the sector was the continuing heavy depreciation of the naira. Although, he argued that the introduction of SAP resulted in abolishing the cumbersome import licensing mechanism, the devaluation of the naira brought about increased production cost which is connected with low level of infrastructures.

Another major constraint as noticed by Louise (2003), was the persistent shortage of final and other petroleum products which had a negative impact on manufacturing operations – the scarcity of fuel hindered the movement of industrial inputs, goods and personnel, while shortage of diesel also reduced the capacity to use generators to provide power in the face of epileptic supply from the Power Holding Company (PHCN) of Nigeria.

Characteristics of the Nigerian Manufacturing Sub-Sector

The Nigeria manufacturing sector is characterized by the following:

i. High Import – Dependency (ii) Low Production (iii) Inward production orientation (iv) High cost of production (v) Low Degree of backward linkages (vi) Dualistic Structure

Benefits of Foreign Private Investment

Shortly after the transaction, which occurred in South East Asian economies, most government particularly those of the LDCs are now acclaiming foreign private investment as good news and there are proliferation of menu of policies across the globe to attract them. In these economies, investment demand is low and inelastic to prevailing economic signals to the extent that growth is hampered and in many of them the economies are stagnated. The belief has thus spread across the globe that any LDCs, that is serious about raising the standard of living of her citizens must open its economy and avail itself to benefits of greater access to capital, technology, higher level of employment and others.

According to Jhingan (1997) foreign private investment does not only provides finance but also managerial, administrative and technical personnel, new technology, research and innovations in products and techniques of oproduction which are in short supply in LDC's.

It encourages local enterprises by either directly fostering local enterprise with men, money and material and by imparting training and experience to its personnel or indirectly by creating demand for ancillary or subsidiary services (like transport and training agents) which are uneconomical for private foreign enterprise to provide. By bringing capital and foreign exchange, foreign private investment helps in filling the savings gap and the foreign exchange gap in order to achieve the goal of national economic development in LDC's. Foreign private investment has also been known for bringing revenue to the government in the recipient country when it taxes profit of foreign firms or gets royalties form concession agreements.

Foreign private investment helps in raising productivity and hence real wages of local labour. When foreign investment induced industrialization takes place, the real wages of the newly employed workers are higher than the real wages of workers in the rural sector of the economy. If foreign private investment is in export-oriented industry, it leads to much higher social benefit than it is in import-substitution industries because the former have large backward and forward linkage effects and if export industries are labour intensive, they also provide large employment opportunities.

In addition to expanding local productivity through the creation of self-sustaining local productivities, these investments can make broad contributions to economic and social development by enhancing competition, expanding local marketing, and providing links to future export market.

To undertake an empirical assessment of the impact of foreign private (Direct) investment on the Nigerian manufacturing sector, data on manufacturing sector output (QMS), exchange rate (EXG) Interest rate INT) External debt ratio (EXD) for the period between 1974 and 2004 were analyzed using ordinary least square method. See appendix for data.

The model is as follows:

Functional form:

$FPI = f(QMS, EXG_{R,} EXD_R, INF_{R,} POL)$

In equation form, it becomes:

$FPI = \alpha_0 + \alpha_1 QMS + \alpha_2 EXGR + \alpha_3 INTR + \alpha_4 EXD_R + \alpha_5 INFR + \alpha_6 POL+U$

Cochrane-Orcutt Method AR(2) converged after five (5) iterations.

LNFPI = 2.3681 + 1.0099LNQMS + 0.31128LNEXG+ 0.40528LNINT + 0.1.4596LNEXD – 0.15665LNINF – 1.0161POL

(0.81734) (1.5166) (2.9864) (0.43889) 1.0792)

(1.1575) (-3.1149)

$R^2 = 0.84003$ $R\text{-}^2 = 0.77604$

S.E.E. = 0.63524 S.sat = 13.1281 DW-STAT = 1.866

The parameters of the autoregressive error specification are thus given:

U = -38429*u(-1) + -.004381*u(-2)+E

The empirical result obtained using this estimation technical which converged after five(5) iterations revealed that the coefficient of determination $R^2 = 0.84$ i.e about 84% of the total variations in the dependent variable is been accounted for by the independent variables, an improvement on the foregoing result obtained by OLS method. And after adjusting for degree of freedom, about 77% of the total variation in the dependent variable were accounted for by the independent variables.

Adopting the Cochrane – Orcutt estimation technique, Manufacturing sector output (QMS), Exchange rate (EXGr), Interest rates and political instability variable (POL) also conformed with a priori as expected while External Debt Ratio (EXDr) and Inflation rate were contrary to expectations. Of all the regressors only interest rate is not statistically significant from zero.

Expectedly, Manufacturing sector output impact positively on foreign private investment but was not statistically significant at both 1% and 5% level of significance (i.e. 2.485 and 1.708). It only passed the test at 10% ($t_{observed}$ = 1.316

< $t_{calculated}$ of 1.5166). This is an indication that manufacturing sector output was a weak and an unreliable predictor of foreign private investment in Nigeria within the period under review (1974-2004).

The exchange rate was directly and positively related to foreign private investment inflow in line with a priori expectation of a depreciating exchange rate. Thus, a fall in Nigeria's exchange rate will cause Foreign Private Investment to rise. It was statistically significant, it passed the test even at ½%, 1% and 5% levels, (the table values being; 2.787, 2/485 and 1.708 respectively, as against the t-calculated value of 2.9864); hence, we conclude that exchange rate is a strong predictor of foreign private investment in Nigeria.

As expected, interest rate also conformed with theory, it was properly signed, the coefficient which is an indication that high interest rate is expected to induce savings and hence make funds available for investment in the country. It was not statistically significant from zero at all levels, hence we conclude that interest rate is a poor predictor of foreign private investment in Nigeria.

Surprisingly, given the increasing nature of Nigeria's debt burden, external debt ratio (Debt/GDP) failed to conform with a priori that a debt ridden country will not be able to attract foreign inventors i.e the higher the debt-GDP ratio the longer the foreign investment in the country. The result showed that when External debt rises by 10% foreign private investment would increase by 1.7%. it was only significant at 25% level of significance i.e t-observed = 0.684 < t calculated = 1.0792).

Inflation rate failed to conform with a priori expectation though the result shows a statistically significant relationship with foreign private investment. It only passed the test to 25% ($T_{obs} = 0.684 < t_{cal} = 1.1575$). The period of relative political instability in the country (captured by the dummy variable) as compared with peace years has a negative effect on the inflow of foreign private investment. That is, the more unstable the political climate is, the less inflow of FPI it might attract as this would reduce the level of confidence in the business community. The relationship is statistically significant as it passed the test even at ½% i.e ($t_{obs} = 2.787 < t_{cal} = 3.149$).

This is an indication that the level of political stability in a country is a good determinant of the level of foreign private investment in that country.

And by extension, we extracted from our results that a unit change in the manufacturing sector output (QMS), holding other variable constants, will cause a 1.0093 unit change in FPI.

Conclusion

The impact of foreign private investment on the manufacturing sector cannot be overemphasized. Hence, for a positive effect of foreign private investment on the manufacturing sector, the relevant policy makers should put in place appropriate policies and strategies with a view to attracting foreign private investment and enhancing the performance of the manufacturing sector, which, in line with current modern trends is the engine of growth for most transitional economies, like those of the "Asian Tigers".

Recommendations

The following recommendations are made based on our findings on this study

1. Maintenance of stable exchange rate by government study.
2. Government should improve its investment (i.e. spending) especially on basic infrastructure such as road, energy, water supply, telecommunications etc.
3. The Nigerian Government should strive to provide adequate security, enforcement of the rule of law, equity and fairness, as this would ensure the existence of a conductive and safe environment for both domestic and foreign investors.
4. Efforts should be made by government to ensure stability in interest rate
5. Finally, the federal government should go beyond mere policy formulation to policy actualization.

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APPENDIX A

TABLE 1: DETERMINANTS OF FPI

YEAR	FPI (INFOOW)	QMS (INDEX)	EXGR	INTR	EXDR= DEBT/ GDP	INFR	POL (DUMMY VARIABLE)
1974	507.1	35.45	0.62	10.0	0.018	13.4	1
1975	757.4	43.9	0.61	9.0	0.017	33.9	0
1976	521.1	54.1	0.62	10.0	0.014	21.1	0
1977	717.3	57.5	0.64	6.0	1.012	21.1	1
1978	664.7	65.8	0.60	11.0	0.036	21.5	1
1979	704.0	97.3	0.59	11.0	0.038	13.3	1
1980	786.4	102.4	0.50	9.50	0.038	11.6	1
1981	584.9	117.3	0.61	10.0	0.046	10.0	1
1982	2193.4	128.6	0.67	11.75	0.170	21.4	1
1983	1673.6	94.8	0.72	11.5	0.188	23.2	0
1984	1385.3	83.4	0.76	13.0	0.237	40.7	1
1985	1423.5	100.0	0.89	11.75	0.245	4.7	0
1986	4024.0	78.2	2.02	12.0	0.577	5.4	1
1987	5110.8	130.8	4.01	19.20	0.932	10.2	1
1988	6236.7	135.2	4.53	17.6	0.939	56.0	1
1989	4692.7	154.3	7.39	24.6	1.092	50.5	1
1990	10450.2	162.9	8.03	27.27	1.098	7.5	1
1991	5610.2	178.1	9.09	20.9	1.037	12.9	1
1992	11730.7	182.7	17.29	31.2	1.015	44.5	1
1993	42624.9	145.5	22.05	18.32	0.920	57.3	0
1994	7825.5	144.2	21.88	21.0	0.718	57.0	1
1995	55999.3	136.3	21.88	20.74	0.370	73.1	0
1996	5672.9	138.7	21.88	20.86	0.228	29.1	1
1997	10004.0	138.5	21.88	23.32	0.213	8.5	1
1998	32434.5	133.1	21.88	21.34	0.233	10.5	0
1999	4035.5	137.7	92.69	27.19	0.778	6.6	1
2000	16453.6	138.2	102.10	21.55	0.662	6.9	1
2001	4937.0	137.7	111.94	21.34	0.59	18.9	1
2002	8958.5	146.3	120.97	22.47	0.631	12.9	1
2003	13531.2	148.0	129.35	22.46	0.739	14.0	1
2004	20064.4	145.6	133.50	20.73	0.758	15.0	1

Source: CBN (2005) Statistical Bulletin Vol. 16 CBN Abuja.