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COMPARISON OF THE ECONOMIC FACTORS THAT INFLUENCE FOREIGN DIRECT INVESTMENT GROWTH IN NIGERIA AND INDIA

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ABSTRACT
The study determined the compound growth rate of FDI and the factors influencing its inflow in India and Nigeria. The study showed that the time series data were non-stationary but differenced stationary and their cointegration residual and error correction model regression showed a long-term relationship and a same time period adjustment of disequilibrium between FDI and the macroeconomic variables. The growth rate and compound growth rate of FDI into India was much higher than that of Nigeria for the same time period; the results raises the question of whether the perceived notion that India is growing at a much faster pace than Nigeria is true. The determination of the relationship between FDI and the chosen economic variables suggests that Nigeria should improve on its GDP, trade openness and human capital while sustaining its inflation at the level to which it encourages FDI inflow. India attracted more FDI than Nigeria due to its large GDP, higher real interest rate and trade openness; it is suggested that a further depreciated currency would encourage more FDI inflow into India.

Key words: foreign direct investment, macroeconomic, Nigeria and India

INTRODUCTION
Foreign Direct Investment (FDI) is an investment made by an investor into a company located in a country outside the investor's country. It involves direct acquisition of a foreign company, participation in enterprise management, joint venture, strategic alliance as well as transfer of technology and expertise. There are two types of FDI: the inward foreign direct investment which is associated with the host country and an outward foreign direct investment; associated with the investors' home country whereby the net FDI inflow could be either positive or negative. FDI has been regarded as the fastest growing economic indicator of globalisation. It plays a major role in the internationalisation of businesses and its operations with respect to home operations may be horizontal or vertical. FDI is horizontal when its product is aimed at the market in which the investments are made and vertical when its products are intended for exports (Walsh and Yu, 2010). FDI could also be market-seeking, efficiency-seeking or strategic-asset-seeking (Ajayi, 2006). For instance, Dunning (1993) cited by Henley *et al*. (2008) observed that investors from China, India and South Africa established operations in Sub-Saharan Africa (SSA) with the motive of market seeking and not efficiency considerations because productivity levels of SSA region are lower than low-income Asian countries. When domestic capital is inadequate to develop the economy and sustain growth, it necessitates the need for external funding either through borrowing or FDI. But FDI is often preferred to borrowing as it does not create nor increase the debt profile of the host country.

FDI has been noted as a key driver of international economic integration through which with the right policy framework; it can provide financial stability, promote economic development and improve societal well being. FDI has been researched to have impacts on

domestic investment, technology, employment, labour skills, the environment and export competitiveness. FDI flows are influenced by both demand side and supply side factors. The supply side factors are mostly associated with developed countries characteristics while the demand factors are the host country characteristics and policies. Makki and Somwaru (2004) stated that FDI is an important vehicle of technology transfer from developed countries to developing countries; these technological spillovers are regarded as a major contribution of FDI to development. Increased productivity spillover also arises when the presence of multinational firms increases the market competition in the host country and forces existing inefficient firms to invest more in physical and human capital (Fung *et al*., 2002). FDI inflows can turn a country from an importing nation to a producing and exporting nation, create jobs for the locals in the host country, provide revenue to the host country government through companies taxes and create a competitive environment that motivates local firms to want to meet up with the international standards set by foreign firms in order to stay in business (Kazembe and Namizinga, 2007). FDI impacts on wages as suggested by Lipsey (2004) who observed that foreign-owned firms tend to pay higher wages on average than privately owned local firms. The impact of foreign direct investment on wages and working conditions suggests that FDI is a potentially important driver of improving living standards for workers (OECD-ILO, 2008). However, some researchers believe that FDI does not foster growth and stability but is rather attracted to countries already growing, politically stable and has sizeable purchasing power. Other studies have indicated that FDI has a negative impact on developing countries in cases where investment was directed towards the primary sector. FDI becomes a problem when multinationals borrow money locally at favourable interest rates to finance their projects as this result in the crowding out of private domestic investors. It also becomes a problem when profits repatriated by multinationals exceed total FDI inflow (Falki, 2009). There may be negative effects on a host country economy if the locals do not benefit from employment and high wages and when there is tax evasion and abusive transfer pricing by multinationals (Ogunkoya and Jerome, 2006). Despite its misgivings, FDI is arguably preferable to foreign borrowing as it contributes more to investment and gross domestic production growth than an equal amount of borrowing (Agrawal, 2000).

While restrictive regulations and factors such as poor infrastructure, poor standard of accounting, inadequate disclosure of requisite information and weak enforcement of legal obligations may impede FDI flow; large domestic market, natural resources endowment and privatisation of inefficiently-run government establishments may boost foreign investment (Kazembe and Namizinga, 2007). Also, the inflation rate, tax burden and government consumption can influence FDI in countries. Tax rates for example were considered a significant barrier to FDI in Malawi (Kazembe and Namizinga, 2007). Low cost of labour is considered as one of the factors that can influence the decision to invest in a country but where the wage rate difference is minimal and insignificant; the skills of the labour force are expected to have an impact on FDI decisions (Iloh, 2011). There is also documented evidence on the relationship between a host country weak currency and inward FDI. Walsh and Yu, (2010) suggested that the determinants of FDI flows differed strongly across economic sectors; while a depreciated currency is associated with more secondary sector FDI, a stronger currency is associated with more tertiary sector FDI but no significant link is observed in the primary sector. Furthermore, a country that is notoriously corrupt with a high crime rate cannot attract much FDI because corruption is an additional cost and it creates uncertainty (Ajayi, 2006).

The Nigerian government in its quest for economic independence and development has intermittently changed its FDI policies to encourage foreign investment into the economy. Although Nigeria started economic reforms in the mid 1980s, it has been interrupted with political shocks and policy reversals (Ogunkola and Jerome, 2006). FDI into

Nigeria before now has been concentrated in oil and extractive industries until recently when there was diversification into the manufacturing sector although foreign participation is restricted from the production of arms and ammunition as well as narcotic drugs and psychotic substances (OECD, 2005). Foreign equity participation in the manufacturing and commerce sector was only allowed to a maximum of 60 per cent by the Nigerian Enterprise Promotion Decree of 1972. Later in 1977, an enacted indigenisation decree further limited foreign participation in Nigeria business to 40 percent. But in 1991, Nigeria adopted the Export Processing Zones to encourage foreign investment and in 1995; the Nigerian Investment Promotion Commission which serves as a one-stop-shop, where prospective foreign investors can complete all the procedures for business permits and licenses was established to provide foreign investors with 100 per cent ownership of business as well as guarantee against nationalisation. Financial experts have noted that Nigeria has had huge losses from FDI and this has been attributed to high level of insecurity that has become the greatest challenge confronting Nigeria economy. Others have attributed the decline of FDI into the country to poor infrastructure such as the epileptic power supply; power generation is a key factor to the success of companies and no foreign investor would be willing to invest in an environment where the power supply is in a state of comatose. Furthermore, Nigeria is seen as a very corrupt country with no regard for the rule of law. It has a complex and inefficient tax system, bureaucratic bottlenecks in establishing business; high transaction costs and inconsistent reform policies that are poorly implemented and monitored.

India is Asia's third largest economy and FDI inflow into India averaged less than 0.1 per cent of its GDP due to restrictive regulatory policy framework until 1991 when it averaged about 0.5 percent of the GDP in the periods of 1992-96. India did not allow more than 40 percent foreign ownership of a firm until 1992 (Agrawal, 2000). A foreign company can enter an approved Indian sector as an Indian company whereby it is a wholly owned subsidiary or joint venture with a local Indian company or as a foreign company. India permits 100 per cent FDI in the manufacture of hazardous chemicals and industrial explosives, 74 per cent in telecoms, 26 per cent in insurance and none in supermarkets (Sweeney, 2010). India's foreign trade and investment regime is made up of the pre 1991 reforms phase which is characterised by extensive regulation of trade and investment and the post 1991 phase which saw the relaxation of controls over FDI. A regression analysis of GDP and FDI flows by Sweeney (2010) showed a statistically significant linkage between FDI inflows and overall GDP in India. Mathiyazhagan (2005) noted that there is a common consensus among all studies done on FDI relating to India that FDI is not growth stimulant but a resultant effect of growth. Dreher *et al*. (2011) emphasized that relative market size, relative financial market development, relative risk, relative endowment of human capital and previous international experience significantly affect the type of engagement by foreign investors in post-reform India. Considerable growth effects of FDI in India have been largely restricted to the manufacturing sector with FDI stocks and output mutually reinforcing each other while causality in the service sector runs from output to FDI in the long run but no evidence of causal relationship in the primary sector (Chakraborty, 2006).

Although Nigeria and India are both developing countries, Indian economy is perceived to be developing at a much faster rate than the Nigerian economy. The study seeks to find; if the same factors are influencing the growth rate of FDI in the two economies. The study like most studies will focus on the demand side or host country factors that determine the inflow of FDI. Many studies research on the effects or impacts of FDI on the home or host country economy and there is also a large literature on the factors influencing the level of FDI but not much has shown any comparison on the relationship of FDI growth rate and the economic factors influencing it in India and Nigeria.

METHODOLOGY

The data for analysis is made up of macroeconomic variables which are part of the World Development Indicators obtained from the World Bank databank. The time period of the data is 1961 to 2010. Being a time series data and in case the error terms are correlated; the stationarity of the data is first tested using the augmented Dickey-Fuller (ADF) method of unit root test then a log-linear form of multiple regression model is applied to determine the factors influencing FDI inflow.

Test of Stationarity and Determination of Growth Rate

The unit root test is applied to the time series data using the model of a random walk with drift as shown in equation 1.

$$\Delta Y_{it} = \beta_{i1} + \delta_2 Y_{it-1} + \Delta Y_{it-i} + U_{it} \quad (1)$$

An error correction model (ECM) is applied to the data to check for cointegration in the case of a non-stationary data in order to avoid spurious regression.

$$\Delta FDI_{it} = \beta_{i0} + \beta_{i1}\Delta X_{it} + \beta_{i2} U_{it-i} + \varepsilon_{it} \quad (2)$$

The compound growth rate of FDI over time is measured using the Log-Linear model (Gujarati and Sangeetha, 2007). Given a compound interest rate as:

$$Y_t = Y_0 (1+r)^t \quad (3)$$

If both sides are expressed in their natural logarithms, it becomes,

$$\ln Y_t = \ln Y_0 + t \ln(1+r) \quad (4)$$

Assuming, $\beta_1 = \ln Y_0$ and $\beta_2 = \ln (1+r)$ (5)

Then equation (3) can be written as: $\ln Y_t = \beta_1 + \beta_2 t + U_t$ (6)

Relationship between FDI and Macroeconomic Variables

$$\text{LnFDI} = \ln\beta_0 + \ln\beta_1 X_1 + \ln\beta_2 X_2 + \ln\beta_3 X_3 + \ln\beta_4 X_4 + \ln\beta_5 X_5 + \ln\beta_6 X_6 \quad (7)$$

Where,

FDI = FDI in BOP (current US$)

X_1 = GDP (current US$)

X_2=Real Interest rate (%)

X_3= Official Exchange rate (LCU per US$, period average)

X_4 = Trade openness (ratio of exports plus imports to GDP)

X_5= Inflation (annual %)

X_6= Labour force (number of persons above 15yrs that are economically active)

The GDP is expected to have a positive relationship with the inflow of FDI because it is thought that a large market size would improve sales of investors' products. The real interest rate is the rate of interest an investor expects to receive after allowing for inflation, it is expected to have a positive relationship with the flow of FDI. The official exchange rate is the government determined price of a foreign currency in its local currency unit. The higher the amount, the more devalued the host country currency and a depreciated currency is expected to attract more would-be investors from stronger currency countries. The availability of labour force is expected to attract more FDI as it is thought that wages are not too high where there is surplus labour; investors would prefer a country with low wages in comparison to wages in their home country. The existing inflation of a country affects the purchasing power of its currency; the higher it is, the less valued a country's currency and this could have a positive impact on FDI to the extent to which it depreciates the currency but inflation has a negative impact on FDI inflow when it exceeds a certain level because investors are wary of investing in an environment of fluctuating and increasing inflation that could affect their profits and erode the value of their investments. Trade openness has a positive relationship with FDI because it indicates the ability of the host country to import and export products from other countries in relation to their market size.

Chow Test of Structural Stability

Based on the grounds that India liberalised its economy in 1991 and Nigeria started its liberalisation reforms after the mid 1980s. A structural stability test is done to investigate any difference in the growth rate of FDI in the pre and post- trade liberalisation era of the two countries. For this test, the data is divided into two sub periods and an F-test is applied (Gujarati and Sangeetha, 2007). A significant F-test would mean there has been a structural change in the respective countries over the period 1961-2010. The sub periods for India are 1961-1993 and 1994-2010 while for Nigeria, it is 1961-1990 and 1991-2010. Assuming,

Sub period $n_1 = RSS_1$ and sub period $n_2 = RSS_2$

$RSS_{UR} = RSS_1 + RSS_2$ and RSS_R = Pooled regression

$$F = \frac{(RSS_R - RSS_{UR})/k}{(RSS_{UR})/(n_1+n_2-2k)} \quad (9)$$

RESULTS AND DISCUSSION

Stationarity

The augmented Dickey-Fuller unit root test showed majority of the economic time series were non-stationary as seen in table1. The variables were found to be stationary at their first differencing except for three Nigeria data variables (real interest rate, exchange rate and trade openness) which were stationary at longer lag length differencing.

Table 1 ADF Test of Stationarity

Variables	Coefficients	
	Nigeria	India
FDI	0.018 (0.250)	-0.039 (-1.084)
GDP	0.003 (0.048)	0.184 (5.914)*
Real interest rate	-0.069 (-1.442)	-0.076 (-1.393)
Exchange rate	0.026 (0.747)	0.003 (0.210)
Trade openness	-0.066 (-1.338)	0.043 (1.528)
Inflation	-0.455 (-3.736)*	-0.918 (-5.572)*
Labour force	-0.097 (-1.519)	-0.011 (-0.326)

Values in parenthesis are t-values. DF t-value at 5% is -2.93

Growth Rate

Nigeria: $LnFDI = 18.134 + 0.082t + U_t$

Se = (0.214) (0.007) $r^2 = 0.801$

The slope coefficient; multiplied by 100 gives the growth rate in FDI with respect to time.

Compound Growth Rate (CGR): (antilog $\beta_2 - 1$)*100

(1.085456 - 1)*100 = 8.55%

India: $LnFDI = 12.227 + 0.243t + U_t$

Se = (25.564) (17.922) $r^2 = 0.912$

Compound Growth Rate (CGR): (antilog $\beta_2 - 1$)*100

(1.275069 - 1)*100 = 27.51%

Table 2 shows the annual growth rate of FDI into India for the period of 1961-2010 was 24.3per cent; much higher than that of Nigeria (8.2 per cent) for the same time period. Also, the CGR of FDI per year as indicated by the Indian economic data for the time period is very much higher than that of Nigeria for the same time period. Similarly, India has a higher FDI growth rate for the two sub periods.

Table 2 Summary of Instantaneous and Compound Growth Rates

Full time period 1961-2010		
Variables	**Nigeria**	**India**
Instantaneous growth rate (%)	8.20	24.30
Compound growth rate (%)	8.55	27.51
Summary of growth rate in sub periods 1and 2		
	1961-1990	**1961-1993**
Instantaneous growth rate (%)	3.90	16.40
Compound growth rate (%)	4.00	17.82
	1991-2010	**1994-2010**
Instantaneous growth rate (%)	11.60	20.90
Compound growth rate (%)	12.30	23.24

Interpretation of Regression Coefficients

Nigeria - The regression coefficients in table 3 shows that GDP, trade openness and labour force had the expected positive signs and were statistically significant. The results showed that a one per cent increase in GDP, trade openness and labour would increase FDI inflow by 0.58 percent, 0.92 per cent and 4.54 per cent respectively. Inflation did not have the expected negative sign but was significant, although with minimal impact because of the value of its coefficient. Also real interest rate and official exchange rate did not have the expected positive signs and were not significant.

Table 3. Multiple Regression Results

Dependent variable: FDI		
	Coefficients	
Variables	Nigeria	India
Constant	-70.985 (-1.651)**	242.118 (1.652)**
GDP	0.580 (2.091)*	3.295 (3.132)*
Real interest rate	-0.002 (0.272)	0.059 (0.891)
Exchange rate	-0.303 (-1.000)	4.212 (3.352)*
Trade openness	0.916 (1.904)**	2.330 (0.221)
Inflation	0.010 (1.795)**	-0.040 (-0.760)
Labour force	4.536 (1.597)**	-16.218 (-1.975)**
R^2	0.879	0.948
S.E	0.398	0.466
F value	26.581	39.236

Critical t-value is 1.701.*Significant at 5% and **Significant at 10%

India – Table 3 also shows that the coefficients of GDP, real interest rate, exchange rate, trade openness and inflation all had the expected economic signs but only GDP and exchange rate were statistically significant. While labour force was also significant; it did not have the expected positive sign which may be as a result of considerable differential flow of FDI into the different sectors of the Indian economy, given that a larger population of illiterate or unskilled labour force would not attract investors. The results showed that a one per cent increase in GDP, real interest rate, exchange rate and trade would increase FDI inflow by 3.3 per cent, 0.06 per cent, 4.21 per cent and 2.33 per cent respectively while a one per cent increase in inflation would reduce FDI inflow by 0.04 per cent.

Table 4. Stationarity Test for Cointegration Regression Residuals

Variables	Coefficients	
	Nigeria	India
δUt-1	-1.110 (-4.649)*	-0.990 (-4.951)*
R^2	0.683	0.466
S.E	0.252	0.244

ADF critical value is -2.93

Although the macroeconomic series were individually non-stationary, their cointgration regression residuals as shown in table 4 were stationary and this indicates a long-run relationship between the variables. Having shown a long term equilibrium, an ECM becomes necessary to show any possible short term disequilibrium.

Table 5. Results of ECM Model

Dependent variable: ΔFDI		
	Coefficients	
Variables	Nigeria	India
Constant	0.139 (0.182)	0.628 (0.733)
GDP	2.841 (0.885)	0.359 (0.058)
Real interest rate	0.373 (1.506)**	0.381 (3.495)*
Exchange rate	0.838 (0.296)	-6.303 (-0.876)
Trade openness	-6.538 (-1.415)	3.820 (1.000)
Inflation	0.025 (0.535)	-0.044 (0.788)
Labour force	-0.564 (-2.989)*	0.038 (0.331)
βU_{t-1}	-1.618 (-0.639)	-0.341 (-0.254)
R^2	0.266	0.301
S.E	4.547	2.219
F value	2.18	2.523

Critical t-value is 1.701.*Significant at 5% and **Significant at 10%

Since the error terms (βU_{t-1}) in table 5 above have the expected negative signs and are not statistically significant; it implies that FDI inflow adjusts to changes in the explanatory economic variables in the same time period.

Chow Test

$$F = \frac{(RSS_R - RSS_{UR})/k}{(RSS_{UR})/(n_1+n_2-2k)}$$

Nigeria: $F = \frac{3.489 - 2.160/7}{2.160/36}$

$= 3.164 > 2.28_{\text{F-critical value}}$

India: $F = \frac{2.829 - 0.929/7}{0.929/36}$

$= 10.51 > 2.28_{\text{F-critical value}}$

The rejection of the null hypothesis of no structural change supports the literature on the influence of a country's macroeconomic policies on the flow of FDI into that country. Thus

the FDI-Macroeconomic relationship had undergone a structural change due to the liberalisation policies of the governments in the period 1961-2010.

CONCLUSION AND RECOMMENDATIONS

The analysis of the study showed that the time series data were non-stationary but differenced stationary and their cointegration residual showed a long-term relationship between FDI and the chosen macroeconomic variables. The compound growth rate of FDI into India was much higher than that of Nigeria for the same time period; lending support to the perceived notion that given the economic benefits that comes with FDI inflow, India as a developing country is growing at a much faster rate than Nigeria. The growth rate and compound growth rates of the two sub periods of each country were also different; which suggests the presence of structural instability that was later reinforced by the Chow test results. It was observed that GDP was positively significant for both countries; with India's GDP having a higher impact on FDI due to large domestic market size as a result of its large population which also explains why India has a higher impact of trade openness on FDI than Nigeria. The negative coefficient of the exchange rate for Nigeria implies that given the economic situation of the country a further devaluation would result in negative effect of inflation and discourage FDI into the tertiary sector. Even though inflation increases FDI into Nigeria, it does so at a lower percentage than its currency depreciation reduces FDI. The positive exchange rate coefficient for India implicitly suggests that a depreciated currency would encourage more FDI inflow into India especially in the manufacturing sector. Although, inflation by its coefficient sign reduces FDI into India; it is at a lesser percentage than its depreciated exchange increases FDI. A depreciated currency would help India more than Nigeria because India has a larger volume of trade while Nigerian has a smaller volume of trade. This is called the Marshall Lerner's condition which states that devaluation will succeed in improving the balance of payment accounts if the sum of price elasticity of exports and imports is greater than one. Otherwise; devaluation will adversely affect it (Ahuja, 2010). Also, labour was significant for both countries but while it was positive for Nigeria, it was negative for India and it is attributed to the possible differences in the percentage of skilled and unskilled labour within the labour force; considering that India has a higher inflow of FDI into its manufacturing and tertiary sector; the non-availability of educated skilled labour would negate FDI inflow.

Based on the analytic results of the study, it is recommended that Nigeria should improve its GDP, trade openness and sustain its inflation at the level to which it encourages FDI inflow as well as improved development of human capital. India is seen to attract more FDI than Nigeria due to its large domestic market size, higher real interest rate and trade openness. The country should thus improve and sustain these factors. Also, appropriate policies should be formulated in order to achieve the aim of creating a balance between currency depreciation and the level of inflation which discourages FDI.

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