

Impact of Foreign Direct Investment on Employment Generation in Nigeria

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ABSTRACT

Given the Nigeria economy resource base, the country's foreign investment policy should move towards attracting and encouraging more inflow of foreign capital. The need for foreign direct investment (FDI) is born out of the under developed nature of the country's economy that essentially hindered the pace of her economic development. Hence, this study investigates the relationship between international trade flows and employment in Nigeria for the period 1990 to 2010. Using time series estimation technique, we found significant link between FDI flows and employment in Nigeria both in the short-run and long run. However, external factors such as, real effective exchange rate, import rate and internal factors such as inflation rate and export rate more important factors in explaining employment rate in Nigeria. Therefore it is recommended that FDI should focus more on Nigeria's agricultural sector because of the strategic relevance of the sector to the nation's economy especially in the area of employment generation and that concerted efforts should be made by the government to attract foreign investors, encourage production and generate employment especially for the rural populace.

Keywords: *Foreign Investment Policies, Foreign Exchange Rate, Import Rate, Employment Rate, Rural Populace, foreign direct investment*

INTRODUCTION

Foreign direct investment (FDI), as a key element of globalization and of the world economy, is a driver of employment, technological progress, productivity improvements, and ultimately economic growth (Asiedu, 2002). It plays the critical roles of filling the development, foreign exchange, investment, and tax revenue gaps in developing countries (Smith, 1997; Quazi, 2007). The issue of employment is very germane to any economy; this is why one of the main macroeconomic objectives of any country is to attain full employment. The overall impact of FDI by multinational corporations (MNCs) is not easy to assess, because of the paucity of data, the difficulty in controlling exogenous factors and conceptual problems in defining strategic counterfactuals (Ajayi, 2006). What would have happened if the foreign investment had not taken place? International experience shows that the impact of MNC investments depends on the overall incentive and capability structures within which such investments are made. However, Africa has never been a major recipient of FDI flows and

so lags behind other regions of the world. On an annual average basis, the regions share of global FDI inflows was 2.6 percent in the period 1980-1989; 19 percent in the period 1990-1999; and 3, 2 percent in the period 2000-2009 (UNCTAD World Investment Report, 2010). During the same periods, the Asian region received FDI inflows 14.2 percent, 19.1 percent, and 19.1 percent of total global inflows, respectively (UNCTAD Handbook of Statistics, 2007). One key question is: Why does Africa not attract much FDI? The answer to this question is important in economics, business, politics and academia in the continent and hence calls for further analysis of the forces driving FDI. Rodrik (1997) argues that international trade generates increased output demand or productivity growth which in turn makes the demand for labour more elastic; consequently induce larger employment and wage shocks. However, Bernard, Redding and Schott, (2006) argue that trade reform will lead to both job creation and job destruction in all sectors when there is perfect competition because both net export and net import sectors would be characterized by expanding high productivity firms and low productivity firms that shrinks or close down (Markusen, 2001).

Nigeria is characterized with a 'dualistic' labour market in which the minority of workers has regular formal sector jobs, while majority work in the informal sector, with a large pool of surplus labour (Kareem, 2012). This is seen from its rapidly increasing labour force. For instance, her labour force increased from 25.7million persons in 1980 to 33.9million persons in 1990 and further increased to 45million and 52.7million persons in 2000 and 2006 respectively (Borenszteun, De Gregona and Lee, 1998). In addition to this, statistical evidences from the government show that the absolute number of total employment in the country has been steadily increasing since 1980. For instance, total employment increased steadily from 18.6million in 1980 to 22.1 million in 1990, which further rose to 27.5million in 2000 and later to 34.4million in 2006 (Asogwa, Umeh and Ater, 2007). However, in spite of the country's rapidly growing labour force and increasing employment, the share of employed workers in total labour force has been declining since 1980, coupled with this, in the last two decade, the trend has been below 70%, which is an indication of high unemployment as more than 30% of its active population are unemployed (Anyawu, 2010). For instance, in 1980, the participation rate was 69%, however, the share of employed in total labour force is given as 72.4% which is indicative that about 27.6% of the labour force are unemployed in this period (Dupasquier and Osakwe, 2003).

However, in 1990, while the participation rate increased to 71%, share of employment in total labour force declined to 65.2% (UNCTAD World Investment Report, 2007). In 2000, both the share of employment in total labour force and participation rate further declined to 61.1% and 70% respectively (Borenszteun, De Gregona and Lee, 1998). However, in 2006, share of employment in total labour force marginally rose to 61.5% while the participation rate marginally fell to 69% (UNCTAD World Investment Report, 2007). UNCTAD World Investment Report (2007) observes that 27.6% of the labour force was unemployed in 1980 and this rose to 34.8% in 1990 and further rose to 38.9% and 38.5% in 2000 and 2006, respectively. These trends are indicative of a huge

employment problem as the economy's capacity to absorb its rising labour force is low as more than 30% of its active population are unemployed (Kareem, 2009). Hence, the study investigates the relationship between Foreign Direct Investment and employment generation in Nigeria.

FOREIGN DIRECT INVESTMENT (FDI)

Foreign Direct Investment (FDI) has been defined as the investment of resources in business activities outside a firm's home country (Hill, Lester and Nordas, 2008). OECD (1995), IMF (1999), and Adeoye (2009), define FDI as the long term investment that reflects the objective of a lasting interest and control by a resident entity of one economy (the direct investor) in an enterprise that is resident in another economy (the direct investment enterprise). Foreign direct investment, a major component of international capital flows, refers to investment by multinational companies with headquarters in developed countries (Miguel, 2006). This investment ranges from transfer of funds to whole package of physical capital, techniques of production, managerial and marketing expertise, products, advertising and business practices for the maximization of global profits.

FDI is believed to be stable and easier to service than bank credit. FDI are usually on long term economic activities in which repatriation of profit only occur when the project earns profit. As stated by Dunning and Rugman (1985), Foreign Direct Investment (FDI) contributes to the host country's gross capital formation, higher growth, industrial productivity and competitiveness and other spinoff benefits such as transfer of technology, managerial expertise, improvement in the quality of human resources and increased investment. According to Riedel (1987) as cited by Tsai (1994) while the potential importance of FDI in less developed countries (LDCs) development process is getting appreciated, two fundamental issues concerning FDI remains unresolved.

In the first place what are the determinants of FDI? Specifically from LDCs points of view are there factors in the control of the host country that can be manipulated to attract FDI? Or as some researchers claim that by and large LDCs play a relatively passive role in determining the direction and volume of FDI (Aitken and Harrison, 1999). This is the question about the demand side determinants (or host country factors) of FDI which are widely discussed in the literature. According to Ragazzi (1973), there are also the supply side determinants or firm specific factors of FDI. The supply side factors are beyond the control of LDCs. A body of theoretical and empirical literature has investigated the importance of FDI on economic growth and development in less developed countries (Dauda, 2007; Daude and Stein, 2007; Akinlo, 2004; Deepak, Mody and Murshid, 2001; Aremu, 2005). FDI, as an element of the rapid globalization process, has made rapid increases in the last few decades. Global inward FDI flows from US\$54.1 billion in 1980, reaching US\$207.7 billion in 1990 to peak of US\$1,401.5 billion in 2000. A fall ensued from 2001 such that by 2003 it had dipped to US\$565.7 billion before peaking again at US\$2100 billion in 2007. Estimates for 2009 put the fall to US\$1114.2 billion consequent upon the financial and economic crisis (UNCTAD, 2010).

The Organisation for Economic Cooperation and development conceptualized FDI as net financing by an entity in a developing country (Oyeranti, 2003). Alfaro, Chanda, KalemliOzcan and Sayek (2006) define Foreign Direct Investment as the process whereby people in one country obtain ownership of assets for the purpose of gaining control over the production, distribution and other activities of a firm in a foreign country. An expanded explanation of the operational meaning of FDI has been offered by Ayanwale and Bamire (2007) as ownership of at least 10% of the ordinary shares or voting stock in a foreign enterprise. Thus, ownership of 10% ordinary shares is the criterion for the existence of a direct investment relationship while ownership of less than 10% is recorded as portfolio investment. From the foregoing appraisal, it is clear that an agreed meaning of FDI exists in the literature (Dutse, 2008). Aremu (1997) categorizes the various types of Foreign Investment in Nigeria into five: wholly foreign owned; joint ventures; special contract arrangement; technology management and marketing arrangements, and subcontract co-production and specialization. Jerome and Ogunkola (2004) assess the magnitude, direction and prospects of FDI in Nigeria. They noted that while the FDI regime in Nigeria was generally improving, some serious deficiencies remain. These deficiencies are mainly in the area of the corporate environment (such as corporate law, bankruptcy, labour law, etc.) and institutional uncertainty, as well as the rule of law. The establishment and the activities of the Economic and Financial Crimes Commission, the Independent Corrupt Practices and other Related Offences Commission, and the Nigerian Investment Promotion Commission is effort to improve the corporate environment and uphold the rule of law.

Foreign Direct Investment Driving Factors: The literature on the forces driving FDI has also identified both policy and non-policy factors as drivers of FDI (Fedderke and Romm, 2006). Policy factors include openness, product-market regulation, labour market arrangements, corporate tax rates, direct FDI restrictions, trade barriers and infrastructure. Non-policy factors include market size of the host country (often measured by the GDP), distance/transport costs, factor proportions (of factor endowments) and political and economic stability (Mateev, 2009). The pull factors or domestic factors include economic, socio-political and structural conditions, including uncertainty, while the push factors relate to cyclical and structural condition, irreversibility and herding (Fernandez-Arias, 1996; Fernandez-Arias and Montiel, 1996; Gottschalk, 2001).

Fernandez-Arias (1996), Fernandez-Arias and Montiel (1996); Gottschalk (2001) and Calvo, Leiderman and Reinhart (1996), present a two-factor classification of the factors that influence FDI flows: as push” (those that are external to the recipients of FDI relating to cyclical and structural conditions, irreversibility and herding) or pull” factors (those internal to them such as economic, socio-political and structural conditions, including uncertainty). A similar classification has emerged from the works of Tsai (1994), Ning and Reed (1995) who see these factors as (i) those on the supply-side” (e.g. skilled labour, research and development and infrastructure), (ii) those on the demand-side” (host country economic and social variables or pull factors, including interest rates, tax and tariff level, market size and potential, wage rates, income distribution, human capital, cost differentials, exchange rate, fiscal policies, trade policies, physical and cultural distance, among others)

(Karakaplan, Ugur, and Sayek, 2005); and (iii) institutional factors” (for example, culture, intellectual property rights, transaction costs, political risk, corruption, and bureaucracy). Also, Qiu (2003) examined the implications of comparative advantage for foreign direct investment incentives. Using a trade-cum-FDI model with two countries (the FDI host country and the FDI source country) and two sectors (auto and textile, in each country), the author found that the host country’s comparative advantage sector is more attractive to inward FDI than its comparative disadvantage sector. In particular, he found that the source country’s auto firms have weaker FDI incentives than its textile firms and hence the host country’s comparative advantage sector is more attractive to inward FDI. The recent empirical literatures on the factors that attract FDI in any country though in many cases results revolve around multiple factors are enunciated as follows (Anyawu, 2010).

Infrastructure Development: Studies by Musila and Sique (2006); Dupasquier and Osakwe (2006) on FDI show that FDI in Africa is dependent on the development of infrastructure. Also, other studies on developing countries (Mengistu and Adams, 2007; Cotton and Ramachandran, 2001), emerging economies, Western Balkan Countries (Kersan-Skabic and Orlic, 2007) and Southeast European Countries (Botric and Skuffic, 2006) show the significant role of infrastructure development in attracting the inflow of FDI. However, the results of a study on US FDI flow to Africa by Nnadozie and Osili (2004) find less robust evidence on the role of infrastructure on foreign direct investment. Dauti (2008) identifies ICT infrastructure market as the major factor positively influencing FDI inflows while seeking factors (GDP growth, GDP per capita, GDP level) have perverse signs, showing significantly negative effects on FDI inflows.

Institutional, Political Factors and Investment Climate: Using bilateral FDI stocks around the world, Daude and Stein (2007) explore the importance of a wide range of institutional variables as determinants of the location of FDI and find that better institutions have overall positive and economically significant effect on FDI. Poor governance and inhospitable regulatory environments (Dupasquier and Osakwe, 2006); foreign ownership ceiling in sector open for FDI, policy on repatriation of capital and remittance of profit (Tarzi, 2005), and government regulations and restrictions on equity holdings by foreigners (Cotton and Ramachandran, 2001) all are found to have negative impact on FDI inflow. Also, political stability is inversely related to FDI inflows (Dupasquier and Osakwe, 2006; and Kyereboah-Coleman and Agyire-Tettey, 2008; Li (2008). Cleeve (2008) uses data on 16 SSA countries and finds that in addition to traditional variables and government policies to attract foreign investment to Africa, tax holidays are important.

METHOD

This study seeks to use Ordinary Least Square (OLS) time series analysis. The justification of using time series OLS estimation techniques is because of its properties of being the Best Linear Unbiased and Efficient Estimator (BLUE) (Damodar, 2004). In addition, Engel and Granger time series approach takes into consideration, the theoretical background of the issue under study. To explore the link between trade flow and employment, we

begin with the variant of following benchmark model using OLS. The model can be written as:

$$E_t = \beta + \beta_1 EX + \beta_2 IM + \beta_3 EX + \beta_4 INF + \beta_5 FGI + \dots\dots\dots 1$$

Where

- E_t = The total employment growth rate in Nigeria at time 't'.
- EX = Export growth rate in a time
- IM = Import growth rate at time
- EX = Exchange rate at a time
- INF = Inflation rate
- FDI = Foreign Direct Investment

RESULTS AND DISCUSSION

The R-square is 0.954, meaning that approximately 95% of the variability of employment rate is accounted for by the variables in the model. In this case, the adjusted R-square indicates that about 93% of the variability of Employment rate is accounted for by the model; even after taking into account the number of predictor variables in the model such as the Inflation rate, Import rate, Export rate, Exchange rate and the Foreign Direct Investment (FDI). From this analysis, consider the variables Import rate and exchange rate which has the highest possible beta. An increase 0.262 and 0.883 respectively in the Employment rate scores for every one unit increases in Import rate and Exchange rate, assuming that all other variables in the model are held constant. What these imply is that these variables correlate positively with the Employment rate.

The higher the import rate, the higher the inflows of investment into the country. The same goes for the exchange rate which also correlates positively with the Employment rate, with reference to the column of Beta coefficients. Also known as standardized regression coefficients. The beta coefficients are used by many researchers to compare the relative strength of the various predictors within the model. Because the beta coefficient is all measured in standard deviations, instead of the units of the variables, they can be compared to one another. In other words, the beta coefficients are the coefficients that one would obtain if the outcome and predictor variables were all transformed to standard scores, also called z- scores, before running the regression. In this analysis, Exchange rate has the largest Beta coefficient, 0.883. Thus a one standard deviation increase in Exchange rate leads to a 0.883 standard deviation increase in predicted Employment rate, with the other variables held constant. And, a one standard deviation increase in Import rate, in turn leads to a 0.262 standard deviation increase in Employment rate with the variables in the model held constant. The value of Durbin-Watson (DW) statistic in the regression results is 1.855 which shows that the variables are not serially correlated. The t-statistics confirm that the coefficients of our model are significant at 5% level of significance. The F-statistics which is (62.551) thereby confirming that all the variables on the Employment rate. The F value is significant at the 5% level showing that there is a linear relationship between the Employment rate and the other independent variables.

Foreign Direct Investment and Employment Generation in Nigeria: Nigeria is the third largest recipient of Foreign Direct Investment (FDI) in Africa after Angola and Egypt (UNCTAD World Investment Report, 2007). U.S. FDI in Nigeria was estimated at \$6.1 billion in 2010, down 29 percent from \$8.65 billion in 2009 (UNCTAD World Investment Report, 2007). According to UNCTAD World Investment Report (2007), the decline in US FDI in 2010 was due to ongoing uncertainty related to the proposed Petroleum Industry Bill (PIB) as well as political unrest in the Nigeria. UNCTAD World Investment Report (2007) further states that Nigeria's unemployment is concentrated in the younger age group, with unemployment of 41.6% among 15-24 years old, 11.5% among the 45-59 years old, and 16.7% among those over 65. Unemployment rates are higher for females (24.9%) than for males (17.7%). The states with the highest unemployment rates are concentrated in the North Eastern part of the country and in the Niger Delta and unemployment rate increased from 21.1% in 2010 to 23.9% in 2011 (UNCTAD World Investment Report, 2007). Baldwin (1995) investigates the impact of trade and foreign direct investment on employment and relative wages using factor content methodology.

Although, he finds support for a small impact of trade on employment in OECD countries, yet, the employment creating effects of increased exports usually dominated the employment displacing effects of increased imports. Morawczynski and Wach (2004) investigate whether Polish foreign trade impact on employment by pooling data for 28 sectors between 1993 and 1999 using regression analysis. They analyse employment effect of trade using employment, export and import and output. Their results found moderate evidences for traditional theories linking trade and employment as they found that import growth negatively affect employment changes in all the 28 sectors. Baldwin (1995) who finds that international trade has little or no link with employment although the countries they studied are not oil-rich countries.

In spite of the large rents from oil exportation, export growth rate does not contribute meaningfully to employment growth in the country, implying that the large revenue from oil is not used to generate employment for Nigeria's surplus labour. Nigeria is the most populous country in Africa and it is blessed with a large pool of surplus labour. Nigeria's labour market is dualistic as it is characterized with both formal and informal employment with the bulk of its labour force engaged in agriculture particularly at the subsistence level (Ogunlela and Mukhtar, 2009). Oni (2006) argues that reducing the level of unemployment will increase the income level in the economy and thereby reduce the level of poverty. To increase the level of employment, some scholars have argued that the flow of goods and services (trade flows) could propel employment generation, especially in developing countries. Growth in employment has a feedback on economic growth, such that an increase in labour incomes would expand domestic demand, which in turn would lead to sustainable GDP growth and reducing risks of excessive reliance on uncertain foreign markets (Wheeler and Moody, 1992).

Table 1:

Years	Empl/Rate	Import	Export	Exchange Rate	Infla/rate	FDI
1990	34.46	22.01	99.53	8.0378	50.5	64,168.2
1991	34.88	23.5	99.2	9.9095	7.5	32,047.2
1992	35.46	23	99.33	17.2984	12.7	62,460.5
1993	35.89	24	99.09	22.0511	44.8	53,140.7
1994	36.47	22.3	99.58	21.8861	57.2	43,270.4
1995	36.96	23.2	99.57	21.8861	57.0	195,533.7
1996	37.54	28.1	98.79	21.8861	72.8	746,916.8
1997	38.13	29.2	97.65	21.8861	29.3	395,946.1
1998	38.71	29.7	96.12	21.8860	10.7	(85,562.0)
1999	39.45	29.4	57.83	81.0228	7.9	326,454.1
2000	40.11	29	73.76	81.2528	6.6	960,700.9
2001	40.86	29	82.09	81.6494	6.9	509,773.5
2002	41.6	28.86	83.17	18.8072	18.9	231,482.3
2003	42.45	42.4	92.62	92.3428	12.9	1,007,651.1
2004	43.37	31.2	92.69	100.8016	14.0	2,615,736.3
2005	43.28	27.5	93.68	111.7010	15.0	4,445,678.5
2006	42.19	23.4	92.77	126.2577	17.8	4,171,011.4
2007	43.09	23.99	89.09	134.0378	8.2	4,324,869.9
2008	43.01	23.4	93.83	132.3704	5.4	4,659,156.3
2009	43.01	23.7	96.09	130.6016	11.6	3,810,251.2
2010	42.84	24.1	96.89	128.2796	12.4	3,810,252.2

Source: CBN Statistical Bulletin, 2010

Correlations

		Empl/rate	Import	Export	Exchg rate	Infla/rate	FDI
Pearson correlation	Empl/rate	1.000	.334	-.293	.948	-.561	.802
	Import	.334	1000	-.326	.132	-.247	-.156
	Export	-.293	-.326	1000	-.337	.449	.041
	Exchg/rate	.948	.132	-.337	1000	-.597	.869
	Infla/rate	-.561	-.247	.449	-.597	1000	-.395
	FDI	.802	-.156	.041	.869	-.395	1000
Sig (1- tailed)	Empl/rate	.069	.098	.000	.004	.000	
	Import	.069	.	.075	.284	.140	.250
	Export	.098	.075	.	.067	.021	.429
	Exchg/rate	.000	.284	.067	.	.002	.000
	Infla/rate	.004	.140	.021	.002	.	.038
	FDI	.000	.250	.429	.000	.038	.
N	Empl/rate	21	21	21	21	21	21
	Import	21	21	21	21	21	21
	Export	21	21	21	21	21	21
	Exchg/rate	21	21	21	21	21	21
	Infla/rate	21	21	21	21	21	21
	FDI	21	21	21	21	21	21

Source: SPSS 15.0., CBN Bulletin 2010

Model summary

Model	R	R square	Adjusted R square	Std. Error of the estimate	R square change	Change Statistics			Sig F change	Durbin-Watson
						F change	df1	df2		
1	.977 ^a	.954	.939	78828	.954	62.551	5	15	.000	1.855

a. predictors (constant), FDI, Export, Import, Infla/rate, Exchg/rate

b dependent Variable: Empl/rate

Coefficients

Model	Non standardized coefficients			Standardized coefficients		
	B	Std. error	Beta	T	Sig	
(constant)	28.527	2.768		10.305	.000	
Import	.179	.046	.262	3.865	.002	
Export	.022	.027	.072	.831	.419	
Exchg. rate	.059	.013	.883	4.403	.001	
Infla/rate	.0051	.011	.033	.442	.665	
FDI	1.48E - 007	.000	.085	.457	.654	

a. Dependent variable: Empl/rate.

Source: SPSS 15.0

CONCLUSION

Foreign direct investment (FDI) as a key element of globalization and of the world economy is a driver of employment, technological progress, productivity improvements and ultimately economic growth. It plays the critical roles of filling the development. The relationship between Foreign Direct Investment (FDI) and employment generation has generated a lot of arguments and has been a source of concern to policy makers and the common man, especially as most fear that trade integration may result in significant job losses for developing countries. However, in the case of Nigeria, this concern is contradicted by the empirical evidence as both our long-run and short-run estimates points out that there is no significant link between Foreign Direct Investment (FDI) and job losses. The adoption of the trade liberalization policies following SAP and the consequent opening up of the economy to free trade has dampened employment generation capability of exports and imports by 480%. Free trade has been identified to be beneficial in terms of increased growth and employment. Based on the findings from this study, it is recommended that FDI should focus more on Nigeria's agricultural sector because of the strategic relevance of the sector to the nation's economy especially in the area of employment generation. In addition, concerted efforts should be made by the government, stakeholders and NGOs to enhance the growth of FDI, by making the Nigeria business environment attractive to foreign investors, encourage production and generate employment especially for the rural populace.

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