Chapter 51
Factors Determining Foreign Direct Investment Inflow to Nigeria during Pre-Financial Crisis:
An Empirical Investigation

Soumyananda Dinda
Sidho-Kanho-Birsha University, India

ABSTRACT

This chapter empirically investigates the determinants of foreign direct investment (FDI) to Nigeria during pre-financial crisis period 1970-2006. This study suggests that the endowment of natural resources, trade intensity, macroeconomic risk factors like inflation and exchange rates are significant determinants of FDI flow to Nigeria. The findings also suggest that in long run market size is not the significant factor for attracting FDI to Nigeria, it contradicts the existing literature. The author's results indicate that FDI flow to Nigeria is resource-seeking FDI. Results also suggest that trading partner like the UK in North-South (N - S) and China in South-South (S - S) trade relation have strong influence on Nigeria's natural resource outflow.

INTRODUCTION

The economic system broke down in the USA during 2007-2008. It began in the US with the bursting of housing bubble and the growth of mortgage defaults, which affected the stability of financial institutions (Roubini & Mihm, 2010). The crisis affected major financial centres across the entire world (Reinhart & Rogoff, 2009) and also generated a collapse of international trade. The world realised the economic crisis in 2008 due to financial crisis in 2007. Economic crisis is a situation in which the economy of a country experiences a sudden downturn. A Country facing an economic crisis will most likely experience a falling GDP, a drying up of liquidity, rising inflation and unemployment rate (Milani, 2013; Roubini & Mihm, 2010). There were four main

DOI: 10.4018/978-1-4666-9814-7.ch051

causes for the 2008 financial crisis: (i) rising inequality and the push for housing credit in the U.S. Growing income inequality in America, exacerbated by technology replacing low-wage jobs and an inadequate education system which failed to re-skill people, led to politicians allowing easier credit conditions to boost asset prices and make people *feel* wealthier that resulted in the subprime and housing crisis (Helleiner, 2011). (ii) export-led growth and dependency of several countries. The debt-fuelled consumption in the U.S. would have been inflationary were it not for these countries not meeting the consumption needs of Americans. In other words, they aided and abetted the consumption binge in the U.S.; (iii) a clash of cultures between developed and developing countries. This relates back to 1997 when the Asian crisis force countries in the region to go from being net importers to substantial net exporters, thereby creating the conditions for a global glut in goods; (iv) the Fed (the U.S Central Bank) policy pandering to political considerations by focusing on jobs and inflation at any cost. The bank acted in accordance with the wishes of politicians by keeping interest rates too low for too long. They did this to maintain high employment; but truly, the basic issues remain unresolved. Many of them have worsened and any adjustments to these problems results in further crises. Consequently balance of payment was also unfavourable to the US.

There has been a shift in the balance of growth as Chinese demand for raw material and as higher wages and strong currencies make many developed economies less competitive. This is not a repeat of the 1990s Asian crises, because domestic conditions are completely different but it is a turn in the global market cycle (Milani, 2013). We need transition from a world where investment is pushed out of the US/Europe/developed nations to one where it is pulled in by attractive prospects. It happens when flows will be differentiated much more from one country to another. Now, we have a large issue with the purported attractive prospects of the US, Europe, Asia and Africa. The bigger issue is that the explanation here appears to be addressing the symptoms of the crisis (global capital flows) rather than the disease (excess credit and an unstable economic system like Argentina, Mexico etc in 1990s). This chapter assesses the symptoms of the crisis and finds the reasons behind it. Financial crisis is also closely associated with foreign direct investment (FDI), which flows in global, regional and country specific level during pre-financial crisis. This chapter mainly investigates the factors determining FDI inflows to Nigeria, one resource-rich poor African nation, and its economic conditions in the pre-financial crisis period.

Foreign Direct Investment

Worldwide Foreign Direct Investment (FDI) has been increasing at an extraordinary speed at the early of the 21st century. The largest FDI flows among developing economies goes to China and most attractive region is South and South-East Asia (UNCTAD 2007). In 21st century, FDI inflows have been remarkably increased in Africa. Huge FDI inflows increased rapidly to Africa, which begins making Africa different (Asiedu 2002, Asiedu & Lien, 2011). FDI flow to Africa increased from \$9.68 billion in 2000 to \$1.3 trillion in 2006 (UNCTAD, 2007). Africa is gradually coming to the focus of the global business. So, new destination of FDI is Africa. This paper studies why Africa is attractive region for foreign direct investment and finds its answer from literature, which is discussed later.

The contribution of FDI is crucial for countries where incomes and hence domestic savings are particularly low, like Nigeria. They need external capital for investment and promote their economic growth and development. After 1990 the crisis facing poor African nations are the rapid depletion of the foreign official sources: official loans (as share of GNP) to Sub-Saharan African countries dropped from 6% in 1990 to 3.8% in 1998; for-