DIRECT FOREIGN INVESTMENT

A Case Study from Nigeria

by Michael I. Obadan, Ilorin*

In INTERECONOMICS No. 4, 1979, Peter Richter suggested that interest payments, royalties and profit retransfers from developing to industrialised countries have already reached such an amazing dimension that the former would in reality have to be regarded as capital exporters rather than importers. The following article supports this proposition with regard to direct investment, using Nigeria as a case study.

Direct foreign investment is often regarded as beneficial to the economies of developing countries. An inflow of direct investment funds is expected to contribute to the recipient country’s development programme by helping to reduce the shortage of domestic savings and by increasing the supply of foreign exchange. Thus foreign investment is typically seen as an avenue for filling in gaps between the domestically available supplies of savings, foreign exchange, government revenue and skills and the desired level of these resources necessary to achieve development targets. It is felt that the condition of foreign exchange shortage caused by the tendency for lagging export proceeds would make the typical developing country highly dependent on foreign investment or aid, even for import-substituting industrialisation programmes. Foreign capital will not only fill gaps between targeted foreign exchange requirements and those derived from net export earnings but will also contribute to foreign exchange earnings or savings. For example, “the greater the proportion of foreign subsidiaries’ products sold in the host country the smaller the dependence on imports will be resulting in greater foreign exchange savings”.

And the more foreign firms procure raw materials from the host country the greater will foreign exchange saving be.

Besides bringing to the recipient country physical and financial capital, gaps in technological knowledge and skills, entrepreneurship, managerial and supervisory personnel, organisational experience, innovations in products and production techniques, etc., are presumed to be partially or wholly filled by the local operations of Multinational Corporations (MNCs). Finally, it is argued, in time as the investment operates the increase in real income resulting from the act of investing is greater than the resultant increase in the income of the foreign investor.

As a result of these expected benefits developing countries, eager to industrialise their economies, have offered various incentives such as tax concessions and subsidies, tariff protection, accelerated depreciation concessions, special facilities like industrial estates, additional public services, etc., to attract foreign capital. These incentives, of course, have their cost in absorbing governmental resources that could be used elsewhere. Indeed, in encouraging foreign investment, “there is thus a fiscal cost through increased government expenditure or forgone revenue”.

And rather unfortunately “for a number of the less developed countries one of the most serious obstacles to a favourable gain from direct foreign investment has been the competition (in the form of a range of fiscal incentives) between the less developed countries themselves in attracting this investment – thus bidding up the terms on which any one nation can obtain the investment – as well as distorting the economic calculation of the international firm in its investment decisions”.

Thus, the MNCs operating in developing countries appear to have the best of both worlds. In addition to

---

*University of Ilorin.


3 Ibid., p. 143.

enjoying numerous incentives subsidiaries of MNCs are able to satisfy their various motives of ensuring stable monopolistic control over sources of raw materials for their parent companies, access to and control of local markets, utilizing low cost labour, realising the possibility of higher profit, etc. These motives complementing the urgent desire for industrialisation and development in the developing countries have created much room for foreign investment to grow in such countries.

Notwithstanding the foregoing anticipated advantages several problems have surfaced with direct foreign investment in developing countries:

☐ First, MNCs apart from typically producing rather inappropriate products often with inappropriate (capital-intensive) technologies and stimulating inappropriate consumption patterns, may succeed in reinforcing dualistic economic structures and worsen inequalities in income distribution.

☐ Secondly, MNCs use their economic power to influence government policies in some developing countries.

☐ Thirdly, although the initial impact of direct foreign investment is to improve the foreign exchange position of the host nation its long-run impact may be to reduce foreign exchange on both trade (through imports of intermediate products and capital goods) and capital accounts.

The negative aspect of direct investment of particular interest to us in this article is the repatriation of profits, interest and dividends on investment. Although an inflow of capital into a developing country may be beneficial under certain circumstances, serious problems arise when the return flows of interest, profits and dividends on the accumulated investments and repatriation of capital put pressure on the developing country's balance of payments. Indeed, the position of dependency on foreign investment may create a situation where the real net export proceeds or real net import savings are low (or even negative) and tolerably insufficient after allowing for remittances of profits, dividends, management fees, salaries of expatriate staff, etc.

The Case of Nigeria

As we shall see in Nigeria's case, remittances may be so substantial relative to capital inflow that direct foreign investment ends up in net capital outflow rather than inflow for a developing country. Under these circumstances the benefits of direct foreign investment will become dubious. Such investment could actually obstruct the development of the host country. In the light of this problem the magnitude, structure and balance of payments effect of direct investment income remittances from Nigeria are examined in the following.

In discussing the issue of Nigeria's dividend remittances abroad for the period 1953 to 1963 May observed that it was "not surprising in view of the moderate profit rate achieved the size of current payments in respect of direct investment has not been a problem in Nigeria's balance of payments . . . that remittances had not been great from the newly established expatriate companies, largely due to unprofitable operations in early years and internal financing of expansion, particularly in manufacturing". Notwithstanding his observation that the older established companies tended to remit a higher proportion of their profits and his correct prediction that investment income remittances outside Nigeria would increase significantly over the following few years, May did not envisage this to be to the detriment of the Nigerian balance of payments. By the middle of the 1960s, however, May's forecast had become questionable in view of the magnitude and balance of payments effect of investment income remittances abroad.

Magnitude of Remittances

Direct investment income remittances which were rather insignificant by the end of the 1950s had become quite substantial by the middle of the 1960s. Such remittances averaged only 12.6 mn Nigerian Naira in 1955-60 compared with 118.7 mn for 1955-73. From a low of 6.8 mn or only 3 % of merchandise export earnings in 1957 direct investment income remittances increased to the maximum of 576.8 mn in 1973, being equivalent to 26 % of merchandise export earnings. The observed declines in remittances during the years 1967 to 1970 were due to the restrictions placed on profits and dividend remittances during those civil war years. The peak remittances of 1973 were actually 45 times the 1955 level (see the table). The table also shows that after 1973 investment income outflows continuously declined to the provisional figure of 201 mn in 1978. Largely accounting for this phenomenon as well as the observed declines in capital inflows was the

---


6 In the following all monetary data relate to Nigerian Naira, the basic currency unit of Nigeria, which corresponds to approximately US $ 1.60.