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**Article — Digitized Version**

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Intereconomics

*Suggested Citation:* Obadan, Michael I. (1980) : A case study from Nigeria, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 15, Iss. 1, pp. 39-42, <https://doi.org/10.1007/BF02924399>

This Version is available at:

<https://hdl.handle.net/10419/139657>

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# 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.**

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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"<sup>1</sup>. 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<sup>2</sup>.

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"<sup>3</sup>.

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"<sup>4</sup>.

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

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<sup>1</sup> T. Ishimine: Performance, Motivation, and Effects on the Balance of Payments of Japan's Direct Investment, in: *Economia Internazionale*, Vol. XXX 1 (1-2), February-May 1978, p. 55.

<sup>2</sup> G. M. Meir: *The International Economics of Development*, New York 1968, p. 138.

<sup>3</sup> *Ibid.*, p. 143.

<sup>4</sup> T. G. Parry: *The International Firm and National Economic Policy*, in: *Economic Journal*, 83, December 1973, p. 1217.

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"<sup>5</sup>.

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<sup>6</sup> 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

<sup>5</sup> See R. S. May: Direct Overseas Investment in Nigeria, 1953-63, in: *Scottish Journal of Political Economy*, 12, November 1965, p. 260.

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

# DIRECT FOREIGN INVESTMENT

## Direct Investment Income Remittances from Nigeria in Relation to Various Economic Indicators, 1955 - 1978

Year	Remittances (in mn) <sup>a</sup>	Net direct investment inflow (in mn) <sup>a</sup>	Ratio of remittances to direct investment inflow (in %)	Ratio of remittances to merchandise exports (in %)	DISR= ratio of remittances to current account receipts (in %)	Ratio of remittances to external reserves (in %)	Ratio of remittances to GNP (in %)	Official Settlements balance of payments <sup>b</sup> (in mn) <sup>a</sup>
1955	13.4	—	—	5	5	3	—	—
1956	10.8	—	—	4	4	2	—	—
1957	6.8	—	—	3	2	1	—	—
1958	11.6	—	—	4	4	3	—	—
1959	17.0	—	—	5	5	4	—	—
1960	16.2	38.0	43	5	4	5	1	— 34.6
1961	13.0	50.0	26	4	3	4	1	— 62.2
1962	21.8	43.4	50	7	6	9	1	— 42.2
1963	34.2	75.8	45	9	8	18	1	— 56.6
1964	51.2	126.0	41	12	11	26	2	— 0.2
1965	106.8	110.4	97	20	18	54	3	— 3.2
1966	146.8	110.0	133	26	24	80	4	— 25.6
1967	80.4	79.0	102	17	15	79	3	— 68.4
1968	99.4	92.8	107	24	21	94	3	+ 15.2
1969	97.2	100.0	97	16	14	85	3	+ 7.4
1970	100.0	128.6	78	11	10	56	2	+ 66.2
1971	325.4	142.8	288	24	23	107	5	+ 121.2
1972	538.6	287.8	187	37	35	197	8	— 29.6
1973	576.8	122.2	472	26	25	132	7	+ 194.7
1974	461.8	181.6	254	8	7	13	3	+2804.0
1975	468.8	252.9	185	9	8	13	3	+ 110.6
1976	415.7	212.5	196	7	6	13	—	— 129.2
1977	229.1	148.4	154	6	6	8	—	—
1978 <sup>c</sup>	201.0	87.1	230.8	8	7	15	—	—

<sup>a</sup>Expressed in Nigerian currency. See the explanations on this in footnote 6.

<sup>b</sup>The Official Settlements balance of payments is defined as the algebraic sum of the balance of current account, short- and long-term capital and errors and emissions.

<sup>c</sup>Provisional.

Sources: Compiled from Central Bank of Nigeria: *Economic and Financial Review and Monthly Reports* (various issues); *Nigeria's Principal Economic Indicators, 1970-77*. Federal Office of Statistics: *Digest of Statistics (1955-59)*. Federal Ministry of Economic Development: *Second National Development Plan (1970-74). First Progress Report*.

implementation of the 1972 Nigerian Enterprise Promotion Decree which barred aliens from certain economic undertakings and required indigenous equity participation ranging from 40 to 60 % in other foreign enterprises<sup>7</sup>. The Decree initially came into effect on April 1, 1974. To ascertain the extent of foreign exchange receipts absorbed by the servicing of foreign investments in Nigeria the concept of direct investment service ratio (DISR) is first employed. This is defined statistically as the percentage of current foreign exchange receipts, exclusive of compensatory financing, absorbed by direct investment income outpayments. Available statistics indicate that the DISR for Nigeria grew to a peak of 35 % in 1972 (see table). The sharp drop in this ratio thereafter to 7 % in

1978 largely reflects the phenomenal increases in merchandise export earnings resulting from the OPEC-induced increases in oil prices in 1973 and to a limited extent the absolute decline in remittances.

The substantial rise in export earnings also accounts for the observed decline in the ratio of remittances to Nigeria's external reserves after 1972. Column 6 of the table actually indicates a significant pressure of remittances on the balance of payments from 1965 to 1973 when the ratio of remittances to foreign exchange reserves was quite high, reaching a peak of 197 % in 1972. This led to the situation where the amount of remittances became larger than the amount of foreign exchange supplied by capital inflow or the amount of foreign exchange available to the country at the end of each year. Thus, although net payments abroad of profits and dividends have been minor in relation to Gross National Product (column 7), they have been apparently excessive in relation to other indicators as will become obvious subsequently.

Further analysis indicates that the inflow of foreign investment funds has grown very much less than profit and dividend outflows. The comparison of the foreign capital inflow with the direct investment income outflow

<sup>7</sup> One of the main objectives of the 1972 Decree was to ensure greater and more effective participation by Nigerians in the equity ownership of many limited liability companies registered and/or incorporated in Nigeria. The Decree comprises two Schedules: Schedule 1 contained enterprises exclusively reserved for Nigerians while Schedule 2 listed enterprises requiring a minimum indigenous equity participation of 40 %. The Decree was revised in 1976 with provisions for three Schedules: Schedule 1 - Enterprises exclusively reserved for Nigerians. Schedules 2 and 3 - Enterprises in which Nigerians must have majority equity interest of 60 and 40 %, respectively. For details see *Nigerian Economics Society: Nigeria's Indigenisation Policy. Proceedings of the 1974 Symposium*, Ibadan n. d., pp. 82-94; "Enterprises Promotion Board formed", in: *New Nigerian*, February 1, 1977, p. 15.

is quite revealing. For example, in 1973 while direct investment income outflow of 576.8 mn was 36 times the 1960 figure of 16.2 mn (indicating 29.1 % annual compound rate of increase) net capital inflow at 122.2 mn in 1973 was just over 3 times the 1960 figure of 38 mn (8.7 % annual rate of increase). Although profit remittances continued to decline, by 1978 they were still 12.4 times the 1960 figure while capital inflows were 2.2 times their 1960 level.

Equally significant is the ratio of income remittances to net direct investment inflow. This ratio rose sharply from 43 % in 1960 to 472 % in 1973. Although this proportion declined thereafter, it was still as high as 230.8 % in 1978. Also between 1960 and 1973 cumulative direct foreign investment increased by 397 % while investment income remittances expanded by 3,460 %. Taking the analysis further, available statistics show that between 1961 and 1978 total direct investment in Nigeria increased by 2,389.3 mn, compared with profit and dividend remittances of 3,968 mn. This indicates a marginal rate of income repatriation of 166 %.

In the context of the balance of payments position direct investment income outpayments have been the major deficit item in the services or invisibles account. As there are no off-setting credit entries in the direct investment income account all profit and dividend outpayments constitute negative balances. In magnitude profits and dividend outflows ranked first among the services items in the 1955-75 period. Actually it was only in a few years, 1969, 1970, 1974, and 1975, that it was displaced to the second position by the item "miscellaneous services" comprising foreign payments for services of contractors, consultants, directors, management fees, etc. Consequently, the profit and dividend outflow has been a major contributor to Nigeria's deteriorating invisible trade deficit. A comparison of columns (1) and (8) in the table gives a rough idea of the overall balance of payments impact of profit and dividend remittances.

From the foregoing analysis it is quite clear that the repatriation of direct investment income from Nigeria has been quite substantial especially when its magnitude is related to various economic indicators. In the light of these enormous profit and dividend remittances the contribution of foreign investment to the economic development of Nigeria becomes significantly reduced below whatever it would have been. While foreign investment might have aided the growth of industrial production in the country, part of

this growth has become illusory because of the liabilities of repatriating earnings.

In essence the profit and dividend remittance position in Nigeria may be characterised by the following statement: "Foreign investment, it seems, far from being a means of developing underdeveloped countries, is a most efficient device for transferring wealth from poorer to richer countries while at the same time enabling the richer to expand their control over the economies of the poorer"<sup>8</sup>. It is hardly surprising, therefore, that in the 1970s Nigeria decided to regulate the activities of MNCs operating in her territory by barring them from participating in certain businesses and requiring indigenous equity participation in many others.

### **Need for Regulations**

The analysis has shown that unless the host country is quite cautious direct foreign investment can be counterproductive. Indeed, excessive dividend remittances vis-a-vis capital inflow may result in net outflow of funds from (rather than inflow into) a developing country. The case of Nigeria supports this.

Admittedly, direct foreign investment can be an important stimulus to economic growth and social development in developing countries so long as the interests of the foreign investors and host governments are congruent. But in many cases this is not so since many MNCs see their role in terms of global output or profit maximization with little interest in the long-run domestic impact of their activities. Consequently, it is important for developing countries to regulate the activities of MNCs to ensure their cooperation in the spheres of taxes, investment income remittances, reinvestment, non-political interference and the avoidance of bribery and corruption. Specifically, MNCs must make substantial reinvestments (although the long-run desirability of this is even in doubt) and conduct researches in the host countries rather than in their metropolitan capitals. Otherwise developing countries may have to absorb substantial portions of the profits, by fiscal measures, for their economic development. Finally, developing countries need to consider seriously the question of significant indigenous equity participation in foreign enterprises. While regulations may reduce the magnitude of private capital investment in developing countries they may, however, make such investments better suited to their real long-run development interests and priorities.

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<sup>8</sup> See P. A. Baran, P. Sweezy: Notes on the Theory of Imperialism, in: K. Boulding, T. Mukerjee (eds.): *Economic Imperialism*, Michigan 1973, p. 164.