

The Determinants of Foreign Direct Investment Inflows in Nigeria: An Empirical Investigation

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Abstract: This research work aims at investigating the critical macroeconomic variables that determine the inflows of FDI in Nigeria over the period of 1990 to 2017 which past studies have not fully explored. Consequently, the study utilized data from UNCTAD, World Bank database and CBN Statistical Bulletin and the Autoregressive Distributed Lag (ARDL) model was used to address the objective of this study. The study came up with following findings as summarized thus; the principal determinants of FDI inflows in Nigeria are the past FDI inflows, market size, exchange rate and growth rate. These macroeconomic variables have a positive and significant impact in driving FDI inflows in Nigeria. However, the inflation rate discourages FDI inflows in the country. Moreover, based on these findings, it is important for this paper to make the following recommendations for both the policy makers and the investors in Nigeria. The policy makers in the country should be committed towards policy measures that will ensure the continuous expansion of the country's market size, double digits growth rate and exchange rate stability. In the same vein, the policy measures that would address inflation rate problem on FDI inflows in the country should be put in place by the policy makers in Nigeria.

Keywords: Market Size; Growth Rate; FDI; Exchange Rate and Nigeria

JEL Classification: F21; F23; F43

1. Introduction

In the recent times, the developing countries of Africa have not been able to be on the same pace in attracting FDI inflows like their counterparts in the Asian continent. In 2017, a total FDI inflows of \$42 billion came into Africa, which is 21% reduction

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of 2016 inflows. The reason for this sharp fall among other factors has been attributed to the perpetual declining in oil prices in one hand and unfavorable conditions of macroeconomic variables in the bulk of host African nations on the other hand (UNCTAD, 2018).

However, over the past few decades, foreign direct investment inflows have contributed to about 20% of fixed capital formation in the continent of Africa, but it continues to be positively skewed in the favour of 15 oil-rich countries which accounted for 75% of FDI inflows (AfDB et al, 2011). Nigeria is the highest oil exporter in Africa, little wonder the country has attracted a substantial stock of FDI inflows over the time. In 2006, the UNCTAD Report indicates that 70% of FDI inflow in ECOWAS countries was received by Nigeria.

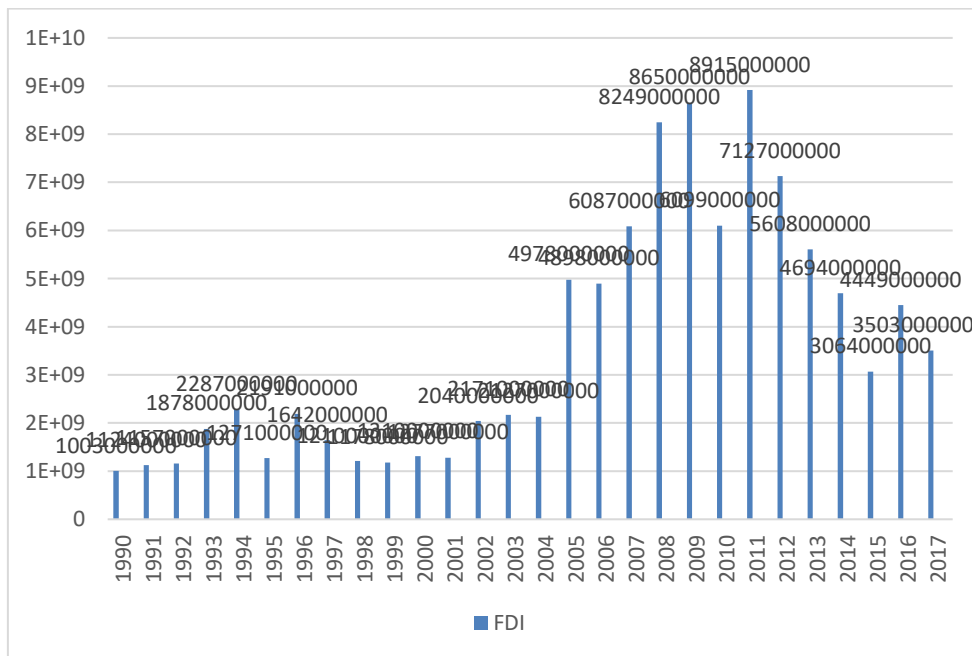


Figure 1. FDI Inflows in Nigeria (1990-2017)

Source: Computation from (UNCTAD, 2018)

The above figure shows that the sporadic FDI inflows began in 2005 in which the figure got to the pinnacle in 2011 before it declined in 2012. From 2012 FDI inflows have been dwindling on the annual basis in the country. Meanwhile, many factors have been affirmed to propel FDI inflows in developing countries, such as sound investment policies and appropriate institution (Samol and Solifano, 2014). Other scholars like Jadhav (2012), Jadhav and Katti (2012), and Vijayakumar et al. (2010) Sahoo (2006) and Nonnenberg and Mendonca (2004) have argued that rule of law, size of domestic market, cheap labour cost, infrastructural facilities, gross capital

formation, efficiency of governance and openness to trade critical variables behind the inflows of FDI in developing economies. But, when it comes to the scenario of Nigerian economy, the literature has divided opinions in which calls for further investigation about the variables that determine the inflow of FDI in Nigeria. For instance, Enoma and Mustafa (2011) attributed the inflows of FDI in Nigeria to the advent of crude oil. However, market size, export, past FDI and wage rates have been recognized as the motivating factors for FDI inflows in the country. See (Offiong and Atsu, 2014; UNECA, 2009; Ayanwale, 2007). In the light of the above argument it is pertinent to empirically revalidate the important factors that determine FDI inwards movement in Nigeria in the recent time. In addition, this study adopts latest econometric technique in addressing its objective in which bulk of recent studies have undermined. The rest of the study is organized in this way; apart from introduction, the section two reviews the relevant theoretical and empirical literature. Meanwhile, methodology, empirical results and policy recommendation are presented in section three.

2. Literature Review

2.1. Theoretical Review

2.2. The Internationalization Theory

According to Dima (2010), internationalization can be conceptualized as a way by which a firm moves its activities outside borders of the indigenous country. This involves the steady acquisition, networking and and utilization of information about the operations of international markets, this leads to the steady commitments of this firm to global platforms (Johanson & Vahlne 1977).

It is important to state that the Internationalization Theory originally emanated from the work of Coase (1937), who posited that transaction costs are pertinent factors to the success of a firm. Consequently, Johanson and Wiedersheim-Paul (1975) extended the frontiers of the Internationalization Theory with two main observations of four firms located in Sweden. As a matter of fact the initial works did not factor competition as a hindrance to the entry of the firm coming from other country as a result of psychical distance. As a result of this, assumptions were made in the course of the study. The first assumption was that the firm first establishes itself in the home country after which the subsidiaries could be introduced into international platform on various decisions. In the same vein, the imperfect competition emanated from the lack of knowledge constitutes an obstacle to internationalization. The experience gained from international market via learning and incremental decisions would assist the firm to overcome the obstacles. Moreover, perceived risk bring about a reduction investments in the foreign market, but the need to control sales is stimulated by internationalization while existing demand in a foreign market bring about an

increment in international operations. However, firms start to export to neighbouring countries or countries which have a comparative similarity in the course of doing business.

Consequently, the firm commences to sell in the global market through agents that independent. At some point home countries could the environment that is most suitable for MNEs, but when conditions change in favour abroad, it is pertinent that subsidiaries are established. In this line, the favourable investment conditions could succinctly provide an explanation for FDI inflows in developing economy like Nigeria.

2.3. Market Size Theory

The FDI Market Size Theory could be linked to Bandera and White (1968). Consequently, it was later popularized by the works of scholars such as Asiedu (2006) and Mughal and Akram (2011). The argument put forward by these scholars was that the motivation behind efficiency seeking FDI was the size of the market, which could be operationally defined as a firm's sales or GDP. The bone of contention here is that even if prices do not rise but markets expand, holding all other factors constant the returns of enterprises will steadily expand. Expansion of GDP brings about rise in GDP per capita and welfare. This justifies why large quantum of FDI flows to countries such as China, India and Pakistan largely due to high population, despite lower GDP per capita. Ditto for Nigeria which dominates ECOWAS sub region as a result of its large population.

3. Empirical Review

In this section, effort has been made to review studies on FDI inflows in Africa in generally and Nigeria to be specific.

Adeyeye, Akinuli and Ayodele (2016) utilizes an Error Correction Model approach to investigate the nexus between spending on security and inflows of FDI in Nigeria spanning from 1985 to 2015. The estimated results in the study argue that the expenditure on security and inflation are inversely related with FDI. But spending on defense and the inflows of FDI have a direct relationship in the long run in Nigeria. In a related paper, Aderemi et al (2018) adopt Dynamic Ordinary Least Square and granger causality to examine the link between security spending and foreign direct investment inflows in Nigeria from 1994 to 2016. It was discovered from the study that a positive link exists between the internal security spending and FDI inflows in Nigeria in one hand and bidirectional causality flows from defense spending to FDI inflows in the country. Samol and Solifano (2014) attribute a strategic determinant of inflows of foreign direct investment to government fiscal

deficit/surplus. In another perspective, Isam (2010) identified the availability of security, infrastructure and economic performance as the primary factors that usually motivate investment decision of foreign investors. But, the author pinpoints factors such as political instability, unstable exchange rate, economic performance and unpredictable inflation as enemies of foreign investment. While examining the nexus between exchange rate uncertainty and foreign direct investment the Nigerian economy, Olumuyiwa (2003) submits that there is an existence of inverse relationship between exchange rate and foreign direct investment in Nigeria. Exchange rate is also tagged as a vital driver of economic activities in Nigeria.

Furthermore, Gui-Diby (2014) uses GMM Technique in investigating the relationship between FDI and economic growth in 50 African nations from 1980 to 1994. It was reported from the study that an inverse linkage exists between FDI and economic growth in 1980 to 1994. Whereas reverse is the case from 1995 to 2009. However, the positive impact in the latter period is linked with how business condition has improved consistently and the contribution of exports to the economies. Mahmood et al (2010) apply econometrics technique to estimate how economic freedom and growth of the economies of SAARC Member Countries interlinked over time. The authors find out that an inverse correlation between government size and growth. Meanwhile, in the case of trade, investment, business, property rights, and freedom from corruption, negative linked with growth was established.

Azman-Saini, Baharumshah, and Law (2010) employs an Econometrics approach to estimate the linkage between growth of economy, foreign direct investment and economic freedom. The paper discovers that foreign direct investment and economic growth have an indirect positive relationship. Meanwhile, FDI was observed to effect contingent impact on economic freedom in the host countries. The implication of this is that higher the level of economic freedom a country possesses the greater benefits from the inflows of cross border capital.

In addition, Saibu and Akinbobola (2014) utilizes a Vector Error Correction Modeling (VECM) to analyze the relationship between globalization, FDI and economic growth in some selected Sub Saharan African nations. The paper submits that trade liberalization and economic growth process have an insignificant relationship in SSA nations. Meanwhile, countries in Africa could not be prevented from the global economic shocks despite the rise in capital inflows to the continent.

Finally, the reviewed of the empirical studies show that studies on FDI inflows and other macroeconomic variables are ongoing in Nigeria, and the literature is still inconclusive regarding this relationship. Hence, the relevance of this study.

4. Methodology

This study utilizes secondary data from 1990 to 2017 for the analysis. Data on FDI inflows were extracted from UNCTAD database published by the World Bank. Meanwhile, data on other macroeconomic variables were extracted from CBN statistical bulletin.

4.1. Model Specification

$$FDI_{infl} = F (MkT, GrT, GDP/CA, Exch, Infl,) \text{----- (I)}$$

If the model (I) is log linearized, it results into model (II) as follows

$$LnFDI = \alpha_0 + \alpha LnMKT + \beta_0 GrT + \beta_1 GDP/CA + \beta_2 Exch + \beta_3 Infl + u \text{----- (II)}$$

$$LnFDI = \beta_0 + \beta_1 Ln FDI + \beta_2 \Delta LnMKT + \beta_3 GDP/CA + \theta_1 Infl + \theta_2 Exch + \theta_3 GrT + \mu_i \text{--- (III)}$$

4.2. Estimation Techniques

The study made use of unit root tools such as Augmented Dickey Fuller (ADF) and Philips-Perron (PP) unit root tests for the stationarity test of the data series and Bound test for testing the long run equilibrium among the variables. It was discovered that the variables had different orders of integration i.e. I(1) and I(0), against this backdrop, an ARDL technique was adopted in this paper (Pesaran, Shin and Smith, 2001, Pesaran and Pesaran, 1997).

$$\Delta LnFDI_t = \beta_0 + \sum_{i=1}^p \beta_1 \Delta Ln FDI_{t-1} + \sum_{i=0}^p \beta_2 \Delta LnMkT_{t-1} + \sum_{i=0}^p \beta_3 \Delta GDP/CA_{t-1} + \theta_1 Infl_{t-1} + \theta_2 Exch_{t-1} + \theta_3 GrT_{t-1} + \mu_i \text{----- (III)}$$

Where

FDI_{infl} is FDI inflows which is measured in millions USD

MkT is used to denote the market size of the economy: the real GDP is used to proxy it and is measured in USD. GrT denotes the annual growth rate of economy and is measured in percentage. GDP/CA connotes GDP per capita growth, and it defines the rate of the standard of living of people. It is measured in percentage. Infl means inflation rate which measures the general price level in the country. Exch connotes exchange rate which shows the value of the country’s currency vis-à-vis dollar. U captures error term. t= 1990-----2017. α_0 is an intercept and $\alpha, \beta_0, \beta_1, \beta_2$ and β_3 are the slope parameters. A priori expectation $\alpha, \beta_0, \beta_1, \beta_2 > 0$ and $\beta_3 < 0$.

4.2. Result and Discussion

Table 1. Descriptive Statistics of Annual Data Series

Descriptive Statistics	LMkT	LFDI	GrT	Exch	GDP/CA	INFL
Mean	42.44046	21.74894	5.217857	4.300743	2.532143	18.71679
Median	31.28159	21.52907	4.350000	4.815250	1.650000	12.55000
Maximum	346.1660	22.91100	33.70000	5.857933	30.40000	72.84000
Minimum	30.60445	20.72626	-1.600000	2.084156	-4.200000	5.380000
Std. Deviation	59.52657	0.726565	6.521989	1.061811	6.364779	17.42350
Skewness	5.003169	0.160137	3.070353	-0.709526	3.095979	1.958346
Kurtosis	26.03362	1.593786	14.19066	2.095351	14.33384	5.646040
Jargue-Bera	735.7866	2.426683	190.0958	3.304115	194.5956	26.06566
Probability	0.000000	0.297203	0.000000	0.191655	0.000000	0.000002
Sum	1188.333	608.9704	146.1000	120.4208	70.90000	524.0700
Sum. Sq. Deviation	95672.13	14.25320	1148.481	30.44095	1093.781	8196.619
Observation	28	28	28	28	28	28

Source: Authors' work (2020)

Table 1 shows the descriptive statistics of the data used to proxy variables in this study. The values of mean and median of the variables FDI and other macroeconomic variables are almost the same, apart from market size and inflation rate which show a slight disparity. This shows that the distribution of the data series is fairly symmetrical in nature. The distribution of data series is perfectly symmetrical when the values of mean, mode and median of such data series converge (Karmel and Polasek 1980).

Table 2. Unit Root Test

Variables	ADF Test			PP Test		
	Level	1 st Diff.	Remarks	Level	1 st Diff.	Remarks
LFDI	-2.976263**	-2.981038**	I (1)	-2.976263**	-2.981038**	I (1)
LMkT	-2.976263**		I(0)	-2.976263**		I(0)
INFL	-2.976263**	-2.981038**	I(1)	-2.976263**	-2.981038**	I(1)
GrT	-2.976263**		I(0)	-2.976263**		I(0)
GDP/CA	-2.976263**		I(0)	-2.976263**		I(0)
Exch	-2.976263**	-2.981038**	I (1)	-2.976263**	-2.981038**	I (1)

Source: Authors' work (2020) *** %5 level

Time series data are always associated with the problem of non-stationarity. This could decrease the validity of forecast based on such data. In order to overcome this problem, this study used the standard Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests to examine the stationarity or otherwise of the data in this study. Consequently, the results of the estimated Augmented Dickey-Fuller (ADF) tests shown in the above table clearly indicate that data on the variables such as FDI, inflation rate and exchange rate were not stationary in their native form. However, market size, growth rate and GDP/CA were stationary at level. This implies that the data employed for the econometric analysis in this work are the combination of I(0) and I(1).

Table 3. VAR Lag Order Selection Criteria

Sample: 1990 2017

Included observations: 26

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-333.3539	NA	8752.620	26.10414	26.39447	26.18775
1	-253.1758	117.1833	317.4149	22.70583	24.73814	23.29106
2	-185.6387	67.53712*	46.72637*	20.27990*	24.05419*	21.36676*

* indicates lag order selected by the criterion

Source: Authors' work (2020)

Unrestricted Vector Autoregression (VAR) by lag selection criteria was modeled to the time series data in order to determine the optimal number of lags for the model. As shown in Table 3, the lowest value for each estimator falls under lags two (2). Based on the result, SBIC criterion was chosen for the determination of optimum lag length of ARDL model in this study. ARDL (1, 0, 1, 2, 2, and 2) model was selected as a common consequence of the SBIC criterion

Table 4. ARDL Bounds Test

Sample: 1992 2017

Included observations: 26

Null Hypothesis: No long-run relationships exist

Test Statistic	Value	k
F-statistic	1.992603	5
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	2.26	3.35

Source: Authors' work (2020)

The above finding indicates that the Null hypothesis of no long run relationship could not be rejected owing to the value in the upper and lower Critical Bounds at 10% level of significance which is greater than the value of F-Statistic. Thus, there is an absence of cointegrating relationship among the variables in the model. This outcome necessitates the estimation of only short run relationship among these variables.

Table 5. Determinants of FDI Inflows in Nigeria

Dependent Variable: LFDI

Selected Model: ARDL (1, 0, 1, 2, 2, 2)

Short Run	Coefficient	t-statistics	P-value
LFDI(-1)	0.826875*	4.958138	0.0003
LMkT	0.002316***	1.724045	0.1103
LExch(-1)	0.291146***	1.504789	0.1582
GDP/CA(-2)	-1.991324	1.148074	0.1015
GrT(-2)	1.962638***	1.777834	0.1008
Infl(-2)	-0.026730**	3.483651	0.0045
R-squared	0.948711		
Adjusted R-squared	0.893147		

*Source: Authors' computation (2019) ***Significant at 10%, **Significant at 5%, * Significant at 1%*

Table 5 presents the ARDL results of the relationship between the FDI and other macroeconomic variables that derive it in Nigeria. It should be noted that it is only GDP/CA that did not follow a priori expectation among all the explanatory variables. The estimated results showed a significant positive value of the first lagged of dependent variable, FDI(-1). The implication of this result is that past FDI inflow increases the level of inflows of FDI in the current year. Meanwhile, it could be established that FDI inflows and market size have a direct relationship which is significant at 10% level of significance. A unit change in the market size increases the inflow of FDI by 0.0023% in Nigeria. This result is validated by the submission of Mughal and Akram (2011) and Asiedu (2006) who attributed the inflows of FDI to the size of the market. In the same vein, exchange rate and FDI inflows have a positive relationship which is significant at 10% level of significance. A unit change in rate of exchange brings about a rise in the level of FDI by 0.29% in the country. This contradicts the finding of Olumuyiwa (2003) in a related study in Nigeria.

However, GDP/CA has an insignificant negative relationship with FDI inflows. Similarly, inflation rate has a significant inverse relationship with FDI inflows. A unit change in inflation rate reduces FDI inflows by 2.7% in the country.

5. Summary and Recommendation

In the course of examining the important macroeconomic variables that derive FDI inflows in the short run in Nigeria over the period of 1990 to 2017, this study has contributed to the literature by establishing the following crucial findings in the study. The driving factors of FDI inflows in Nigeria are past FDI inflows, market size, exchange rate and growth rate. However, the inflation rate discourages FDI inflows in the country. Moreover, based on this study, the following important recommendations were made for both the policy makers and the investors in Nigeria. The policy makers in the country should be committed towards policy measures that will ensure the continuous expansion of the country's market size, double digits growth rate and exchange rate stability. In the same vein, the policy measures that would address inflation rate problem on FDI inflows in the country should be put in place by the policy makers in Nigeria.

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