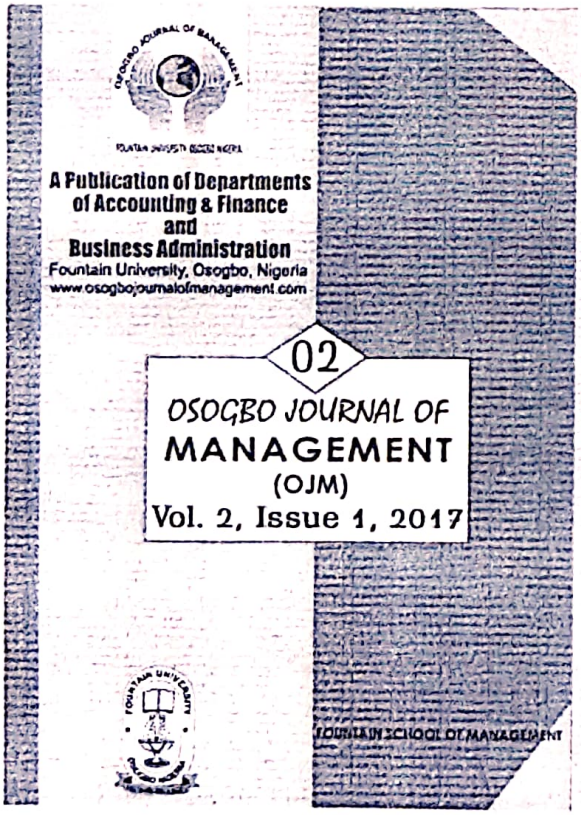
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DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN NIGERIA

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Abstract

Most countries strive to attract foreign direct investment (FDI) because of its perceived advantages as a tool of economic development. This study investigates the determinant of FDI in Nigeria from 1985 to 2015. The study sourced secondary data from Central Bank of Nigeria (CBN) statistical bulletin (2013), IMF financial report (2013) and World Bank Data base. The data obtained were subjected to Units root test, Johansen Co-integration test and Error correction method. Essentially, the variables in the model show a long-run disequilibrium. It was discovered that market size (GDP) and openness impacted positively on FDI flow while inflation, exchange rate, and infrastructure development were unfavourable. Since the success of FDI in any host country is dependent upon the level of infrastructural facilities, political and social security in terms of lives and property in the country, we therefore recommend that improvement in infrastructure and technological development through knowledge spillover, sound monetary and fiscal policy management, maintaining a conducive political and social environment for development will go along way in attracting FDI to Nigeria.

Keywords: *foreign direct investment, economic development, Nigeria*

1. INTRODUCTION

Foreign Direct Investment (FDI) is the ownership or control of some portion of companies or firms by foreigners in a domestic economy. As noted (Piana, 2005) it consists of acquisition or creation of assets (e.g firm's equity, buildings, oil drilling rigs, etc) and in some cases these companies join together with the government of the domestic economy and termed as joint ventures companies. Some factors determine the inflow of capital either in form of financial resources or real capital for investments. These factors could be economical or political and Nigerian security situation determines largely the aggregate investments in the country. Since independence in 1960, FDI has been given prominence in the quest for the growth and sustainable development of Nigeria. Nigeria dominates the recipient of the FDI to African

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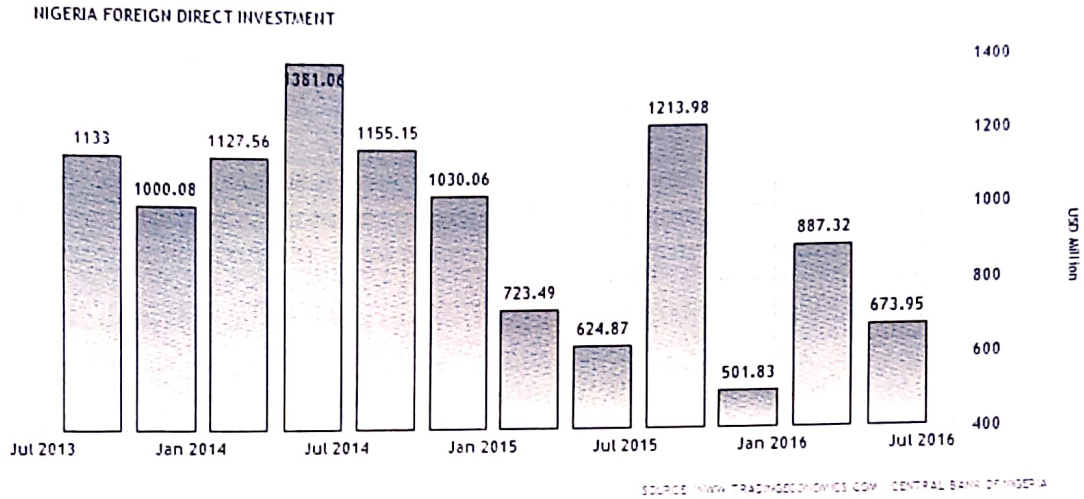
continent which received 70% of the sub-regional total and 11% of Africa's total and out of this; Nigeria's oil sector alone received 90% between 1970 and 2006 (Dinda, 2009).

There have been factors which are seen to drive the growth of FDI in Nigeria. Udeaja (2008) notes that the causes of capital flow to domestic economy include improvement in creditor relations, adoptions of sound fiscal and monetary policies and neighbourhood externalities and the presence of natural resources that offer a strong locational specific advantage in attracting FDI to a host country. The oil rich nature of the economy helps attract large quantum of FDI for technology transfer, improvement in productivity, efficiency in resource allocation. Specifically, with the introduction of Structural Adjustment Programme (SAP) in 1986, Nigeria has continued to embark on liberal, regional, bilateral and multi-lateral trade agreements aimed at achieving more FDIs. The SAP programme incorporated trade and exchange rate reforms with monetary and fiscal measures aimed at improving the economy through the discouragement of importation and make export-oriented multinationals gain on their investments (Udeaja, 2008).

With SAP, there has been inflow of FDI in the nigerian economy. The nominal FDI inflow ranged from N128.6 million in 1970 to N434.1 millionin 1985 and N115.952 billion in 2000. Prior to the early 1970s, foreign investment played a major role in the Nigerian economy. Until 1972, for example, much of the non-agricultural sector was controlled by large foreign owned trading companies that had a monopoly on the distribution of imported goods. Between 1963 and 1972 an average of 65% of total capital was in foreign hands (Jerome and Ogunkola, 2004). FDI forms a small percentage of the nation's gross domestic product (GDP), however, making up 2.47% in 1970, -0.81% in 1980, 6.24% in 1989 (the highest) and 3.93% in 2002. Nigeria is one of the few countries that have consistently benefited from the FDI inflow to Africa. Nigeria's share of FDI inflow to Africa averaged around 10%, from 24.19% in 1990 to a low level of 5.88% in 2001 up to 11.65% in 2002. UNCTAD (2003) showed Nigeria as the continent's second top FDI recipient after Angola in 2001 and 2002.

Because successive Nigeria governments have viewed FDI as a vehicle for politicaland economic domination, the thrust of government's policy through the Nigeria Enterprise Promotion Decree (NEPD) (indigenization policy) was to regulate rather than promote FDI. The NEPD was promulgated in 1972 to limit foreign equity participation in manufacturing and commercial sectors to a maximum of 60%. In 1977 a second indigenization decree was promulgated to further limit foreign equity participation in Nigeria business to 40%. Hence, between 1972 and 1995 official policy toward FDI was restrictive. The regulatory environment discouraged foreign participation resulting in an average flow of only 0.79% of GDP from 1973 to 1988. The adoption of the structural adjustment programme in 1986 initiated the process of termination of the hostile policies towards FDI. A new industrial policy was introduced in 1989 with the debt to equity conversion scheme as a component of portfolio investment. Till date Nigeria still expericen inflow of FDI. Nigeria recorded increased by 673.95 USD Million in the second quarter of 2016. It averaged 1348.23 USD Million from 2007 until 2016, reaching an all time high of 3084.90 USD Million in the fourth quarter of 2012 and a record low of 501.83 USD Million in 2015 (see Figure 1)

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Given the importance of FDI to developing countries, there is a dearth of research on the factors that affect FDI inflow to Africa. This paper is one of such studies which intend to empirically estimate the determinates on FDI with particular reference to Nigeria economy. The rest of this paper is organized as follows: Section 2 presents a review of the theoretical and empirical literature as well as conceptual issues. Section 3 Methodology and data description 4. Data, estimation and empirical result, conclusion and recommendation of the paper are presented in Section 5.

2. LITERATURE REVIEW

In theoretical literature, economic theories as neo-classical theory, dependencytheory, eclectic theory and endogenous growth model theory have been propounded to evaluate the role of FDI in the country. The Neoclassical perspective is based on a basic principle in economics, which suggests that economic growth requires capital investment in the form of long-term commitment. The dependency theory maintains that the poorness of developing countries is due to imperial neglect, overdependence upon primary products as exports to developed countries, foreign investors' malpractice, foreign firm control of key economic sectors with crowding-out effect of domestic firms, implantation of inappropriate technology in developing countries, prevention of independent development strategy fashioned around domestic technology and indigenous investors and distortion of the domestic labour force through discriminatory remuneration. Dependency theorists focused on the several ways by which FDI of multinational corporations distort developing nation economy. It has also been argued that FDI are more exploitative and imperialistic in nature, thus ensuring that the host country absolutely depends on the home country and her capital (Anyanwu, 1993). This theory from its points of analysis could be discovered that it creates negative relationship between FDI and economy growth of the developing countries.

The endogenous growth model theory explaines that physical investment is not a measure of economy growth of a country but the effectiveness and efficiency in the use of these investments. Economic models of endogenous growth have been applied to examine the effects of FDI on economic growth through the diffusion of technology. (Barro, 1991). Romer (1990)

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argues that FDI propels economic growth through strengthening human capital, the most essential factor in R&D effort; while Grossman and Helpman (1991) emphasize that an increase in competition and innovation will result in technological progress and increase productivity and, thus, promote economic growth in the long run. The last theory to be considered is eclectic theory of FDI. According to the "eclectic" theory of FDI, countries that have a 'location advantage' will attract more FDI (Dunning, 1993). Location specific advantage embodies any characteristic (economic, institutional and political) that makes a country attractive for foreign direct investment. Where domestic resources to investment are limited, foreign capital inflows are necessary. So, the common perception is that FDI is largely driven by market size and natural resources. Essentially, this study is specifically built upon the eclectic theory.

On the empirical view, a wide range of studies is available in literature on the determinants of FDI. Most of the studies focus on the overall effect of FDI on macroeconomic growth and other welfare-enhancing processes, and on the channels through which these benefits take place and is transmitted (OEDC, 2002). It is important to note that the review of literature will explore studies on the empirical determinants of FDI inflows in host country economies and the FDI led Economic improvement nexus. Shan (1997) studied separately FDI led growth hypothesis using econometrics evidence from China. Their study re-examined FDI led growth hypothesis in the case of China, a country which has become one of the major recipient of FDI in the world. They employed a quarterly time series data and a vector auto regression model (VAR) applying the granger no-causality procedure. Their result indicates a two causality running between industrial growth and FDI inflow for China.

Herzer (2006) using a time series and panel co integration test on FDI and growth with the aid of a bi-variate model revealed that there is no clear association between the growth impact of FDI and the level of per capita income, the level of education, the degree of openness and the level of financial market development in the developing countries.

Ahmed (2007) however using evidence from Sub-Saharan African country on the causal link between export, FDI and output observed a causal link between FDI- export and FDI income. He noted that FDI has contributed to higher economic growth directly and indirectly. Hasen and Glanluigi (2007) using a panel data and a regression technique in their studies on the determinant of FDI in Arab Maghreb Union (AMU) countries noted that trade openness and foreign market are not significant for FDI inflow in the AMU countries and exchange rate also has a negative impact while growth of market size and existing stock of FDI are significant.

Udoh and Egwaikhide (2008) in their studies on FDI in Nigeria between 1970 and 2005 using the GARCH model found that exchange rate volatility and inflation uncertainty exerted significant negative effect on FDI. Their study also revealed that infrastructural develoment, appropriate size of government sector and international competitiveness are crucial determinant of FDI inflows into the Nigerian economy. Carkovic and Levine (2008) examine the acceleration effect of FDI using a generalized method of moment panel estimator (GMM) from 1960 to 1995 and dynamic panel procedure with five year averaged data. They examined if the growth effect of FDI depends on the recipient country's level of education attainment, economic development, financial development and trade openness. They noted that while sound macroeconomic policies may spur both growth and FDI, their result indicated an inconsistency with the view that FDI

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exert a positive impact on growth that is dependent on other growth determinants. In the same vein Abosi (2008) using OLS and error correction model highlighted GDP per capita and openness as having positive impact on FDI while infrastructure like telephone have negative impact on FDI in Ghana. Alba and Garde (2008) in the work on a new look at host countries determinants of FDI inflows, a log model regression analysis observes that inward FDI is determined by economic factors, quality of business environment and the quality of governance.

Cleeve (2010) in his study on the effectiveness of fiscal incentive to attracting FDI to Sub-saharan African countries using a multiple regression analysis provided support for fiscal incentive to attracting FDI to SSA after controlling for the traditional, political, institutional and policy variables. Barthel (2013) also in his studies on the characteristic and determinants of FDI in Ghana using a qualitative and quantitative method based on data from the World Bank emphasis the growth enhancing capability of FDI and noted that the most important factor attracting FDI to a country are macroeconomic and political stability.

3. METHODOLOGY

In line with eclectic paradigm, we inn order to empirically capture the depterminants of FDI in the Nigerian economy, we employ equation (3.1) below. Equations

$$FDI = f(GDP, OPEN, INFL, INFRA, EXR) \quad (3.1)$$

The equation (3.1) shows how Foreign Direct Investment, FDI largely depeds on Gross Domestic Product, GDP; Exchange Rate, EXR; Economic Openness, OPEN; Inflation, INFL and Electricity consumption, NFRA.

Next, we adopt a simple logarithmic form:

$$InFDI_t = \alpha_0 + \alpha_t InGDP_t + \alpha_2 InEXR_t + \alpha_3 InOPEN_t + \alpha_4 InINFL_t + \alpha_5 InINFRAt + \varepsilon_t \quad (3.2)$$

Where: ε_t is the he error term

It is expected that variables included as explanatory variables such as Gross Domestic Product (GDP), openness of trade and electricity consumption , show positive relationship with FDI while inflation and exchange rate could exhibit either negative or positive relationship depending on the type of investment that dominate the FDI within the study period. The period coverred is 1985 to 2013. The data were sourced from the Central Bank of Nigeria's StatisticalBulletin (2013),United Nation Conference On Trade And Development (UNCTAD, 2013), United Nations Organisation for Education, Science and Cultureand the World Bank's World Development Indicators *(2013).*

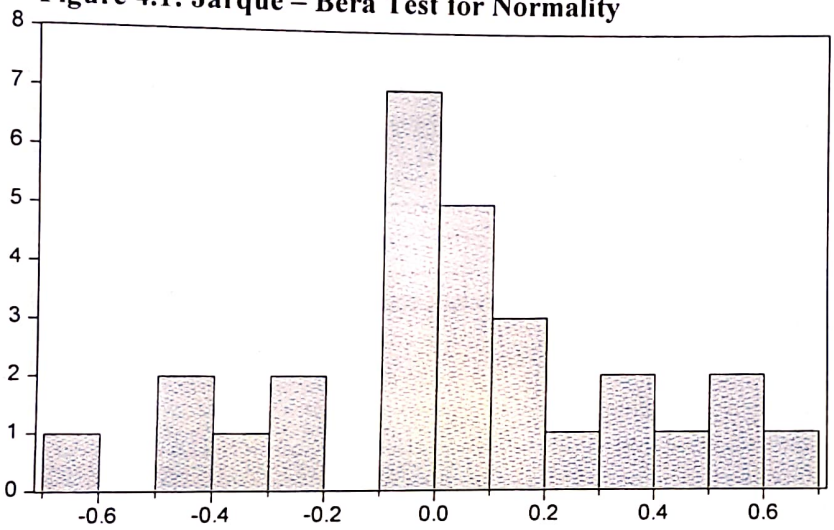
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4. RESULTS AND DISCUSSION

Pre Tests

There are some features that these models should satisfy in order to be appropriate for policy consideration and implementation, the residuals must be normally distributed, absence of autocorrelation, no serial correlation, homoscedastic, etc. in this study these tests were conducted on the residuals to decide if these models are robust.

Figure 4.1: Jarque – Bera Test for Normality



Series: Residuals	
Sample 1986 2013	
Observations 28	
Mean	0.034555
Median	0.029102
Maximum	0.685855
Minimum	-0.676929
Std. Dev.	0.317347
Skewness	-0.059546
Kurtosis	2.845236
Jarque-Bera	0.044490
Probability	0.978000

Source: *Eviews output computed by the author, 2017*

Table 4.1: Breusch-Godfrey Serial Correlation LM Test

F-statistic	1.854793	Prob. F(2,20)	0.1824
Obs*R-squared	4.090445	Prob. Chi-Square(2)	0.1294

Table 4.2: Breusch-Pagan-Godfrey Heteroskedasticity Test

F-statistic	0.665167	Prob. F(6,21)	0.6785
Obs*R-squared	4.471531	Prob. Chi-Square(6)	0.6131
Scaled explained SS	2.516051	Prob. Chi-Square(6)	0.8667

Source: *Eviews output computed by the author, 2017*

The Jarque-Bera residual normality test result for the model is 0.044 with a P-Value of 97.8% which is more than 5% indicates that the null hypothesis cannot be rejected, meaning that the residuals are normally distributed. The Breusch-Godfrey serial correlation LM test shows a P-Value of 18% for the observed R^2 which means we cannot reject null hypothesis that the

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residuals are not serially correlated. The Heteroscedasticity test also shows a P-Value of 61.3% for the observed R^2 meaning that the null hypothesis that the residual has no ARCH effect cannot be rejected. All these tests confirm that the model is robust for policy consideration.

Unit Root Test

To study the effect of FDI on economic growth, variables stationary should be checked. To test the stationarity, the series (LogGDP, LogFDI, LogEXR, LogOPEN, LogINFL and LogINFRA) is exposed to unit root tests. The results are listed in the tables below. The ADF results below show that all the variables are non stationary at level, i.e.I(0) at 5 percent confidence levels. the ADF results in a table 4.3 show that all the variables that are non stationary at level. However, Table 4.4 makes us conclude that each variable are differenced stationary.

Table 4.3: Unit Root Tests in Level form

Variables	Order of Integration	Included in Test Equation	ADF Test Statistic	Mackinnon Critical Value
LogGDP	I(0)	Trend & Intercept	-2.0738	-3.5806
LogFDI	I(0)	Trend & Intercept	-0.6506	-1.9533
LogEXR	I(0)	Trend & Intercept	-2.2507	-3.5875
LogOPEN	I(0)	Intercept	-2.1646	-2.9718
LogINFRA	I(0)	Trend & Intercept	-2.0588	-3.5875
LogINFL	I(0)	Intercept	-2.7337	-2.9718

Source: *Eviews output computed by the author, 2017*

Table 4.4: Unit Root tests in First Differenced Form

Variables	Order of Integration	Included in Test Equation	ADF Test Statistic	Mackinnon Critical Value
LogGDP	I(1)	Trend & Intercept	-4.6475	-3.6032
LogFDI	I(1)	Trend & Intercept	-10.5901	-3.5875
LogEXR	I(1)	Trend & Intercept	-4.6533	-2.9762
LogOPEN	I(1)	Intercept	-3.2804	-2.9762
LogINFRA	I(1)	Trend & Intercept	-6.3761	-2.9762
LogINFL	I(1)	Intercept	-4.6779	-2.9762

Source: *Eviews output computed by the author, 2017*

4.5. Johenson Cointegration Test Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.871301	127.2749	95.75366	0.0001
At most 1 *	0.721118	71.91732	69.81889	0.0337
At most 2	0.459685	37.43924	47.85613	0.3271
At most 3	0.351755	20.81797	29.79707	0.3691
At most 4	0.280901	9.113829	15.49471	0.3550
At most 5	0.007763	0.210410	3.841466	0.6464
Trace test indicates 2 cointegrating eqn(s) at the 0.05 level * denotes rejection of the hypothesis at the 0.05 level				

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**MacKinnon-Haug-Michelis (1999) p-values
Source: *Eviews output computed by the author, 2017*

Table 4.6: Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.871301	55.35755	40.07757	0.0005
At most 1 *	0.721118	34.47808	33.87687	0.0424
At most 2	0.459685	16.62127	27.58434	0.6126
At most 3	0.351755	11.70414	21.13162	0.5771
At most 4	0.280901	8.903419	14.26460	0.2943
At most 5	0.007763	0.210410	3.841466	0.6464

Max-eigenvalue test indicates 2 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values
Source: *Eviews output computed by the author, 2017*

The trace test statistic indicates 4 cointegreting equations at the 5 percent confidence level while the max-eigenvalue test statistic also indicates 4 cointegreting equations at 5 percent level. Meaning that the variables are cointegrated and having long – run equilibrium relationship.

Table 4.6: Persimonious Error Correction Model (ECM)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LOGINF)	-0.008135	0.098533	-0.082559	0.9349
D(LOGEXCH)	-0.014420	0.189668	-0.076030	0.9401
D(LOGINFRA)	-0.527365	0.628251	-0.039418	0.0413
D(LOGDOP1)	0.270375	0.119192	2.268404	0.0635
D(LOGGDPPC)	0.042856	0.278389	0.153944	0.8791
γ (-1)	-1.117356	0.193763	-5.766605	0.0000

R-squared	0.644592	Mean dependent var	0.087354
Adjusted R-squared	0.563817	S.D. dependent var	0.535579
S.E. of regression	0.353719	Akaike info criterion	0.946780
		Schwar	
Sum squared resid	2.752574	criterion	1.232253
Log likelihood	-7.254926	Hannan-Quinn criter.	1.034052
Durbin-Watson stat	1.617532		

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Source: *Eviews output computed by the author, 2017*

According to the estimation results, it is discoverred that the coefficient associated with the restoring force towards equilibrium is negative (-1.11) and statistically significant at 5%. Therefore the vector error correction mechanism, that is to say the γ can tend towards the long-run equilibrium, has been validated.

From the statistical analysis, the change in the GDP directly affects FDI flows but not statistically significant effect on FDI flows to Nigeria economy. The non significant of GDP was an indication that the economic growth in Nigeria is not brought about by expansion in the overall investment but determined by the oil sector which is not sufficient to bring the needed FDI in Nigeria. The openness of trade directly affects FDI flows but not statistically significant effect on FDI flows. The non-significant of the openness of trade could be justified on the ground that the Nigeria's foreign sector needs to perform better in the areas of manufacturing and value addition for our foreign account balance to improve. This is consistent with the World Bank report (2001) in Onayemi and Akintoye (2009) indicates that the percentage share of primary commodities in the Nigeria's export is 99% while manufacturing shares only 1%.

As regards the impact of inflation as explanatory variable on FDI, the sign based on the a priori expectation is correct since it could be negative or positive depending on the line of investment as per consumer goods or producer goods as well as the tolerable level of inflation. The inflation in Nigeria is not justified on the ground of improved living standards but as a result of deficient domestic production which is lower than the market demand and as such, it has to import most of her goods. Coupled with system failures, foreign investors are not motivated by the demand in Nigeria to move in their capitals and such inflationary pressures in the country scare away foreign investors because the business environments which when put together add to the overhead costs which could prevent high return on investment.

On the examination of the impact of the electricity consumption on the FDI, it shows that the level of electricity supply in Nigeria has negative impact on the flow of FDI to Nigeria. This justifies the many claims by researchers that unless power is stabilised in Nigeria, efforts to motivate foreign investors to the economy might not yield much result. The negative sign of the parameter shows that the electricity generation and consumption in Nigeria prevents investors to move in their capital from foreign economies to the economy.

Exchange rate conforms to the economic apriori expectations though it is insignificant at 5% confidence level. Form our results; it can be deduced that the depreciation of naira has a negative impact on the rate of FDI inflow. Suffice it to say that a fall in exchange rate of a country we are trading with is a major boast for foreign direct investment inflow. This is because it takes less amount of foreign exchange from parent country to invest in a host country. Though the naira has depreciated over the years, Nigeria has not been able to attract a significant growth in FDI because of instability and youth restiveness in the polity.

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5. CONCLUSION AND RECOMMENDATIONS

Different contributions of FDI to the economy of host country has been reviewed and discussed. FDI would not be able to succeed in any country without the availability of needed factors, which have been discussed as determinants of FDI in the body of the study. One of the most important factors to attract the attentions of foreign investors is a adequate infrastructural facility. Without the availability of these needed facilities, it would be risky for investors to come into any country. This simply means that, for a nation to enjoy the merits and advantages of multinational companies, her government would have done much more enough to put in place a better infrastructure. This can be concluded that the success of FDI in any host country is dependent upon the level of infrastructural facilities in the country. Without the availability of these needed facilities, it would be risky for investors to come into any country. Finally, recommendations to strengthen the investment environment by reducing the obstacles to doing business, improving economic management, stemming the tide against international financial crimes, repositioning investment agencies and export promotion schemes, strengthening intellectuals property and commitment to democratic principles have been advocated in this research as significant in attracting FDI. This is important to overcome barriers to FDI inflows and increase Nigerian's share of FDI as a substantial percentage of world FDI stock.

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