Determinants of Foreign Direct Investment in Nigeria (1980-2014)

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a) Background

Foreign Direct Investment (FDI) has been at the center stage as a phenomena of discussion amongst international cum development economists since the breakthrough made by Hymer's Thesis in 1960 which serves as a basic reference in subsequent study on the Multinational Corporations (MNC). Therefore, there has being a continuous growing concern on research in the area of FDI due to globalization of markets and companies emerging to be internationalized. Also, the existing liberal regulations in various countries give rise to the influx of companies across borders in an effort to engage in FDIs. According to Mehrene and Tim (1999), FDI tend to flow into countries with low wage rate due to wage differentials but Musila and Sigue (2006) argue that FDI inflow into the African continent are highly different among regions and countries depending on the economic and political environment.

b) Research Problem

The issue of FDI determinants remains relative and debatable owing to different results found empirically. Asiedu (2006) suggests that in Nigeria, FDI is determined by large local markets, natural resources, infrastructure and low inflation but to Bakare (2011) the major determinants of FDI are attributed to political cum macroeconomic instability; while Okafor (2012) conclude that the key FDI determinants are real gross domestic product (GDP), interest rate, and real exchange rare. Therefore, the problem of ascertaining the real FDI determinants in Nigeria is yet to be unanimously established and that calls for further research. During the period under review FDI declines and later fluctuates from $US5.62m in 1980 to $US7,887.65m dollars in 2014.

c) Objectives

The main objective of this study is to find out the determinants of FDI in Nigeria and to find the causality between the other variables in the equation.

d) Research Methodology

In this study the eclectic theory of Dunning (1979) called eclectic paradigm or Ownership, Locational and Internalization (O-L-I) paradigm is employed. We then use the cointegration technique on our model; *FDI =(RGDP, EXR,DOP,OM,OX)*

where ; *NFA* represents Net Foreign Assets proxied as *FDI* in Million dollars; *RGDP* is Real Gross Domestic Product in million naira; *EXR i*s the Naira Exchange Rate Vis-a-Vis US dollar; *DOP* is Degree of Openness of the economy with other countries in the world; while *OM* is Total Import receipts and *OX* represent Total Export receipts. The data used is time series from the World Bank data base and the Central Bank of Nigeria Statistical Bulletin (various issues) for a period 1980 to 2014.All the variables are converted into logarithms in order to find the responsiveness and for consistency. Further, since the data used is time series, the Phillips Perron stationarity test was conducted on the log values of the variables which include both the explained and explanatory variables. The unit root results show that all the variables are 1(0) at level denoting non-stationarity in their level form but their first differencing converts all the variables to stationary implying that the variables are 1(1) ,at first difference.

Cointegration Test

The Johanssen cointegration result with intercept and No trend shows that there are three cointegrating equations. Therefore, in order to correct the short-run disequilibrium a vector error correction is adopted to upset the short-run dynamics in the model, the result of the ECM was interpreted using impulses response function (IRF) and forecast error variance decomposition (FCEVD).

Key Findings

The cointegrating equation shows that a 10 per cent increase in imports brings about 0.7 per cent increase in *FDI* while a 10 per cent increase in exports reduces *FDI* By 5.5 per cent. However, a 10 per cent increase in *GDP* raises *FDI* by 47.9 per cent. Invariably, even though it is in different proportion, both imports and *GDP* promotes *FDI*. During the period under review. The coefficient of determination R^2 shows a joint statistical significant effect of the independent variables and dependent variable *(FDI)*.

Granger Causality test

The result of granger causality reveals a uni-directional causality running from exchange rate to foreign direct investment, meaning that exchange rate granger causes *FDI* for the Nigeria economy. Also a uni-directional causality between exchange rate and total imports exists denoting that favorable exchange rate regime causes export to appreciate and vice versa. Further, a uni-directional causality between exchange rate and real *GDP* exists implying that for Nigeria, favorable exchange rate causes real *GDP* to improve and vice versa. Finally, the result of granger causality show that *FDI* causes imports, denoting that improvement in *FDI* causes inflow of foreign goods and services.

e) Conclusions

The implication of this result is that there is a long-run relationship between *FDI* and variables in this study (R*GDP,EXR,DOP,OM AND OX).* Again, the result shows a unidirectional causality between exchange rate and real *GDP* per capita of Nigeria signifying that favorable exchange rate improves *GDP* and vice versa .Also, the result of granger causality reveals that *FDI* causes import denoting that increase in *FDI* inflow brings about more inflow of foreign goods and services.

f) References

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