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Empirical Investigation of the Determinants of Foreign Private Investment in Nigeria

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Abstract: *This study empirically examined the Determinants of Foreign Private Investment (FPI) in Nigeria within 1980 to 2014. The study made use of secondary data sourced from CBN Statistical Bulletin various years. The Error Correction Model was adopted following the stationarity status of the data set. From results, it was observed that Gross Domestic Product (GDP) and Openness (OPNS) were the only significant determinants of Foreign Private Investment in Nigeria within the period under review at 5% level of significance. The economic implication of this result is that GDP which measures the market size of the Nigerian economy in this study was a significant determinant of FPI. Furthermore, OPNS which measures the degree of openness of the Nigerian economy in this study was also a significant determinant of FPI. Therefore, this result suggests that FPI inflow flourishes in countries with liberal trade policies. Political Instability (PI) which was a dummy variable showed that there was no significant difference in the inflow of FPI between the military regime and the civilian regime. The result further indicated that coefficients of GDP and OPNS were significantly positive, indicating that there exists a positive and direct relationship between FPI and GDP, FPI and OPNS. The implication of the result is that when GDP and OPNS increase in Nigeria, FPI increases. The error correction mechanism indicated that the model has an adjustment speed of approximately 52% if there was disequilibrium in the short run. The result also showed that bi causality relationship exists between FPI and GDP, and between FPI and OPNS. The implication is that both FPI and GDP cause each other so also is with FPI and OPNS. In the light of these findings, this study recommends that government should pursue economic policies which include addressing socio-economic and infrastructural challenges in Nigeria so as to attract FPI inflows in Nigeria. That government should review her commercial and trade policies like the custom regulations and make them friendly so as to attract FPI inflows in Nigeria. That government should address the issues of low wage rates so as to boost domestic consumption and improve aggregate demand in Nigeria.*

Keywords: *Foreign Private Investment Determinants, Error Correction Model, Nigeria.*

Background to the study

The overall economic performance of Nigeria since independence has been rather unimpressive. One key indicator of economic performance is the GDP growth of a country. In Nigeria, domestic savings are low. Increase in Foreign Private Investment (FPI) will be an important channel for increasing aggregate investment and by extension economic growth. According to Nnanna, (2004), Nigeria, like many other developing economies, lack adequate capital to fully harness her natural resources and potentials to optimum advantage. Hence, the need for foreign investments to bridge the resource gap required to achieve sustainable economic growth and development.

The crucial role of private investment in sustainable economic growth has been established as private investment in many developing countries is more directly related to economic growth than public investment (khan and Reinhart, 1990).

The Nigerian government on her part has shown much interest and has made great effort in promoting private investment. This is evidenced by various policies and programmes such as the Structural Adjustment programmes (SAP) whose

thrusts included lessening the dominance of unproductive investments in the public sector and enhancing the growth potential of the private sector. In addition are many economic reform policies that have been adopted by successive governments, over the years, so as to create a framework and more appropriate incentives for private sector development (Ekpo, 2016).

The benefits of Foreign Private Investment (FPI) in a host country's development effort are enormous. It ranges from the provision of additional direct capital financing supplies to a viable source of valuable technology transfer which can help jumpstart an economy. Since it is a known fact that Foreign Private Investment (FPI) grows an economy, it must first be attracted into a country before its benefits can be observed. Accordingly, a determinant of Foreign Private Investment (FPI) is the policy environment. Researchers like Obadan (2000), Iyoha (1999), Chete (1998), and Ekpo (1997) have established in their various studies the critical role of policy environment in the determination of Foreign Private Investment (FPI).

One important aspect of the policy environment is institutional capacity. It has been as a key factor attracting Foreign Private Investment (FPI) to developing countries. In this context, fair administration of justice, respect of property rights, minimal political intrusion in private business, absence of corruption, transparency and accountability are key elements of favourable policy environment.

This study is therefore timely because Foreign Private Investment is an important component of private investment, which is widely believed to be the engine of economic growth in modern economy. Ascertaining the determinants of Foreign Private Investment will significantly enable policy makers formulate policies that will increase rate of inflow of Foreign Private Investment and as such accelerate the rate of economic growth.

Literature Review

Fundamentally, factors that determine investments include new discoveries, products, territories and frontiers, resources, new population, and income. In effect, investment depends on the dynamics and unpredictable elements of growth in and outside the economic system. Some of the non-economic factors include technology, politics, investor expectations and government policies. Most investor advisors agree that though the rate of returns is cardinal to final decision, it only underscores the importance of credible and verifiable information (Schall and Harley 1986).

According to Anyanwu (1993), Foreign Private Investment refers to the acquisition by institutions or individuals in one country of assets of firm in another. It consists of external resources, including capital, technological, managerial and marketing expertise. Foreign Private Investment (FPI) is made up of Foreign Direct Investment (FDI) and Foreign Indirect Investment (FII) or Portfolio Investment.

Foreign private investment not only provides developing countries like Nigeria with the much needed capital for investment, it also enhances job creation, managerial skills as well as transfer of technology. In fact, one of the arguments for pursuing Foreign Private Investment by countries is the belief that it bridges the gap between rich and poor nations by promoting economic growth and development.

Private sector investment plays an important role in any economy. Therefore, there is the need to provide incentives to private investors in order to boost their impact on the economic growth of a nation. The need for the provision of incentives is to cushion the negative impact of the harsh economic environment engendered by higher costs of transaction and increased risks when compared with industrialized economies. Thus, the essence of investment incentives is to reduce business costs and economic inefficiencies arising from poor infrastructural facilities, political uncertainty, insecurity, long bureaucratic processes, slow and inadequate legal provision (World Bank, 1996).

The Dynamic Macroeconomic Theory of Foreign Private Investment shows that inflow to a

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country is influenced by the economic situation of the prospective country. If the economic situation of the prospective country is conducive, Foreign Private Investment will flow into the country, but if the economic situation is unfavourable, Foreign Private Investment will not flow into that country. According to the theory, the time of investment depends upon the host country's macroeconomic environment at that time. Some of the macroeconomic factors that influence decision of foreign countries to invest in other countries include but not limited to market size measured by the country's GDP, the degree of openness of the prospective country, exchange rate volatility in the prospective country, and risk perception of the investing.

Another theory of Foreign Private Investment is the Neo-classical Theory. According to neo-classical theory, all development is dependent on use of land, labour and capital. Since developing countries have underutilized land and labour, low savings rate, productivity of capital is likely to be greater there. The theory assumes that interdependence between countries benefited the developing countries, more than the developed ones. This is based on assumption that capital will normally flow from rich to poor areas where the returns on capital investments will be highest, helping to bring about a transformation of the backward economies. The theory predicts that poor nations grow faster because of diminishing returns on capital and that poor countries would converge with richer ones over time because of their higher capacity for absorbing capital.

However, empirical evidence has shown that divergence has been the case; the gap between the rich and poor has continued to widen, and the volume of capital flow to the poorer countries relative to richer ones has continued to be low. Some of the reasons of critics of this theory are that FPI is associated with commune investment, income inequality and high external dependency. The argument regarding the potential harmful impact of FPI on growth point to the importance of certain conditions to ensure that the negative effects do not outweigh the positive effects. Presently, the consensus seems to be that there is positive association between FPI inflow and growth, provided the enabling environment is guaranteed. Given the fact that growth is associated with increased productivity, FPI inflow is well suited to affect growth positively (Dunning, 1993).

Current empirical studies like that of Iwedi and Igbanibo (2015) on foreign private investment and the developing economies: evidence from Nigeria, established that while foreign private investment had positive statistical insignificant relationship with economic growth in Nigeria in the short-run , in the long-run, there exists a positive significant relationship between foreign private investment and economic growth in Nigeria. Ariyo and Raheem (1991) in Ekpo (2016) who studied the determinants of private investment in Nigeria found that public investment, rate of GDP growth, domestic credit to private sector and interest rate impacted positively on private investment. The implication of these studies is that an increase in foreign private investment will propel economic growth of Nigeria.

According to Asante (2000) who analyzed the determinants of private investment in Ghana using a time series analysis and complementing it with a cross-sectional one. The study indicates that while some of the individual effects of the components of macroeconomic instability were found to be negligible, the overall measure of macroeconomic instability has been a major hindrance to private investment. The study further established that private investment and public investment are found to be complementary and thus there is the need for the government to continue to develop the infrastructural base of the economy to boost the private sector.

Nevertheless, Obwona (2001) reported in his study on the determinants of foreign direct investment and their impacts on growth in Uganda that political stability and macroeconomic policy consistency were important parameters determining the inflow of foreign direct investment into Uganda

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and that for l as ratio of exports positively bu

The summary from literature is that the determinants of foreign private investment include, but not limited to the following variables; interest rate, exchange rate, favourable macroeconomic environment, availability of natural recourses, nature of labour force, local demand, infrastructure, closeness between the two countries in terms of geographically, economically and culturally and some institutional factors such as good governance, political stability, large markets etc.

Methodology

The theoretical framework of this study was anchored on the Dynamic Macroeconomic Theory. This means that Foreign Private Investment inflow to a country is influenced by the economic situation of the prospective country. If the economic situation of the prospective country is conducive, Foreign Private Investment will flow into the country, but if the economic situation is unfavourable, Foreign Private Investment will not flow into that country. Some of the macroeconomic factors that influence decision of foreign countries to invest in other countries include but not limited to market size measured by the country's GDP, the degree of openness of the prospective country, exchange rate volatility in the prospective country, and risk perception of the investing.

Model Specification

To pursue broad objective of this study which is to *ascertain the determinants of Foreign Private Investment in Nigeria*, the study adopted the multiple regression model below:

$FPI_t = f(GDP_t, INF_t, LR_t, EXR_t, OPNS_t, PI_t,)$ 3.1

Where,

FPI_t = Foreign private investment inflow for period t

GDP_t = Gross Domestic Product for period t
INF_t = Inflation rate for period t
LR_t = Lending rate for period t
EXR_t,= Exchange rate for period t
PI_t,= Political instability $\sum_{0=if\ militry\ government}^{1=if\ non\ militry\ government}$

The linear function estimated is given as follows:

$FPI_t = \alpha_0+\alpha_1 GDP_t+\alpha_2 INF_t+\alpha_3 LR_t+\alpha_4 EXR_t+\alpha_5 OPNS_t+\alpha_6 PI_t+\mu_t$ 3.2

Where,

μ = a stochastic error term, assumed to be independently and normally distributed.

The a priori expectations would require that the parametric coefficients in equation (3.2) above have the following algebraic signs $\alpha_1>0$, $\alpha_2<0$, $\alpha_3<0$, $\alpha_4<0$, $\alpha_5>0$, $\alpha_6<0$.

To test the causality relationship between foreign private investment and each determinant in Nigeria, the study adopted the Granger Causality model (Gujarati and Porter, 2009; Isiwu, 2004). The relevant models are specified as follows:

$$\mathbf{FPI_t = \sum_{i=1}^{n} \pi_i FPI_{t-i} + \sum_{j=1}^{n} \pi_j GDP_{t-i} + \sum_{j=1}^{n} \pi_j INF_{t-i} + \sum_{i=1}^{n} \pi_i LR_{t-i} + \sum_{i=1}^{n} \pi_i EXR_{t-i} + \sum_{j=1}^{n} \pi_j OPNS_{t-i} + \sum_{i=1}^{n} \pi_i PI_{t-i} + \mu_{1t}} \quad \mathbf{3.3}$$

$$\mathbf{GDP_t = \sum_{i=1}^{n} \Omega_i GDP_{t-i} + \sum_{j=1}^{n} \Omega_j \Delta FPI_{t-i} + \sum_{j=1}^{n} \Omega_i INF_{t-i} + \sum_{i=1}^{n} \Omega_i LR_{t-i} + \sum_{i=1}^{n} \Omega_i EXR_{t-i} + \sum_{j=1}^{n} \Omega_i OPNS_{t-i} + \sum_{i=1}^{n} \Omega_i PI_{t-i} + \mu_{2t}} \quad \mathbf{3.4}$$

$$\mathbf{INF_t = \sum_{i=1}^{n} \alpha_i INF_{t-i} + \sum_{j=1}^{n} \alpha_i FPI_{t-i} + \sum_{i=1}^{n} \alpha_i GDP_{t-i} \sum_{i=1}^{n} \alpha_i LR_{t-i} + \sum_{i=1}^{n} \alpha_i EXR_{t-i} + \sum_{j=1}^{n} \alpha_i OPNS_{t-i} + \sum_{i=1}^{n} \alpha_i PI_{t-i} + \mu_{3t}} \quad \mathbf{3.5}$$

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$$LR_t = \sum_{i=1}^{n} \beta_i LR_{t-i} + \sum_{j=1}^{n} \beta_i FPI_{t-i} + \sum_{j=1}^{n} \beta_i GDP_{t-i} + \sum_{j=1}^{n} \beta_i INF_{t-i} + \sum_{i=1}^{n} \beta_i EXR_{t-i} + \sum_{j=1}^{n} \beta_i OPNS_{t-i} + \sum_{i=1}^{n} \beta_i PI_{t-i} + \mu_{4t} \quad 3.6$$

$$EXR_t = \sum_{i=1}^{n} \partial_i EXR_{t-i} + \sum_{j=1}^{n} \partial_i FPI_{t-i} + \sum_{j=1}^{n} \partial_i GDP_{t-i} + \sum_{j=1}^{n} \partial_i INF_{t-i} + \sum_{i=1}^{n} \partial_i LR_{t-i} + \sum_{j=1}^{n} \partial_i OPNS_{t-i} + \sum_{i=1}^{n} \partial_i PI_{t-i} + \mu_{5t} \quad 3.7$$

$$OPNS_t = \sum_{i=1}^{n} \varphi_i OPNS_{t-i} + \sum_{j=1}^{n} \varphi_i FPI_{t-i} + \sum_{j=1}^{n} \varphi_i GDP_{t-i} + \sum_{j=1}^{n} \varphi_i INF_{t-i} + \sum_{i=1}^{n} \varphi_i LR_{t-i} + \sum_{i=1}^{n} \varphi_i EXR_{t-i} + \sum_{i=1}^{n} \varphi_i PI_{t-i} + \mu_{6t} \quad 3.8$$

$$PI_t = \sum_{i=1}^{n} \int_i PI_{t-i} + \sum_{j=1}^{n} \int_i FPI_{t-i} + \sum_{j=1}^{n} \int_i GDP_{t-i} + \sum_{j=1}^{n} \int_i INF_{t-i} + \sum_{i=1}^{n} \int_i LR_{t-i} + \sum_{i=1}^{n} \int_i EXR_{t-i} + \sum_{j=1}^{n} \int_i OPNS_{t-i} + \mu_{7t} \quad 3.9$$

Data required and sources

This study used time series data which were collected on yearly basis. The time series data regarding variables under study spanned from 1980 to 2014, a period of 35 years. Data analysis was carried with the help of E-views 9.0 econometric software. The major source of data was CBN Statistical Bulletin various years.

Empirical Results

Table 4.1: Stationarity Result (Unit Root)

Variables	ADF Statistic	Critical Values	Order of Integration
FPI	-3.058570	1% = -3.6496 5% = -2.9558 10% = -2.6164	I(1) Stationary at first difference
EXCR	-3.577651	1% = -3.6496 5% = -2.9558 10% = -2.6164	I(1) Stationary at first difference
LR	-5.461378	1% = -3.6496 5% = -2.9558 10% = -2.6164	I(1) Stationary at first difference
GDP	-4.647586	1% = -3.6576 5% = -2.9591 10% = -2.6181	I(1) Stationary at first difference
OPNS	-5.169249	1% = -3.6422 5% = -2.9527 10% = -2.6148	I(1) Stationary at first difference
INF	-3.166581	1% = -3.6422 5% = -2.9527 10% = -2.6148	I(0) Stationary at level
PI	-3.807887	1% = -3.6496 5% = -2.9558 10% = -2.6164	I(1) Stationary at first difference

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Source: Author's Computation, 2017

From the table above, the Mackinnon critical value for rejection of unit root hypotheses indicates that all the variables with the exemption of INF that was stationary at level are stationary after first differencing and as such they are integrated at order one, I (1).

Table 4.2: Johansen Co integration Test Result

Eigen Values	Likelihood Ratio	5% Critical Value	1% Critical Value	Hypothesized no of CE(s)
0.950390	207.1909	124.24	133.57	None **
0.685630	108.0735	94.15	103.18	At most 1 **
0.581017	69.88640	68.52	76.07	At most 2 *
0.420017	41.17890	47.21	54.46	At most 3
0.260648	23.20192	29.68	35.65	At most 4
0.208729	13.23656	15.41	20.04	At most 5
0.153795	5.510771	3.76	6.65	At most 6 *

Source: Author's Computation, 2017

*(**) denotes rejection of the hypothesis at 5 % (1%) significance level

Likelihood ratio test indicates four co integrating equations at 5% level of significance. This is shown by critical values being less than likelihood levels. Therefore, this suggested that there is long run relationship among the variables.

We therefore analyses our data with an error correction model.

ERROR CORRECTION MODEL RESULT

Dependent Variable: FPI
Method: Least Squares
Date: 04/23/17 Time: 12:22
Sample(adjusted): 1982 2014
Included observations: 33 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-192989.6	194750.2	-0.990960	0.3312
OPNS	78943.17	8775.306	8.996060	0.0000
GDP	0.046361	0.007443	6.228811	0.0000
EXCR	-2662.674	2696.047	-0.987621	0.3328
LR	13111.98	11040.91	1.187581	0.2462
PI	13130.38	243949.3	0.053824	0.9575
INF	-1366.431	3116.052	-0.438514	0.6648
ECM(-1)	-0.517284	0.259337	-1.994642	0.0571
R-squared	0.938908	Mean dependent var		466860.4

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Adjusted R-squared	0.921802	S.D. dependent var	888980.2
S.E. of regression	248593.2	Akaike info criterion	27.89224
Sum squared resid	1.54E+12	Schwarz criterion	28.25503
Log likelihood	-452.2220	F-statistic	54.88842
Durbin-Watson stat	1.997445	Prob(F-statistic)	0.000000

The result of the Error Correction Model above shows that the error correction mechanism is correctly signed - 0.52 and statistically significant. This implies that tee model corrects its short run disequilibrium by about 52% speed of adjustment to the long run equilibrium.

GRANGER CAUSALITY TEST RESULT

Pairwise Granger Causality Tests
Date: 05/01/17 Time: 05:20
Sample: 1980 2014
Lags: 1

Null Hypothesis:	Obs	F-Statistic	Probability
GDP does not Granger Cause FPI	34	28.0662	9.1E-06
FPI does not Granger Cause GDP		6.43597	0.01643
OPNS does not Granger Cause FPI	34	23.4340	3.4E-05
FPI does not Granger Cause OPNS		75.6580	8.0E-10
EXCR does not Granger Cause FPI	34	2.81362	0.10352
FPI does not Granger Cause EXCR		1.31270	0.26067
LR does not Granger Cause FPI	34	0.00414	0.94909
FPI does not Granger Cause LR		1.76442	0.19377
PI does not Granger Cause FPI	34	0.76428	0.38871
FPI does not Granger Cause PI		0.62220	0.43622
INF does not Granger Cause FPI	34	0.16526	0.68715
FPI does not Granger Cause INF		0.28324	0.59838

The Granger Causality test results above show that bi directional causal relationship exists between FPI and GDP and between FPI and OPNS at 5% level of significance.

Discussion and Implications of Results

The coefficient of multiple determination R^2 from model 3.1 of 0.93 revealed that about 93% variation in FPI is caused by changes in OPNS, GDP, EXCR, LR, PI, and INF.

From results estimated above, objective one of this study which was ***to ascertain the determinants of Foreign Private Investment in Nigeria***, it is observed that GDP and OPNS are the only significant determinants of Foreign Private Investment in Nigeria within the period under review at 5% level of significance.

The implication of this result is that GDP which measures the market size of the Nigerian economy in this study is a significant determinant of FPI. Therefore, this result suggests that FPI inflow flourishes in countries where the domestic demand is high. Furthermore, OPNS which measures the degree of openness of Nigerian economy in this study is a significant determinant of FPI. Therefore, this result suggests that FPI inflow flourishes in countries with liberal trade policies. The dummy variable Political Instability (PI) showed that there is no significant difference in the inflow of FPI between the military regime and the civilian regime.

From the results estimated, objective two which was ***to find out the relationship between Foreign Private Investment and each determinant in Nigeria***, it is established that coefficients of GDP and OPNS are significantly positive, indicating that there exists a positive and direct relationship between FPI and GDP, FPI and OPNS. The implication of the result is that when GDP and OPNS increase in Nigeria, FPI increases. Furthermore, EXCR and INF were negatively signed in consonance with economic a priori, but were not significant. Therefore, these relationships have no statistical significance. Furthermore, the error correction mechanism indicated that the model has an adjustment speed of approximately 52% if there is disequilibrium in the short run.

From the results estimated, objective three which is ***to test for the direction of causality relationship between Foreign Private Investment and each determinant in Nigeria***, it was observed that bi directional causal relationship exists between FPI and GDP, and between FPI and OPNS at 5% level of significance. However, there is no evidence to support the existence of causality between the remaining pairs of variable.

Summary of Findings, Conclusion and Recommendations

Summary of Findings

This study on the *Empirical Investigation of the Determinants of Foreign Private Investment in Nigeria spanning from 1980 to 2014* established that GDP and OPNS were the only significant determinants of Foreign Private Investment in Nigeria within the period under review at 5% level of significance using the Error Correction Model. It also established that coefficients of GDP and OPNS were significantly positive, indicating that there exists a positive and direct relationship between FPI and GDP, FPI and OPNS. Furthermore, EXCR and INF were negatively signed in consonance with economic a priori, but were not significant. Therefore, these relationships have no statistical significance. Finally, it was observed that bi directional causal relationship exists between FPI and GDP and between FPI and OPNS at 5% level of significance.

The F-statistic of 54.888 with 0.000 probability at 5% level of significance indicated that all explanatory variables are jointly significant in determining FPI Nigeria, while the coefficient of multiple determination R^2 of 0.93 revealed that about 93% variation in FPI is caused by changes in OPNS, GDP, EXCR, LR, PI, and INF.

Conclusion

From the findings of this study, we can conclude that GDP which measures the market size of the Nigerian economy in this study was a significant determinant of FPI and OPNS which measures the degree of openness of Nigerian economy in this study was a significant determinant of FPI. Therefore, this result suggests that FPI inflow flourishes in countries where the domestic demand is high and with liberal trade policies.

Recommendations

Sequel to the findings and conclusion of this study, the following recommendations were made:

- Since GDP which measures market size had significant impact on FPI, government should pursue economic policies which include addressing socio-economic and infrastructural challenges in Nigeria so as to attract FPI inflows in Nigeria.
- Since OPNS which measures degree of openness had significant impact on FPI, government should review her commercial and trade policies like the custom regulations and make them friendly so as to attract FPI inflows in Nigeria.
- Since GDP was significantly related to FPI, government should address the issues of low wage rates so as to boost domestic consumption and improve aggregate demand in Nigeria.

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