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Effect of country risks on foreign direct investment in Nigeria

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Abstract
Ever since the beginning of debt crises in 1980s Nigeria had paid considerable attention to FDI by introducing various policies and reforms to attract foreign capital inflows into the country. However, the state of business, economic, political and security in Nigeria which is generally considered deficient and parlous has continued to pose threats to the nation's economy and hindrances to foreign investment. This study therefore examined the effect of country risks on Foreign Direct Investment (FDI) in Nigeria. Time series data were collected from the Central Bank of Nigeria (CBN) 2016 Financial Statistical Bulletin and Transparency International Index that covered the period 1980 to 2016. The study adopted Johansens's Multivariate Cointegration Test and Error Correction Model (ECM) techniques. The findings of the study revealed that, country risk variables: Political instability (PINs), Insecurity (DSV), Corruption Index (CI) were found to be statistical significant on FDI. However, the study revealed that Inflation Rate Volatility (IRV) has no significant effects on FDI in Nigeria. The implication of the findings is that country risk factors are responsible for the recent capital flight and decline in FDI inflow been experienced in the country. The study recommends among others, that Nigerian government can achieve the war against corruption by strengthening and granting of autonomy to the anti-graft agencies, control of nominal effective exchange rate as well as the adoption of a holistic approach in tackling the state of insecurity in the country. In conclusion, government can increase the inflow of FDI by ensuring that they maintain the current democratic system of government and reduce the incidences of political violence in the country especially during election periods.

Keywords: foreign direct investment, defense security vote, inflation and exchange rate volatility, corruption index and political instability

1. Introduction

1.1 Background of the Study

Globalization has created investment opportunities for enterprise worldwide. Foreign Direct Investment (FDI) is one of the traditional options to expand international markets and has been an important form of private external financing for developing countries. Today, FDI is regarded as the major source of foreign capital for developing countries as opposed to portfolio investment or foreign aid. FDI is playing a great role for economic development in developing and developed countries. The host country benefit as FDI creates employment opportunities, promotes growth and facilitates technology transfer (UNCTAD, 2004) [27].

In Nigeria, the promulgation of the Nigerian Enterprise Promotion Decree (NEPD) and the Indigenization Decree limited foreign equity participation to 60% and 40% in 1972 and 1977 respectively. However, the introduction of the Structural Adjustment Programme (SAP) in 1986 abated these policies. This led to the establishment of the Industrial Development Coordinating Committee (IDCC) in 1989 to facilitate the attraction of investment into the country.

Subsequently, the Nigerian Investment Promotion Commission (NIPC) Act No. 16 of 1995 was enacted as the successor to the Industrial Development Coordination Committee (IDCC); it repealed the IDCC Decree No 36 of 1989 as well as the Nigerian Enterprise Promotion Decree of 1989 to allow a foreigner to set up business in Nigeria with 100% ownership. Also, enacted along with the NIPC Act 16 of 1995 was the Foreign Exchange (Monitoring and Miscellaneous) Provisions Act 17 of 1995. Essentially, this Act guaranteed the unrestricted transferability of investment capital, profit and dividend through authorized institutions. With these two Acts, Nigeria's government demonstrated a clear determination to promote and encourage foreign private investment participation in the economy. Under these two regimes, government had effectively guided the operations of foreign investors in the economy and freely encouraged local entrepreneurs to flourish (Tumala, Ajibola, Omotosho and Baruwa 2011) [30].

Despite the efforts of successive government to encourage the inflow of FDI into the country, the macroeconomic environments have not been encouraging due to the negative effects of various country risk factors. The emergence of ethno-religious crises in some part of the country, militancy and vandalization of oil installations in the South-South, robbery in South-West, kidnapping in the South-East and heinous killing/bombing of innocent Nigerians in Northern Nigeria

(Daily Independent Online, 2010) [10]. Other manifestations of country risks in Nigeria include drug trafficking, human trafficking, human sacrifice, ritual killing, sectarian violence, political violence, communal strife, natural disasters and corruption. In fact, corruption in Nigeria is getting worse, as indicated by Transparency International (TI) in its corruption perception report. For instance, the 2013 corruption index revealed that Nigeria moved from 139th position in 2012 to 144th position out of 177th in 2013. The consequence of the various country risk factors is the daunting image of the country internationally as serious investors find it difficult to invest in Nigeria due to uncertainty as there is no guarantee of getting the desired return on their investment.

1.2 Statement of the Problem

Recent studies have shown that Foreign Direct Investment (FDI) is what is needed to bridge savings investments gap that exists in Africa in general and Nigeria in particular. Therefore, ever since the beginning of debt crises in 1980s Nigeria had paid considerable attention to FDI and has given a prominent role to policies that improve corporate environment and encourage foreign investors to attract foreign capital inflows into the country. Policies such as deregulation, liberalization, commercialization, investment promotion, privatization of some sectors and even the introduction of sustainable security measures such as the amnesty programme of 2007 among others.

However, the state of business, economic, infrastructures (such as roads, power, etc) and security in Nigeria is generally considered deficient and parlous. In fact, the current state of cases of insecurity such as killings, kidnappings in the eastern part of the country as well as terrorist attacks in the Northern part of Nigeria all have posed serious challenges to the peace and stability of Nigeria macroeconomic environment. Also, there is still high incidence of corruption and political tension in the country which further discourage foreign investors and the inflow of FDI. Reports show that capital imports into Nigeria in 2014 fell by $576.61 million, or 2.66 per cent, to $20.75 billion, down from $21.31 billion in the 2013 fiscal year (NBS, 2014) [20]. In fact, in October 2014, foreign investors pulled N101.2 billion from quoted equities on the Nigerian Stock Exchange which greatly affected the financial system (NBS, 2014) [20]. Also, Foreign Direct Investment in Nigeria decreased to 723.49 Million USD in the first quarter of 2015 from 1030.06 Million USD in the fourth quarter of 2014 (tradingeconomics, 2015) [35]. Therefore, it is imperative to consider the various factors responsible for the capital flight being experienced in the country such as the issue of corruption, insecurity, currency devaluation, inflation among others and their effects on foreign direct investment in the country.

1.3 Research Questions

In the light of the above problems, the study raised the following research questions:

1. What is the effect of corruption on FDI inflows in Nigeria?
2. Do inflationary volatility has any effect on FDI inflows in Nigeria?
3. What is the effect of exchange rate volatility on FDI inflows in Nigeria?
4. What is the effect of insecurity on FDI inflows in Nigeria?
5. Do political instability has any effect on FDI inflows in Nigeria?

1.4 Research objectives

The main objective of the study is to investigate the effects of country risks on FDI inflows in Nigeria. The specific objectives are to:

6. Evaluate the effects of corruption on FDI inflows in Nigeria;
7. Examine the effects of inflationary uncertainty on FDI inflows in Nigeria;
8. Investigate the short and long run effects of exchange rate volatility on FDI inflows in Nigeria;
9. Examine the effects of insecurity on FDI inflows in Nigeria; and
10. Assess the effects of political instability on FDI inflows in Nigeria.

1.5 Research Hypotheses

The following null research hypotheses were therefore, formulated:

Ho_1: There is no functional relationship between Foreign Direct Investment (FDI) and corruption in Nigeria.

Ho_2: There is no functional relationship between Foreign Direct Investment (FDI) and inflation uncertainty in Nigeria.

Ho_3: There is no functional relationship between Foreign Direct Investment (FDI) and exchange rate volatility in Nigeria.

Ho_4: There is no functional relationship between Foreign Direct Investment (FDI) and insecurity in Nigeria.

Ho_5: There is no functional relationship between Foreign Direct Investment (FDI) and political instability in Nigeria.

1.6 Justification of the Study

Many researchers have worked on various aspects of Foreign Direct Investment (FDI) in Nigeria such as Akinde and Yusuf (2014) [3]; Odubunmi and Agbelade (2014) [21]; Ndemi, Okoronkwo and Nwamuo (2014) [19]; Ugwuegbe, Modebe and Onyeanu (2014) [33]; Erhieyovwe and Onokero (2013) [13]; Opaluwa, *et al*. (2013) [26]; Adejumo (2013) [1]; Eravwoke and Eshanake (2012) [12]; Ogunmuyiwa (2012) [22]; Akinlabi, *et al*. (2011) [4]; and others.

However, in previous studies, not much attention has been given to the role of country risks in determining FDI trends in Nigeria. Most of the empirical investigation focused on the effect of FDI on Telecommunication, Manufacturing, Non-oil export and the Economic Growth in Nigeria. Though some studies adopted some country risks variables in their study, for instance, Akinde and Yusuf (2014) [3]; and Oriakhi and Osemwengie (2012) [32] included National security in their study; Udoh and Egwaikhide (2008) [29] and Omankhanlen (2011) [25] captured the effect of exchange rate volatility and inflationary uncertainty in their studies; Odubunmi and Agbelade (2014) [21], Erhieyovwe and Onokero (2013) [13], Ogunmuyiwa (2012) [22] and Akinlabi, Hamed and Awonoyi (2011) [4] applied corruption as a study variable nevertheless, none of the studies focused totally on country risk factors so as to reveal the depth and impact of various country risks on FDI

inflows into Nigeria. Therefore, a study which focuses on country risks holistically is considered necessary to provide a detailed understanding of the variables at work in the Nigerian context.

Knowledge of these findings would be helpful to various stakeholders such as the Central Bank of Nigeria (CBN), Deposit Money Banks, other Financial Institutions, Ministry of Finance, Ministry of Commerce and Industry, Federal and State Governments, etc.

Finally, the study will add to the existing and growing literature on the Foreign Direct Investment which can also serve as reference for future researcher interested in the subject matter.

1.7 Plan of the Study

With the introductory section, this study is presented in five sections: section two reviews various literatures relating to the effects of country risks on FDI in Nigeria as well as other important concepts. Section three deals with data, sampling and methodology applied in the study, section four provides results of the empirical research together with its discussion, while section five brings up conclusion and recommendations of the study.

2. Literature Review

2.1 Conceptual Framework

This section provides meaning to the concepts used in the study so as to provide specific clarifications as to the context in which they are used as well as a basis for a clear measurement of the study variables. The conceptual framework explains the various independent variables used to proxy country risk as well as Foreign Direct Investment (FDI), which is the dependent variable in the study. The concepts includes: The meaning of Foreign Direct Investment (FDI), Insecurity in Nigeria, Inflationary Uncertainty, Exchange Rate Volatility and Political Instability

2.1.1 National Insecurity

According to Oriaklin and Osemwengie (2012) [32] National security refers to a state where the unity, well-being, values, beliefs, democratic process, mechanism of governance welfare of the nation and her people are perpetually improved and secured through military, political and economic resources. In other words, the absence of continuous improvement in the socio-political and economic well-being of the people and states are tagged insecurity. Insecurity is not only limited to communal crisis, ethnic and religious violence, and political conflict but also include the presence of natural disasters such as floods, earthquakes etc. Insecurity and terrorism are serious challenges confronting Nigeria today. The level of insecurity and renewed hostilities by several groups in Nigeria has continued to pose a threat to the nation's economy and investment. High crime rate, religious, ethnic and political upheavals have not only caused the country death to the tune of several thousands, loss of properties worth several billions of naira and one of the worst international embarrassments ever recorded but also constitute an impediment to foreign direct investment flow into the country (Akinde and Yusuff, 2014) [3].

2.1.2 Corruption in Nigeria

According to Transparency International (2010), cited in Akinlabi, Hamed and Awoniyi (2011) [4] corruption is the abuse of entrusted power for private gain. Corruption is a value concept which broadly defined as immorality, moral debasement and depravity. Akinlabi, Hamed and Awoniyi (2011) [4] also describe corruption as consisting of several elements including deceit, trickery, cheating, intentional deception, dishonesty and the conscious premeditated action of a person or group of persons to alter the facts of a matter or transaction for the purpose of selfish personal gains.

The Transparency International index (CPI) rates countries on a scale of zero to 10, with zero for high levels of corruption and 10, low levels. The Index, which is closely watched by investors, economists, and civil society campaigners, is based on expert assessments and data from 17 surveys from 13 independent institutions, covering issues such as access to information, bribery of government officials, kickbacks in public procurement procedure, and the level of enforcement of anti-corruption laws.

The nature of corruption in Nigeria as Kolade (1999) and Ogboru (2009) cited in Erhieyovwe and Onokero (2013) [13] put it, such that corruptible transactions take place i.e. where award of government contracts which are grossly inflated by government officials to friends, their family members or even to themselves directly for self-enrichment at the expense of the populace and the nation. Transparency International, 2000 global report rated Nigeria as the 2nd most corrupt country on earth, among 89 countries in the world, using its corruption perception index (CPI). The spate of corruption in Nigeria necessitated the setting up of the Independent Corrupt Practices Commission and the Economic and Financial Crime commission in 2000 and 2003 respectively. In this study, we adopt corruption index as defined by transparency international for Nigeria.

2.1.3 Inflationary Rate

Inflation is the persistent and appreciable increase in the general price levels of goods and services unaccompanied by increase in production. In other words, it is a state in an economy where more money chases fewer goods. Inflation usually disrupts the tax system, and investors are usually unfavorably disposed to it because of money illusion. The level of inflation is positively correlated with its volatility. In fact, greater inflation volatility is consistent with higher inflation rates and hence increase uncertainty and discourages long-term investment (Romer, 1990) cited in (Omankhanlen, 2011) [25]. The study applied inflation rate volatility as a country risk variable. The inflationary volatility rate is computed using the continuous compounded growth rate formula which is given as:

$$INFRV = log\left(\frac{INFR_t}{INFR_{t-1}}\right)$$

2.1.4 Exchange Rate

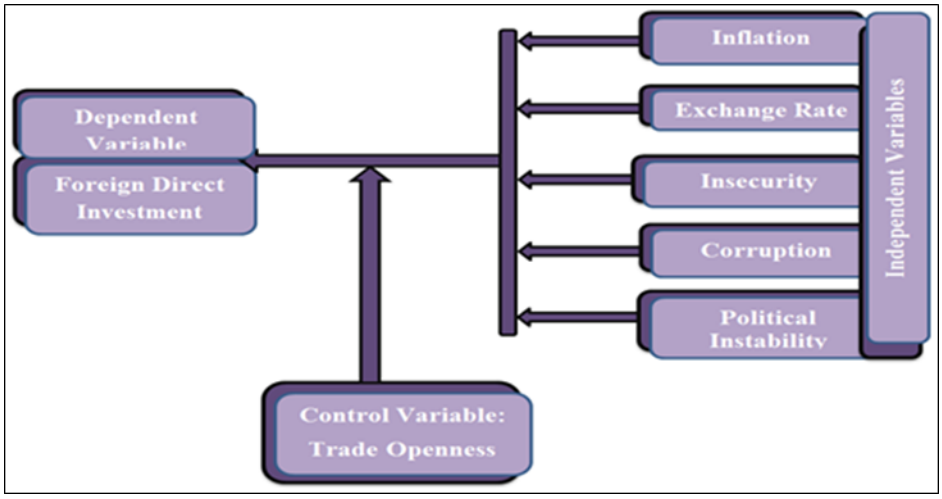
Exchange rate is the rate which is used to convert one currency to another. Exchange rate is important to inflow of foreign direct investment. An over-prized exchange rate will discourage exports and negatively affect foreign direct investment. The traditional theory treats real exchange rate as endogenous: The equilibrium level of real exchange rate is the one that ensures the equilibrium of the balance of payments

Calvo, Reinhart and Vegh, (1995) cited in (Udoh and Egwaikhide, 2008) [29]. Another aspect of exchange rate is its volatility which is defined as the risk associated with the unexpected movement in the exchange rate (Ozturk, 2006) [34]. In addition, it is the risk associated with currency depreciation or appreciation. Volatility is the day to day, month to month variability of exchange rate, a variability that may have no trend to it (Marston *et al*, 1988) cited in Chukwudi and Madueme, (2010) [8]. In other words, volatility is a high frequency concept referring to movements in the exchange rate over relatively short period of time. The study equally applied exchange rate volatility as the country risk variable. The exchange volatility rate is computed using the continuous compounded growth rate formula which is given as:

$$ERV = log\ (\frac{ER_t}{ER_{t-1}})$$

2.1.5 Foreign Direct Investment in Nigeria

Indexmundi (2015) [36] explained foreign direct investment as the net inflows of investment to acquire a management interest of at least (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. Also, FDI can be considered as the net outflows of investment from the reporting economy to the rest of the world and is divided by GDP. Adeoye (2009) [2], also, define FDI as the long term investment that reflects the objective of a lasting interest and control by a resident entity of one economy (the direct investor) in an enterprise that is resident in another economy. Report shows that Foreign Direct Investment in Nigeria averaged 1434.26 USD Million from 2007 until 2015, reaching an all-time high of 3084.90 USD Million in the fourth quarter of 2012 and a record low of 667.88 USD Million in the first quarter of 2007 (tradingeconomics, 2015) [35]



Source: Researchers' Illustration, 2017

Fig 1: Conceptual Framework on the effect of Country Risk on Foreign Direct Investment in Nigeria

2.2 Theoretical Underpinning

In an attempt to provide sound theoretical underpinning for the study, this study adopts the push and pull factor theories in order to explain the country risk factors on FDI in Nigeria.

2.2.1 Push factors Theory

The push factor theory attributes the direction of capital flows to what happens on the international front such as a fall in international interest rates, business cycles in industrial countries and a rise in international diversification (Calvo and Reinhart, 1998) cited in (Udoh and Egwaikhide 2008) [29]. The theory explains that the development has important implications for the sustainability of foreign investment and hence, policy design. For example, if it is lower interest rate that is the driving force for the upsurge in capital flows to developing countries, it means that a reversal in such rates would threaten the sustainability of capital flows.

2.2.2 Pull factors Theory

(Calvo, *et al*, 1996) cited in Udoh and Egwaikhide (2008) [29] described pull factors theory as sources of capital flows to domestic factors. These include domestic factors such as autonomous increases in domestic money demand and increases in the domestic productivity of capital, improvement in external creditor relations, adoption of sound fiscal and monetary policies and neighborhood externalities. Also, pull factors include among others, domestic factors, macroeconomic performance, the investment environment, infrastructure and resources and the quality of institutions. However, a reversal in the aforementioned factors could reduce the inflow of foreign direct investment in a country. This is corroborated by Rogoff and Reinhart (2003) cited in Udoh and Egwaikhide (2008) [29] that most African countries tend to be less open than other emerging markets because they are perceived as very risky and are characterized by poor policy Environment relative to other developing countries. Thus, high incidence of regional conflicts, high and volatile rates of inflation, as well as frequent currency devaluation is responsible lagging behind of African countries in attracting FDI.

The pull factor theory is also in line with the Country Risk Hypothesis formulated by Calver, (2013) [7] that country risk directly affects returns on investment, cost of business, and the repatriation of capital. The hypothesis states that if a country

has a high degree of risk then it will have a low amount of FDI, similarly if a country has a low degree of risk then it will have a higher relative amount of FDI.

2.3 Empirical Studies

This study examined the empirical analysis and findings of scholars on some country risks variables such as national security, inflation, exchange rate, corruption and political instability on FDI. Also, the study considered the effect of FDI on manufacturing, non-oil sector and telecommunication in Nigeria. First of all, Akinde and Yusuf (2014) [3] examined the implication of Ineffective National Security Administration on Foreign Direct Investment (FDI) in Nigeria. The research work used time series data spanning from the period 1980-2011 from the Crime Statistics and Central Bank of Nigeria Statistical Bulletin. The methodology adopted was Error Correction Model (ECM). The study revealed that the proxies of insecurities represented by armed robbery and murder have inverse relationship and significant shock on the inflow of foreign direct investment. Similarly, Oriaklin and Osemwengie (2012) [32] examined the relationship between FDI and National security covering the period of 1980 to 2009. The study employed Least Squares technique in its analysis of Defense and Security Vote (DSV) amount in the budget was used as a proxy for National security. The findings revealed that there is a negative relationship between FDI and National security.

In addition, Odubunmi and Agbelade (2014) [21] investigated the causality between corruption and economic growth in Nigeria. The study applied a time series data, covering the period between 1990 and 2010. The methods of analysis were Johansen cointegration test, ADF unit root test, Granger causality test and Ordinary Least Square. The result revealed that economic growth and other variables such as government expenditure (GOV), foreign direct investment (FDI), Gross capital formation (GCF) has significant relationship with corruption, thus indicating that corruption exhibited a positive relationship with economic growth (GDP). Likewise, Akinlabi, Hamed and Awoniyi (2011) [4] studied the causality and effect of corruption on the foreign direct investment inflow to Nigeria. The paper employed Granger causality test and Ordinary Least Square method. The data used were purely time series (secondary) data, covering 1990 to 2009. The sources of these data are Central Bank of Nigeria Statistical Bulletin and the Federal Bureau of Statistics. The methods of analysis were Johansen cointegration test, ADF unit root test, Granger causality test and Ordinary Least Square. The OLS result showed that there is an inverse significant relationship between FDI inflow and corruption in Nigeria

Similarly, Ogunmuyiwa (2012) [22] analysed the influence of corruption on Foreign Direct Investment (FDI) from two contending hypotheses-the efficiency enhancing hypothesis and the efficiency reducing paradigm. A time series data from 1980-2009 using various econometric techniques such as ADF unit root test, the Engel and Granger Co-integration method and the Dynamic Error Correction Mechanism. The findings revealed that corruption is negatively related to FDI in Nigeria but the result was not significant. In addition, Erhieyovwe and Onokero (2013) [13] studied corruption, foreign direct investment and its impact on exchange rate of the Nigerian economy. The study applied ordinary least squares regression analyses, augmented dickey fuller unit root test and the co-integration test. The short run result revealed that corruption is very high and significant on FDI in Nigeria and that it is responsible for depreciation in the currency of Nigeria with regards its exchange rate to other currencies.

Moreover, Opaluwa, Abdullahi, Abdul, Okpanachi and Edogbanya (2013) [26] examined the effect of Foreign Direct Investment (FDI) on the growth of the telecommunications sector in Nigeria covering the period from 1997 – 2011. The methodology adopted in the study was Ordinary Least Square (OLS). The result of study showed that FDI has positive effect on the productivity of the telecommunications sector and it is statistically significant. Similarly, Adejumo (2013) [1] examined the relationship between foreign direct investment and the value added to the manufacturing industry in Nigeria. The study covered the period between 1970 and 2009 applying autoregressive lag distribution technique. The study discovered that in the long-run, foreign direct investments has a negative effect on the manufacturing sub-sector in Nigeria. However, Olayiwola and Okodua (2013) [24] examined the contribution of Foreign Direct Investment (FDI) to the performance of non-oil exports in Nigeria within the framework of the export-led growth (ELG) hypothesis. The output generated from the causality analysis showed that a unidirectional causality exists between FDI and non-oil exports. The results also show that an encouragement of non-oil exports is a necessity for an effective FDI in Nigeria.

Furthermore, Eravwoke and Eshanake (2012) [12] assessed the direction of causality between foreign direct investment and Economic growth in Nigeria. They applied an exploratory research design that involves a combination of Augmented Dickey Fuller (ADF) unit root test, and the Granger causality test. The findings revealed that economic growth (GDP) Does not granger cause Foreign Direct Investment (FDI) in Nigeria. Likewise, Ogbonna, Uwajumogu1, Nwokoye and Nzeribe (2012) [37] investigated the empirical relationship between FDI and economic growth in Nigeria. Secondary data source were used from CBN publications using OLS and granger causality regression method of analysis covering the period between 1986 and 2010. The findings revealed that there is no relationship between FDI and economic growth in Nigeria. The result of the granger causality test however showed a bi-directional causality between FDI and GDP which was used to proxy economic growth in Nigeria.

Similarly, Okon, Augustine and Chuku (2012) [23] investigated the relationship between foreign direct investment and economic growth in Nigeria between 1970 and 2008. The findings showed that (both single and simultaneous equation models) provide evidence that suggest that there is a bi-directional relationship between economic growth and FDI inflows to Nigeria. This implied that FDI and economic growth are jointly determined in Nigeria and there is positive feedback from FDI to growth and from growth to FDI. Also, Ndemi, Okoronkwo and Nwamuo (2014) [19] investigated the determinants of foreign direct investment and their impact in Nigerian economy from 1975 to 2010. They applied Ordinary Least Square (OLS) and co-integration Error Correction Method (ECM) in their analysis and discovered that Market Size (GDP), openness, and exchange rate impact much on FDI inflow while political risk was unfavorable to it. Also they

discovered that infrastructure was favorable but its level is inadequate to improve FDI required for sustainable growth and development in Nigeria.

Moreover, Udoh and Egwaikhide (2008) [29] examined the effect of exchange rate volatility and inflation uncertainty on foreign direct investment in Nigeria. The investigation covered the period between 1970 and 2005. The analysis was conducted using GARCH model. The results indicated that exchange rate instability and inflation uncertainty had significant negative effect on foreign direct investment during the period. Likewise, Omankhanlen (2011) [25] examined the effect of exchange rate and inflation on foreign direct investment and its relationship with economic growth covering a thirty year period. A linear regression analysis was applied. The study revealed that Inflation has no effect on FDI. However exchange rate has effect on FDI. Similarly, Chukwudi and Madueme (2010**)** [8] examined the impact of Dollar/Naira exchange rate volatility on FDI in Nigeria. Time series data was compiled from Central Bank of Nigeria Statistical Bulletin [9] for a period of 39 years. The study applied ARCH based measure of nominal exchange rate volatility and found that exchange rate volatility as a result of depreciation of the currency of the host country, Nigeria, attracts FDI, while volatility as a result of appreciation of the host country's currency discourages FDI.

Kolo, Aminurraasyid and Tapiwa (2017) [31] also investigated the consequences of political risk on FDI in Nigeria. Secondary data from 2000 to 2014 were analyzed using simple linear regression. The study combined from select variables, the institutional factors with location determinants peculiar to Nigeria's risk environment and found that political risk holds a positive and significant association with FDI to Nigeria but not close enough to hinder the inflow of foreign investment into the country.

Finally in Nigeria, Ugwuegbe, Modebe and Onyeanu (2014) [33] investigated the impact of FDI on capital accumulation in Nigeria covering the period between 1986 and 2012. The data was obtained from CBN statistical bulletin using OLS method of estimation, ADF test and ECM. The findings revealed that in the long-run all the variables included in the model has a positive impact on GFCF with only FDI and TCR exerting a significant impact on capital accumulation in Nigeria for the period under review.

The study also considered some literatures from other countries on the issue of Foreign Direct Investment. To start with, Lee (2016) [17] explores whether terrorism reduces foreign direct investment (FDI) inflows and argues that foreign investors adjust their information by observing whether the host country has the capability to deal with terrorism. The research work used terrorism data sets and drew from a time-series cross-sectional data analysis. It was found that while terrorism can be an obstacle to FDI inflows, countries that receive more counterterrorism aid are less vulnerable to this adverse effect. Moreover, such assistance alleviates the undesirable effects of terrorism on FDI as it sends a similar message to foreign investors.

Anyanwu and Yameogo (2015) [5] analyzed factors affecting foreign direct investments (FDI) to West Africa using a panel dataset from 1970 to 2010. The study employed the OLS and GMM techniques for its estimations. The results indicate that there is a U-shaped relationship between economic development and FDI inflows to West Africa. It was reported that the real per capita GDP, domestic investment, trade openness, first year lag of FDI, natural resources (oil and metals) endowment and exports, and monetary integration have positive and significant effect on FDI inflows to West Africa; however, there is a negative relationship between FDI inflows to the sub-region and second-year lag of FDI, economic growth, level of economic development (real GDP per capita), and life expectancy.

The next section deals with method of analysis and presentation of result

3. Methodology

3.1 Research Design

This study empirically investigated the effect of country risks on FDI inflows in Nigeria covering a period of 36 years (1980-2016). Secondary data obtained from 2016 Central Bank of Nigeria (CBN) statistical Bulletin[9] various issues and Transparency International index (CPI) was used in the study. The study therefore, applied a causal research design method.

3.2 Methods of Data Analysis

The paper initially conducted a preliminary analysis which includes unit root test and lag selection criteria. Subsequently, econometric techniques of Error Correction Model were used in establishing the degree of relationship between the dependent and independent variables. Also, residual diagnostic test such as serial correlation test and normality test were also applied to establish the reliability of the OLS model used in the study. All the techniques were applied using E-Views 9.0 econometric package.

3.3 Empirical Model

To examine the effect of country risks on FDI inflows in Nigeria, the study estimated the model below which was adopted and modified from Mambo and Muturi (2013) [18] for the time series data analysis. The period before and after the structural adjustment programme of 1986; that is from 1980 to 2016 were chosen because according to Jerome and Ogunkola. (2004) [16] the period was characterized by intense political conflicts, corruption, insecurity, exchange rate volatility as well as inflationary uncertainty that paralyzed every sphere of the Nigerian economy. Also it was chosen based on the availability of data and because the period is long enough to provide the desired result for the study. The empirical model is based on the pull factor theory which is also in line with the country risk hypothesis formulated by Calver, (2013) [7] The hypothesis underpinned the model below that high country risks are associated with low Foreign Direct Investment (FDI) vice versa. Considering the original model from Mambo and Muturi (2013) [18] two additional variables were adopted. They are political instability and trade openness used as the control variable in the model.

$$FDI = F(COR, INFRV, ERV, INS, PINS, OPEN) \quad \ldots\ldots (1)$$

$$FDI = \alpha_0 + \beta_1 COR + \beta_2 INFRV + \beta_3 ERV + \beta_4 INS + \beta_5 PINS + \beta_6 OPEN + \xi \quad \ldots\ldots (2)$$

When transformed into a log form equation 2 becomes:

$$\text{Log } FDI = \alpha_0 + \beta_1 COR + \beta_2 INFRV + \beta_3 ERV + \beta_4 \text{LogINS} + \beta_5 PIS + \beta_6 OPEN + \xi \quad \ldots\ldots (3)$$

The apriori theoretical expectations for these parameters are as follows:

$\beta_1 < 0; \beta_2 < 0; \beta_3 < 0; \beta_4 < 0; \beta_5 < 0; \beta_6 > 0$……..(4)

Where:

FDI = Foreign Direct Investment

COR = Corruption proxy by (Transparency International Corruption Index (CPI) for Nigeria).

INFRV = Inflationary Rate Volatility

ERV = Exchange Rate Volatility

INS = Insecurity proxy by (Defense and Security Vote in the National Budget)

PINS = Political Instability (Captured by Dummy Variables of 0 and 1)

OPEN = Country's Openness (Ratio of Export to Import Multiplied by GDP)

By stating the error correction model (ECM) from equation (3), the model becomes:

$\Delta \log FDI = B_0 + B_1 \sum COR_{t-1} + B_2 \sum INFRV_{t-1} + B_3 \sum ERV_{t-1} + B_4 \sum LogINS_{t-1} + \beta_5 \sum PIS_{t-1} + \beta_6 \sum OPEN_{t-1} + \sum ECM + \sum_t$ (5)

$\sum ECM$=error correction term

t-1=variable lagged by one period

$\sum_t$=white noise residual

Table 1: Apriori Expectations on Country Risk Factors Relationship with FDI

Variables	Relation with FDI	Supporting Scholars
COR	-	Odubunmi and Agbelade (2014) [21]; Ogunmuyiwa, (2012) [22]; Asien and Oriavwote (2013) [39]
INFRV	-	Asien and Oriavwote (2013) [39]; Omankhanlen (2011) [25]
ERV	-	Udoh,and Egwaikhide, (2008) [29], Omankhanlen (2011) [25]
INS	-	Oriaklin and Osemwengie, (2012) [32]; Chukwudi, and Madueme, (2010) [8]
PINS	-	Udoh, & Egwaikhide, (2008) [29].
TRADE OPEN	+	Udoh, and Egwaikhide, (2008) [29].

Source: Author's Research, 2016

Note: The log of FDI, and INS were taken to give equal weight to all the observations since they were presented in Million (Naira) while other variables were presented in percentages and ratios. This is to avoid serial auto correlation given that the data covered a long period of 36 years.

4. Analysis of data collected

This session captured data analysis, presentation, and discussions of the results. These include Unit Root Test, Volatility Test, Lag Selection, Cointegration Test, Fully Modified Ordinary Least Square (OLS), Error Correction Model, residual tests as well as discussion of findings.

4.1 Unit Root Test

In modeling the country risks equation, the paper examined each series entering the model to determine whether it is stationary and its order of integration. The results of the Augmented Dickey-Fuller(ADF) and Philip Peron Test (PP) unit root test show that all the variables were non-stationary in levels 1(0) since the ADF and PP value of each variable at level is less than the MCKinnon critical value but became stationary at first difference or integrated of order one 1(1) and 1(2). See table 2 and 3 below.

Table 2: The results of Augmented Dickey-fuller test (ADF) for unit root

Variables	ADF Calculated Value at Level	ADF Calculated Value at 1st Difference	ADF Calculated Value at 2st Difference	McKinnon at Critical Value	Order of Integration
LFDI*	-0.541989	-8.393035	-	-3.670170	1(1)
LDSV**	-0.929322	-2.316565	-6.338343	-3.689194	1(2)
CI*	-0.541989	-6.411762	-	-3.646342	1(1)
INFRV *	-2.811741	-5.428971	-	-3.653730	1(1)
ERV*	-0.139633	-5.446852	-	-3.646342	1(1)
INS*	-1.424728	-5.567764	-	-3.646342	1(1)
OPN*	-1.779207	-7.332712	-	-3.646342	1(1)

Source: Author's Computation, 2017

Note: *Significant at 1 per cent level of significance, **Significant at 5 per cent level of significance

Table 3: The results of Philip Peron Test (PP) for unit root

Variables	PP Calculated Value at Level	PP Calculated Value at 1st Difference	PP Calculated Value at 2st Difference	McKinnon at Critical Value	Order of Integration
LFDI*	-0.518667	-9.040987	-	-3.670170	1(1)
LDSV*	-0.906915	-6.183156	-	-3.646342	1(1)
CI*	-0.298255	-6.665272	-	-3.646342	1(1)
INFRV *	-2.810822	-10.72446	-	-3.646342	1(1)
ERV*	-0.154286	-5.446852	-	-3.646342	1(1)
INS*	-1.491859	-5.567764	-	-3.646342	1(1)
OPN*	-1.681570	-7.391939	-	-3.646342	1(1)

Source: Author's Computation, 2017

Note: *Significant at 1 per cent level of significance, **Significant at 5 per cent level of significance

4.2 Optimal lag Length Selection

Vector Autoregressive, VAR, is used to determine the optimal lag length for the Johansen co-integration test which is based on the AIC criterion as shown in table 4 From the result, the optimal lag length is 2 according to AIC and which is consistent with most of the other criteria. Using this optimal lag length, the likelihood ratio test which depends on the Maximum Eigen values of the stochastic matrix of the Johansen (1991)[38] procedure for exploring the number of cointegrating vectors was used.

Table 4: Selection of Optimal Lag Length

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-273.0756	NA	77.40953	18.53837	18.77190	18.61308
1	-150.9350	195.4249	0.122490	12.06234	13.46353*	12.51059
2	-118.3746	41.24316*	0.086115*	11.55831*	14.12717	12.38011*
3	-94.78974	22.01257	0.146292	11.65265	15.38918	12.84800

Source: Author's Computation, 2017

4.3 Co-integration Test Result

Since the unit root test shows that the variables are stationary at first order difference 1(1), we therefore test for co-integration among these variables. Cointegration may occur when a linear combination of variables that are I (1) produces a stationary series, and then the variables may need to be cointegrated (Engle and Granger, 1987) [11]. This means that a long-run relationship might exist between them, which connotes that they might wander from one another in the short-run but in the long-run they will move together. In view of this, we needed to establish whether there is a long-run relationship among the variables or not hence, we applied the Cointegration test using Johansen's multivariate method. See Table 5 below.

Table 5: Johansens's Multivariate Cointegration Test

Hypothesized No of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.970545	163.5715	125.6154	0.0000	63.44811	46.23142	0.0003
At most 1 *	0.934208	100.1234	95.75366	0.0242	58.98254	40.07757	0.0039
At most 2	0.687402	94.14088	69.81889	0.0076	40.93108	33.87687	0.0493
At most 3	0.578287	60.20981	47.85613	0.0082	35.54176	27.58434	0.0543
At most 4	0.329931	14.66805	29.79707	0.8011	7.206739	21.13162	0.9453
At most 5	0.309283	7.461310	15.49471	0.5247	6.660444	14.26460	0.5300
At most 6	0.043517	0.800866	3.841466	0.3708	0.800866	3.841466	0.3708

Source: Author's Computation, 2017. Trace test indicates 4 cointegrating eqn (s) at the 5% level Max-eigen value statistics indicates 4 cointegrating eqn(s) at the 5% level

The conclusion drawn from the results is that there exists four (4) unique long run relationship between FDI, Inflation, Exchange Rate, Corruption Index, Political Instability and Trade Openness.

4.4 Presentation of Error Correction Model

The study estimated the short-run dynamics within the error correction model in order to capture the speed of adjustment to equilibrium in the case of any shock to any of the independent variables. The study therefore, introduced two lags into the equation specification based on Akaike and Schwarz information criteria to select the appropriate lag length as we earlier discussed in Table 4 However, variables with huge probabilities were removed to obey the rule of having a parsimonious model and also the adjustment helped in making the lagged ECM (-1) negative and statistically significant. The result of the overparameterize ECM result is shown see Table 2 in the appendix. The result of the parsimonious (preferred) ECM is shown in Table 6 below.

Table 6: Parsimonious Error Correction Model

Dependent Variable: FDI			
Variable	Coefficient	T-Statistic	Prob.
D(DSV)	0.376137	2.123194	0.0452
D(CI(-2))	-0.479646	-1.942811	0.0549
D(ERV(-1))	-0.006422	-0.720497	0.4788
D(INFRV(-1))	-0.009521	-1.905794	0.0698
D(OPEN)	2.356725	2.816433	0.0101
D(PINS(-1))	-0.695517	-1.279958	0.0139
C	0.257133	2.715129	0.0126
U(-1)	-0.701669	-4.448877	0.0002
R-squared	0.647284		
Adjusted R-squared	0.535056		
F-statistic	5.767581	Durbin-Watson	2.201453
Prob (F-statistic)	0.000691		

Source: Author's Computation, 2017.

4.4.1 Interpretation of the Result

The ECM result on (table 6) above disclosed that the estimated coefficient of Trade Openness D (OPEN) and Defense Security Vote (DSV) are positive. The positive sign on the coefficient established that each of these variables are positively related to Foreign Direct Investment (FDI) in Nigeria. This implies that for every 1% increase in Trade Openness D (OPEN) and Defense and Security Vote (DSV) will cause Foreign Direct Investment (FDI) in Nigeria to increase by 236% and 38% respectively. This result is in order with the economic a priori condition except Defense and Security Vote (DSV) as earlier discussed. The study revealed that Trade Openness D (OPEN) and Defense and Security Vote (DSV) are significant at 5% level of significance.

Also, the estimated coefficient for Corruption Index D (CI), Exchange rate Volatility D (ERV), Inflationary Volatility D (IRV) and Political Instability D (PS) are negative. The negative sign implied that there is an inverse change in the FDI which means that for every 1% increase in Corruption Index D (CI), Inflationary Volatility D (INFRV), Exchange Rate Volatility D (ERV), and Political Instability D (PS) will cause Foreign Direct Investment (FDI) to reduce by 84%, 0.95%, 0.64%, and 70% respectively. However, Political Instability D (PS) and Corruption Index are statistically significant at 5% level of significance while Inflationary Volatility D (INFRV) and Exchange rate volatility D (ERV) are not statistically significant at 5%. In a nutshell, four variables out of the six explanatory variables used in the model are statistically significant.

The parsimonious ECM model further showed that the coefficient of error correction mechanism (ECM) is negative -0.701669 and significant at 1% critical level as evident by the low probability value of 0.0002. This shows that about 70% disequilibria in the explanatory variables in the previous year are corrected in the present year. The importance of the ECM is an indication and a confirmation of the existence of a long run equilibrium relationship between Foreign Direct Investment (FDI) and some of the explanatory variables.

4.4.2 Reliability and Residual Test on ECM

The diagnostic aspect of the result revealed that Durbin-Watson was 2.201453 which is close to 2; implied the absence of first order autocorrelation in the regression model (Field, 2005) [14]. Therefore, we can make valid prediction(s) with the equation. Moreover, the coefficient of multiple determinations - R-squared is 0.647284 which showed that 65% of the variation in Foreign Direct Investment (FDI) in Nigeria was caused by the variations in the explanatory variables as explained by the model. This showed that about 35% change in the dependent variable was caused by other variables not found in the equation but measured by the error term. The F-statistics of 5.767581 is significant at 1 percent level of significance; hence the model was of good fit.

To authenticate the reliability of the result, normality test, serial correlation test and Heteroskedasticity Test were conducted. Jacques Bera (JB) statistic is computed from skewness and kurtosis statistics to determine whether the series is symmetrically (normally) distributed or not. The normality test using Jacques Bera statistic is distributed and based on the null hypothesis of skewness = 0 and kurtosis is equal to "3" (Jarques and Bera, 1987) [28] or -3 and +3 (Asika, 2006) [6]. The Jarque-Bera test revealed 0.851633 which is not significant at 5% level of significance. This implied that the error term of the regression analysis is normally distributed (see table 7) below. Also, the R^2 is also less than the Durbin-Watson statistic meaning that ECM model is good.

Table 7: Normality Tests of Residual

Jarque Bera	Probability
0.321198	0.851633

Source: Authors' Computation, 2017

In addition to these, the serial correlation test of 0.5100 is also not significant at 5% which indicated that the error term is also not serially correlated see (table 8).

Table 8: Breusch-Godfrey Serial Correlation LM Test

Obs*R-squared	2.112734	Prob. Chi-Square(2)	0.3477

***Source*:** Authors' Computation, 2017

Also, the study conducted heteroskedasticity test which is basically on the variance of the error term. The test helps to ascertain whether the variance of the error term is constant of not (Gujuarati 2004)[15]. Heteroskedasticity Test is not significant at 5% level of significant meaning that error term have a constant variance and there is no heteoskedasticity problem in the model see Table 9. Overall, the stability of the parameters from the ECM is remarkable, considering the great number of economic reforms implemented during the analyzed period.

Table 9: Breusch-Godfrey Heteroskedasticity Test

Obs*R-squared	3.100252	Prob. Chi-Square(7)	0.8756

***Source*:** Authors' Computation, 2017

Table 10 below provides a snap shot of the summary of findings of hypotheses Ho_1 to Ho_5 which state that there is no functional relationship between the dependent variable (Foreign Direct Investment (FDI) and the specified independent variables: (corruption, inflation uncertainty, exchange rate volatility, insecurity and political instability).

Table 10: Findings on Hypothesis Ho_1 to Ho_5

Hypotheses	Variables	Findings	Decision
Ho_1	There is no significant relationship between corruption index (CI) and FDI inflows in Nigeria	**Significance**	**Reject**
Ho_2	There is no significant relationship between inflationary Volatility (IRV) and FDI inflows in Nigeria	Not Significance	Accept
Ho_3	There is no significant relationship between exchange rate volatility (ERV) and FDI inflows in Nigeria	Not Significance	Accept
Ho_4	There is no significant relationship between Insecurity (DSV) and FDI inflows in Nigeria	Significance	Reject
Ho_5	There is no significant relationship between Political Instability(PI) and FDI inflows in Nigeria	Significance	Reject

***Source*:** Researcher's Design, 2017

Table 10 above concluded the ECM Section used in examining the short run effects of the country risks factors on FDI in Nigeria. The findings show that the Null hypotheses Ho_1, Ho_4, and Ho_5: are all rejected and there alternative hypothesis were accepted while Ho_2, and Ho_3 were accepted and alternative hypothesis rejected.

4.5 Implication of Findings

From the regression results discussed above, some findings and implications can be highlighted. First, the cointegration test shows the existence of a unique long-run relationship between Foreign Direct Investment and the specified independent variables with four cointegrating equations. The study further estimated the short-run dynamics within the Error Correction Model (ECM) and the result revealed that three variables namely: Corruption Index (CI), Insecurity (DSV) and Political Instability (PIS) significantly affect Foreign Direct Investment (FDI) while Inflationary uncertainty and exchange rate volatility do not significantly affect (FDI). The negativity and significant value of the ECM lag showed that there is an existent of long run relationship between FDI and the specified independent variables.

Considering the significant variable; Corruption (CI) has a significant relationship a negative coefficient of -48%. In line with the findings from this paper corruption has a significant effect on Foreign Direct Investment (FDI) within the period covered by the study and this is in line with the work of Odubunmi and Agbelade (2014) [21]; Erhieyovwe and Onokero (2013) [13] as well as Akinlabi, Hammed and Awoniyi (2011) [4]. However, Ogunmuyiwa (2012) [22] had different view that corruption is insignificant on FDI in Nigeria. It is clear that FDI in Nigeria has been on a low rise because investors are skeptical about their investment in the country as successive government have failed to clap down corruption, thus the issue has been a major challenge in the country.

Similarly, the study adopted defense and security vote as a proxy for National Security because National Security cannot be capture in quantitative term. Defense and Security Vote (DSV) are significant with a positive coefficient 37%. This finding is also in line with the work of Oriaklin and Osemwengie (2012) [32] that Insecurity does not significantly affect foreign direct investment in Nigeria. As a misguided solution to the multifarious crises of national security, the government has consistently increased the annual fiscal allocation to internal security and defense within the period under study. Therefore, the annual increase in the Defense and Security Vote (DSV) has continued to encourage the inflow of FDI into the country. The annual increment in the (DSV) means that there are serious security challenges in the country within the period covered by the study. Also, the expenditure pattern of government on the security sector reflects the amount of security in place and the perception of government about the weight of security issues in Nigeria (Otto and Ukpere, 2012 cited in Oriaklin and Osemwengie 2012) [32].

The study therefore went ahead to examine the effect of exchange rate volatility on FDI within the period covered in the study. The findings thus revealed that exchange rate volatility has a negative insignificant coefficient value of -0.64%. The short run insignificant negative value is in line with the findings of Omankhanlen (2011) [25] and Chukwudi and Madueme (2010) [8] and contrary to the outcome of Udoh and Egwaikhhide (2008) [29]. The negative coefficient of the exchange rate volatility on FDI is not surprising. This is because exchange rate is a price and therefore its movements affect resource allocation in the economy. The exchange rate has been highly volatile and uncertain, in Nigeria since the adoption of a market determined exchange rate in 1986 (Udoh and Egwaikhhide, 2008) [29]. However, the regression result revealed that, inflationary volatility does not have any significant effect on FDI. This finding is related to the work of Omankhanlen (2011) [25].

Finally, the study examined the effect of Political Instability (PI) on Foreign Direct Investment (FDI) in Nigeria. The coefficient of the political instability dummy also has negative sign in all the regressions The findings showed that Political Instability (PI) is significant with a coefficient of -253% and -69% respectively. This finding revealed that political instability has the highest coefficient in the model. As expected, the overall impact of the intermittent political unrests as well as the long years of military rule in the country over the covered period hindered the inflow of FDI into the country. The result is corroborated with the findings of Ndemi, *et al*, (2014) [19]. However, the study is contrary to the finding of Kolo *et al* (2017) [31] who obtained a positive significant relationship.

Generally, country risk factors can be considered within the context of pulled factor theory which states that domestic issues is the main determinant of foreign direct inflow of investment. According to (Calvo, *et al*, 1996) cited in Udoh and Egwaikhide (2008) [29] and Rogoff and Reinhart (2003) cited in Udoh and Egwaikhide (2008) [29] pull factors tends to fail when a country is characterized by poor policy environment, high incidence of regional conflicts, high volatile rates of inflation and exchange rate as well as political instability which is responsible for the lagging behind of most African countries including Nigeria in attracting FDI. Therefore, the implication of the findings is that country risk factors are responsible for the recent capital flight and decline in FDI inflow been experienced in the country which is working against the pulled factor theory expected to increase the inflow of FDI in to the country.

5. Conclusion

This paper has empirically examined the effect of country risk on Foreign Direct Investment (FDI) in Nigeria. The estimated model takes into consideration several country risk variables affecting the inflow of foreign investment in accordance with the literature. The findings reveled that corruption, insecurity, exchange rate, political instability are the country risk factors affecting the inflow of Foreign Direct Investment (FDI) in Nigeria. It is also worthy of note to state that political instability account for the highest coefficient and implication for the low inflow experienced within the sampled period. For future studies variable that really captured national insecurity like the crime rate or crime perception rate should be incorporated to reveal a better result and other country risk factors such as unemployment are included.

5.1 Recommendations

In the light of the above, the following recommendations are made in line with the results generated from the study:

Firstly, the government should intensify her efforts in fighting

the war against corruption or totally declare a state of emergency on corruption. This will enhance the image of the Nigerian economy and encourage more foreign investors in to the country. Nigerian government can achieve the war against corruption by strengthening and granting of autonomy to the anti-graft agencies such as the economic and financial crime commission (EFCC) and the independent corrupt practice and related offences commission (ICPC) to vigorously fight corruption in the country. Similarly, in line with the recommendation given by Akinlabi, Hamed, and Awoniyi, (2011) [4], Nigeria's legal and judicial system should be reviewed and restructured to handle swiftly the cases of people that are engaged in corrupt practices. Also, there should be incentive for patriotic and honest citizens as well as protection of whistle blowers in the country.

It is also recommended that since the nominal effective exchange rate is relatively under the control of monetary authority in Nigeria, therefore, efforts must be intensified or made to ensure that monetary policies targeted towards stability in exchange rate is formulated or maintained in order to stem any inflationary tendencies and provide a predictable exchange rate which can attract the inflow of FDI to the economy.

It is also recommended that key actors in policy formulation as well as government at all levels should adopt an holistic approach to tackling the state of insecurity in the country by embedding the culture of accountability and transparency in the utilization of funds and other resources allocated to security sector especially in the aspect of procurement of military equipment and other logistics to combating issues of insecurity and insurgency in the country. Also, there should be continuous collaboration with the regional as well as neighboring countries in battling the issues of insurgency in the sub-region. Also, the federal government should continually seek technical supports and assistance in the areas of intelligence and capacity building for the military personnel from developed countries.

It is finally recommended that the government can increase the inflow of FDI by ensuring that they maintain and stabilize the democratic system of government currently been practiced as well as reduce the incidences of political violence in the country especially during election periods as this will promote investment stability, reduce capital flight and also encourage new FDI inflow in to the country.

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