INSTITUTIONAL QUALITY AND FOREIGN DIRECT INVESTMENT IN NIGERIA: An ARDL Approach.

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Abstract
The study investigates the impact of institutional quality on foreign direct investment (FDI) in Nigeria for the period 1986 to 2019. This study tends to ascertain if there is a relationship between institutions and FDI and if so, is it a short run or long relationship. The study employed the ARDL Co-integrating Bound test to show if the variables are cointegrated while the ARDL estimation technique was used to ascertain its short run and long run relationship. the findings show that political instability, corruption index, terrorism index negatively and significantly affect the inflow of FDI in both the short run and long run. While voice and accountability, rule of law, government effectiveness, gross fixed capital formation and trade openness positively and significantly impact on FDI both in the short run and long run. The study recommends that government should maintain high quality institutions in the country at all costs for effective inflows of FDI and the growth of the economy.
Keywords: Institutions, FDI, ARDL, Nigeria

I. INTRODUCTION

Globally, inappropriate regulation of institutions or absence of institutional control has resulted to extra costs to the willingness to invest in Sub-Sahara Africa countries (SSA) like Nigeria (Iyoboyi, & Pedro, 2014). The high costs associated with investing, along with the uncertainty associated with weak enforcement of regulations and ineffective legal systems, has progressively forced firms to be progressively discriminatory as to where to invest. Anna (2018) asserted that institutional quality in Nigeria had over the years been recorded poorly as the degree of property rights protection, degree to which laws and regulations were not fairly applied due to unfavourable level of corruption, voice and accountability, political instability, terrorism, and government effectiveness. Worldwide government indicator (2019) reported that out of 100% expected international rank for political stability and absence of violence across countries of the world, Nigeria's political stability and absence of violence stood at 2.84% in 2010, 3.32% in 2011, 3.32% in 2012, 3.79% in 2013, 5.24% in 2014, 6.19% in 2015, 6.19% in 2016, 5.24% in 2017, 4.76% in 2018 and 5.24% in 2019. Worldwide government indicator (2019) also reported that the control of corruption was ranked low in Nigeria as its level of corruption control stood at 15.24% in 2010, 10.90% in 2011, 10.90% in 2012, 9.48% in 2013, 8.17% in 2014, 12.50% in 2015, 13.46% in 2016, 12.50% in 2017, 13.46% in 2018 and 12.98% in 2019.

Wei (2012) submitted that the underlying principles behind the importance of institutional quality in attracting FDI are attribute to what constitutes these qualities. For instance, good institutional qualities which are often characterized by political stability, absence of violence; terrorism, control of corruption, government effectiveness and the rule of law in the host country are more likely to convince ant attract foreign investors. Muhammed and Charles (2018) asserted that anywhere institutional quality is lacking as reflected in corruption of civil servants, bureaucracy and high levels of extortions may spawn mistrust which may be unhealthy for doing business both for domestic and foreign investors, Therefore, poor institutional quality may lead to unnecessarily high costs in doing business in a highly corrupt economy. More so, property rights are not well defined, which may lead to high risks of expropriation and hence may discourage investors to patent their products to local enterprises (Ebekozien, Ugochukwu, & Okoye, 2015). It is therefore crucial to take into cognizance the peculiar rudiments in analyzing the institutional quality underpinning FDI.

Nigeria had over the years made several attempts to attract the interest of Foreign Investors but with all these efforts, they have not been able to achieve their aims to the fullness. The issue of institutional quality as a major obstacle of FDI inflow to the region most in particular Nigeria would be the center focus of this research work Sound institutional quality ranges from absence of political instability, absence of corruption and terrorism, sound government effectiveness and rule of law. The inability of Nigeria in particular and African countries in general to enhance the development of their institutional quality has made it difficult for foreign investors to come into the region. Though there are other factors that could make a country more attractive to inflow FDI according to different authors. Dinda (2009) revealed that the blessings of natural resources, openness, macroeconomic risk factors like inflation and exchange rates are significant determinants of FDI inflow to Nigeria. Asiedu (2006) found natural resources, large market size, lower inflation, good infrastructure, an educated population,

and openness to FDI, less corruption, political stability and a reliable legal system as major determinants of FDI inflow. Arnyanwu (1998) identified change in domestic investment, change in domestic output or market Size, indigenization policy, and change in openness of the economy as major determinants of FDI.

Institutional quality has been attributed as one of the leading factors that attract foreign direct investment in developing economies such as Nigeria in recent years (Bisson, 2011). This is because FDI gives much needed resources to developing countries such as capital, technology, managerial skills, entrepreneurial ability, brands, and access to markets. These are necessary for developing countries to industrialize, develop, and create jobs attacking the depressed condition in their countries to improve economic performance. As a result of the benefits that accrue to countries through FDI, most developing countries recognize the potential value of FDI and nave liberalized their investment regimes and engaged in investment promotion activities to attract various countries (Ejuvbekpokpo R. &Sallahuddin, 2015). Nigeria as one of the developing economies with great demands for goods and services and has attracted some FDI as the country's direct investment stood at US$12,576.43 million in 2010, US$12,507.77 million in 2011, US$13,145.29 million in 2012, US$13,704.07 million in 2013, US$13,139.49 in 2014, US$11,630.16 million in 2015, US$7,751.31 million in 2016, US$8,036.64 million in 2017, US$8,574.19 million in 2018 and US$8,850.65 million in 2019 (Central Bank of Nigeria, 2019).

An economy with weak institutional quality would not grow sufficiently to experience macroeconomic target of growth and development through foreign direct investment inflows. Hence, the issue of institutional quality's role as a determinant of Foreign Direct Investment (FDI) is very vital to economic growth and development especially in a country like Nigeria. It is on the basis of this the study intends to ascertain the impact of institutional quality on Foreign Direct Investment in Nigeria.

In literature, considerable number of studies had been carried out in this area of research interest, but most of the previous studies such as; Sule (2020), Anna and Krista (2018), Radzeviča and Bulderberga (2018), Nabila, Shazia and Muhammad (2015), Alexiou, Tsaliki and Osman (2014) focused on impact of institutional quality on economic growth. It is the bid to add to existing literature that motivated this current study to examine the impact of institutional quality on foreign direct investment in Nigeria. The two objectives of this study are to; (i) find out the co-integrating relationship between institutional quality and foreign direct investment inflow in Nigeria

(ii) find out if both long run and short run relationships exist between institutional quality and foreign direct investment inflow in Nigeria.

II. EMPIRICAL REVIEW

This section is divided according to similar findings based on different methodology irrespective of countries.

Institutional Quality and Economic Growth Using OLS Approach

Several studies such as (Sule, 2020; Ernest and Young, 2015; Raheem and Oyinlola, 2013; Sikwila, 2015and Uda and Ayara, 2014) all investigated the effect of institutions on economic growth in Nigeria and found that institutions respond positively and significantly to economic growth and performance. On the relationship basis, studies done by (Ejiubekpokpo and Sallahuddin 2015; and Okoh and Ebi 2013) found that institutional quality exhibits both long run and bidirectional causality with economic growth. However, contrary to the usual findings, Zawoiska and Suidek (2013) who did a cross regional study found a negative and significant effect of institutions on economic growth.

Institutional Quality and Economic Growth and FDI Using SGMM and GMM Approach

Several studies also found a positive and significant influence of institutions on economic growth, economic development and foreign direct investment. For instance, (Ann and Krista, 2018; Radzevica and Bulderberga, 2018; Epaphra and Kombe, 2018; Nguyen and Nguyen, 2018; and Kilishi *et. al.*,2013) found a positive and significant effect of institutions on economic growth while studies like (Madani and Nobakht, 2014; and Akbar and Akbar,2015) showed a positive and significant impact of institutions on foreign direct investment. However, few studies such as Izilein and Mohammed (2017), and Devangi, Perera, and Lee (2013) found a negative and significant influence.

Institutional Quality and Economic Growth and FDI and Stock Market Using Panel ARDL, FE, DE.

Numerous studies such as (Iheonu, Ihedimma, and Onwuanaku ,2017; Peres, Ameer and Xu,2018a; Valeriani and Peluso,2011; Peres, Ameer and Xu,2018b; Bonnie et al.,2012; Ernest, David and Jones,2016; Ozioko,2014; Chimere, Godfrey and Chigozie,2017; Fregha,2014; Harms and Ursprung,2012; Jensen,2013; Busse and Hefker,2014; Pierpont,2015; Nabila, Shazia and Muhammad,2015; Muhammad and Malarvizhi,2014; Olarinde and Omojolaibi,2014) all found a positive and significant impact of institutions either on economic growth, FDI or Stock market. Some studies found a unidirectional causality

between institutions and economic growth (Olarinde and Omojolaibi,2014; Busse and Hefeker,2014; Muhammad and Malarvizhi,2014), and some found a bidirectional causation (Nabila, Shazia, and Muhammad,2015; Dandume,2013) while Busse and Hefeker (2014) also found no causation between some institution variables and FDI. However, some studies found a negative and significant effect of institutions on economic growth and FDI such as Alexiou, Tsaliki and Osman,2014; Yusuf and Malarvizhi,2014; Li and Resnick,2013).

III. METHODOLOGY

Theoretical Framework

This study is anchored on eclectic paradigm theory propounded by Dunning (1980). The study is hinged on this theory because it seeks to provide better insight on the decision of a firm on locating its investment in foreign countries rather than producing locally and exporting to other countries. The study stated that that better institutions are good for inward Foreign Direct Investment given that they provide enabling environments for multinational companies to profitably invest outside their home countries. Thus, this study utilized this theory because it also assumed that poorly regulated institutions add to the constraints to bilateral Foreign Direct Investment flows. This theory also adopted because it agrees with the deduction of Brunetti (1998) who contributed by arguing that Foreign Direct Investment tends to move to different destinations when property rights are not clearly defined and enforced. Hence, the theoretical underpinning of the theory is that countries with workable level of institutional quality enjoys foreign investors' attraction to invest outside their resident as compared to the non-workable institutional framework. The theory is analytically explained as showed in Equation 3.1 below;

$I_t = \pi_0 + \lambda_1 INQ_t$ ……..3.1

Where, I_t is the level of foreign direct investment attraction and INQ is the workable level of institutional quality. Equation 3.1 explains that the intensity of the institutional quality determines the level of foreign direct investment in a non-resident country.

Model Specification

The study employed the Autoregressive distributive lag (ARDL). ARDL is a least squares regression approach involving the lag of both the endogenous variable and exogenous variables. ARDL model is normally denoted using ARDL notion (p_1 q_1, q_2, q_3, ……. qk). P denotes the number of lags of the endogenous variable and q1 is the number of the lags of the first exogenous variable, and q_k is the lags of the k^{th} exogenous variable.

In building the ARDL model for the study, the functional form of the model is presented in Equation 3.2 as showed below.

$$FDI = F(PII, CPI, TEL, GEI, VOA, RLI, TOP, GFC) \quad \text{.....3.2}$$

FDI represents Foreign Direct investment, PII represents political instability index, CPI represents corruption perception index, TEI represents terrorism index, GEI represents government effectiveness index, VOA represents voice and accountability, RLI represents rule of law index, TOP represents trade openness and GFC represents gross fixed capital formation

The functional form of the model is represented to show the ARDL model in Equation 3.3

$$\begin{aligned}\Delta LFDI_t = \alpha_0 &+ \sum_{i=1}^{p} \delta_i \, \Delta LFDI_{t-1} + \sum_{k=0}^{p} \beta_k \, \Delta LPII_{t-k} \\ &+ \sum_{k=0}^{p} \in_k \Delta LCPI_{t-k} + \sum_{l=0}^{p} \gamma_l \, \Delta LTEI_{t-l} \\ &+ \sum_{m=0}^{p} \varphi_m \, \Delta LGEI_{t-m} + \sum_{n=0}^{p} \Psi_n \, \Delta LVOA_{t-n} \\ &+ \sum_{k=0}^{p} \varrho_k \, \Delta RLI_{t-k} + \sum_{n=0}^{p} \Psi_n \, \Delta LTOP_{t-n} \\ &+ \sum_{k=0}^{p} \varrho_k \, \Delta GFC_{t-k} + \lambda_1 LFDI_{t-1} \\ &+ \lambda_2 LPII_{t-1} + \lambda_3 LCPI_{t-1} + \lambda_4 LTEL_{t-1} \\ &+ \lambda_5 LGEI_{t-1} + \lambda_6 VOA_{t-1} + \lambda_7 RLI_{t-1} \\ &+ \lambda_6 TOP_{t-1} + \lambda_7 GFC_{t-1} + \mu_t \; - - \\ &- -3.3\end{aligned}$$

Where α_0 and μ_t are the autonomous component and white noise respectively. The expression with the signs of summation in the equation is error correction. The parameter coefficient denotes the short run effects while lamda (λ) is the corresponding relationship in the long run.

IV. ANALYSIS AND DISCUSSION OF FINDINGS

4.1 Descriptive Statistics

Table 4.1: Descriptive Statistics Result

	FDI	PII	CPI	TEI	GEI	VOA	RLI	TOP	GFC
Mean	3.933529	-0.958	10.93824	0.062059	-0.16	0.017	4.71	55.49	14.4

Median	3.060000	-0.900	8.300000	-0.825000	-1.20	-1.06	5.00	58.94	13.9
Maximum	10.83000	-0.730	27.00000	7.450000	6.800	7.940	9.00	81.81	26.0
Minimum	0.930000	-1.350	1.000000	-1.55000	-1.43	-2.21	0.00	23.72	6.13
Std. Dev.	2.643639	0.1554	6.795186	2.488459	2.251	2.767	3.05	13.92	3.86
Skewness	1.383899	0.9092	0.898680	1.797817	1.977	1.686	0.14	0.532	0.40
Kurtosis	3.941084	3.1559	2.892875	4.978643	5.560	4.547	1.68	2.905	4.16
Jarque-Bera	12.10732	4.7192	4.592802	23.86178	31.44	19.492	2.57	1.620	2.84
Probability	0.002349	0.0945	0.100620	0.000007	0.000	0.0001	0.28	0.445	0.24
Observations	34	34	34	34	34	34	34	34	34

Source: Author's computation

Table 4.1 indicated 34 observations for all the variables of interest which included; Foreign Direct Investment (FDI) as the dependent variable while Institutional quality indicators such as political instability index (PII), corruption perception index (CPI), terrorism index (TEI), government effectiveness index (GEI), voice and accountability (VOA), rule of law index (RLI) as well as other control variables such as trade openness (TOP) and gross fixed capital formation (GFC) serve as the independent variables. The reason for the descriptive statistic is to test the normality of the variables of interest in this study. Based on the skewness values for all the variables of interest, it is revealed that all the variables are positively skewed. Finally, based on the Jarque-Bera statistic, the probability value of FDI shows is not normally distributed since the probability value is less than 0.05 based on the rule of thumb, 0.002349, PII is normally distributed given the p-value of 0.094458, CPI is normally distributed given the p-value of 0.100620, TEI is not normally distributed given the p-value of 0.000007, GEI is not also normally distributed given the p-value of 0.000000, VOA is not normally distributed given the p-value of 0.000059, RLI is normally distributed given the p-value of 0.277207, TOP and GFC are normally distributed given the p-values of 0.444760 and 0.241407 respectively. Hence, since the variables were not normally distributed, there is need to carryout unit root test for stationarity.

4.2 Stationarity Test

To establish the order of integration of the variables, this test was carried out to account for the presence of unit roots (that is whether the variables are stationary or not) using the Augmented Dickey Fuller (ADF) test.

Table 4.2: Unit Root Test Results

Variables	ADF Statistic at level	ADF Statistic at 1st Diff	Critical values of 5% at level	Critical values of 5% at 1st Diff	P-values at level	P-values at 1st Diff	Order of integration
FDI	-1.35387	-8.38239	2.960411	-2.96397	0.5736	0.0002	1(1)
PII	-1.49374	-6.39876	-2.96041	-2.96397	0.0765	0.0000	1(1)
CPI	-3.48739	-	-2.96041	-2.96397	0.0034	-	1(0)
TEI	-2.34984	-5.48392	2.960411	-2.96397	0.3458	0.0000	1(1)
GEI	-1.58746	-7.49374	-2.96041	-2.96397	0.2387	0.0012	1(1)
VOA	-3.45484	-	-2.96041	-2.96397	0.0003	-	1(0)
RLI	-1.34532	-6.38928	2.960411	-2.96397	0.6847	0.0000	1(1)
TOP	-2.18452	-4.09891	-2.96041	-2.96397	0.2156	0.0036	1(1)
GFC	-1.67664	5.429971	2.960411	-2.96397	0.4328	0.0004	1(1)

Source: Author's Computation, 2021

The unit root test in Table 4.2 revealed that all the variables were not stationary at level, because their Augmented Dickey Fuller (*ADF*) statistic values were less than the critical values at 5% level of significance. The variables were all stationary at first difference as their Augmented Dickey Fuller (*ADF*) statistic values were greater than their critical values at 5% level of significance.

4.2 ARDL Bound Co-integration Test

Table 4.3: Bound Co-integration Test for Long Run Relationship

F-Bound Test **Null Hypothesis: No levels relationship**				
Test Statistic	**Value**	**Significance**	**1(0)**	**1(1)**
F-Statistic	4.45	10%	1,89	2.89
K	6	5%	2.17	3.23
		1%	2.73	3.91

Source: Author's Computation, 2021

In table 4.3, since the calculated F-statistic (4.45) is greater than the lower bound and upper bound critical values at 1%, 5% and 10% levels of significance, the null hypothesis of no long-run relationship among the variables of the selected ARDL (1, 1, 1, 1, 2, 2, 2) is to be rejected. Thus, the variables employed in this study were co-integrated. Thus,

there existed a long run relationship between institutional quality and foreign direct investment in Nigeria.

4.3 Autoregressive Distributed Lag (ARDL) Result

Table 4.4: Estimated ARDL Result

Dependent Variable: D(LNFDI)

SHORT RUN FORM

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.658743	1.598473	0.412108	0.7213
D(LNFDI(-))	0.345769	0.024763	13.96313	0.0001
D(LNPII(-1))	-0.529584	0.084349	-6.278486	0.0278
D(LNCPI(-1))	-0.474893	0.108732	-4.367556	0.0164
D(LNTEL(-1))	-0.401348	0.064453	-6.226987	0.0019
D(LNGEI(-1))	0.303933	0.075930	4.002805	0.0034
D(LNVOA(-1))	0.587573	0.087432	6.720343	0.0165
D(LNRLI(-1))	0.742493	0.631203	1.176314	0.7654
D(LNTOP(-1))	0.097542	0.056443	1.728148	0.1076
D(LNGFC(-1))	0.536825	0.631203	0.850479	0.4105
ECT(-1)	-0.644983	0.091562	7.044221	0.0093

Source: Author's Computation using Eviews 10.

LONG RUN FORM

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNFDI	0.328749	0.287564	1.143221	0.6213
LNPII	-0.457853	0.085153	-5.376828	0.0042
LNCPI	-0.538473	0.074532	-7.224722	0.0152
LNTEL	-0.483456	0.053463	-9.042815	0.0061
LNGEI	0.505678	0.064345	7.858854	0.0004
LNVOA	0.393523	0.087315	4.506935	0.0007
LNRLI	0.622474	0.074326	8.374916	0.0000
LNTOP	0.568151	0.088120	6.447469	0.0010
LNGFC	0.710387	0.098502	7.211904	0.0002

R-squared	0.815764	Durbin-Watson stat	1.745778
Adjusted R-squared	0.508695		
F-statistic	17.37483		
Prob(F-statistic)	0.000002		

Source: Author's Computation using Eviews 10.

The result of the short run and the long run models in table 4.4 revealed that the independent variables such as; political instability index (PII), corruption perception index (CPI), terrorism index (TEI), government effectiveness index (GEI), voice and accountability (VOA), rule of law index (RLI), trade openness (TOP) and gross fixed capital formation (GFC) explained about 82% of the total variations in Foreign Direct Investment while the remaining 18% unexplained is captured by the error term. Considering the prob (F-statistic) of 0.000002 the entire model is robust and is devoid of the presence of autocorrelation problem.

The short run model accounts for the speed of adjustment to long run equilibrium of the variables employed. Hence, the speed of adjustment of the model to long run equilibrium is measured by the coefficient of the first lag of the error correction term (ECT (-1)). The error correction term (-0.64) has the right a priori sign and it is statistically significant. Hence, the result of the ECT (-1) showed that 64% of the deviation of the variables in the short run will be restored in the long run within one year.

Based on the long run model, Political instability index (PII) has an estimated coefficient value of -0.46 meaning a 1% increase in political instability index led to 46% in Foreign Direct Investment (FDI) in Nigeria. This revealed that political instability index has negative impact on foreign direct investment (FDI) in Nigeria. Hence, Political instability index as one of the indicators of institutional quality had significant negative impact on Foreign Direct Investment in Nigeria within the study period. This means that political instability affects the inflows of foreign direct investment from other countries of the world which invariably and indirectly affects the economic growth of that receiving country.

Corruption perception index (CPI) has an estimated coefficient of -0.54 meaning a 1% increase in corruption perception index leads to 55% decrease in foreign direct investment (FDI) in Nigeria. This implied that corruption perception index had significant positive impact on foreign direct investment (FDI) in Nigeria. Hence, corruption perception index as one of the indicators of institutional quality that has significant negative impact on Foreign Direct Investment in Nigeria within the study period. This implies that corruption affects the inflow of FDI from other countries of the world which indirectly reduces the economic growth and development of that recipient country.

The terrorism index (TEI) has an estimated coefficient of -0.48 meaning that 1% increase in terrorism index leads to 48% decrease in foreign direct investment (FDI). This reveals that terrorism index has negative impact on foreign direct investment (FDI) in Nigeria. Hence, terrorism index as one of the indicators of institutional quality had significant negative impact on foreign direct investment in Nigeria within the study period. This implies also that terrorism affects the inflow of FDI from other countries of the world which indirectly reduces the economic growth and development of that recipient country.

Government effectiveness index (GEI) has an estimated coefficient of 0.51 meaning that 1% increase in government effectiveness index leads to 51% increase in foreign direct investment (FDI). This revealed that government effectiveness index has positive impact on foreign direct investment (FDI) in Nigeria. Hence, government effectiveness index as one of the indicators of institutional quality had significant positive impact on foreign direct investment in Nigeria within the study period. This implies that government effectiveness is a necessity for the inflow of FDI into Nigeria which will indirectly increase her economic growth and expansion.

Voice and accountability (VOA) have an estimated coefficient of 0.39 meaning that 1% increase in voice and accountability led to 39% increase in foreign direct investment (FDI). This revealed that voice and accountability have positive impact on foreign direct investment (FDI) in Nigeria. Hence, voice and accountability as one of the indicators of institutional quality had significant positive impact on foreign direct investment in Nigeria within the study period. This implies that the more democratic and accountable a government is in a country, the higher the inflow of FDI in that particular country which invariably increases her economic base.

Rule of law index (RLI) has an estimated coefficient of 0.62 meaning that 1% increase in voice and accountability led to 62% increase in foreign direct investment (FDI). This reveals that rule of law index has positive impact on foreign direct investment (FDI) in Nigeria. Hence, rule of law index as one of the indicators of institutional quality had significant positive impact on foreign direct investment in Nigeria within the study period. This simply means that the more effective the rule of law of a country, the higher the FDI inflows into that country likewise the increase in the country's economic growth.

Trade openness (TOP) has an estimated coefficient of 0.57 meaning that 1% increase in trade openness leads to 57% increase in foreign direct investment (FDI). This reveals that trade openness has positive impact on foreign direct investment (FDI) in Nigeria. Hence, trade openness had significant positive impact on foreign direct investment in Nigeria within the study period. This means that the more a country opens up for international trade the more inflow of FDI into that country which inadvertently increases the country's economic growth, all things being equal.

Gross Fixed Capital Formation (GFC) has an estimated coefficient of 0.71 meaning that 1% increase in gross fixed capital formation leads to 71% increase in foreign direct investment (FDI). This reveals that gross fixed capital formation has positive impact on foreign direct investment (FDI) in Nigeria. Hence, gross fixed capital formation had significant positive impact on foreign direct investment in Nigeria within the study period. This implies that the higher the gross capital formation of the country, the higher the inflow of FDI into the country thereby increasing the economic growth of the country.

V. SUMMARY, CONCLUSION AND RECOMMENDATIONS

Having exhaustively discussed the findings above, this study then concludes that institutional quality variables are determinants and enhancers of economic growth in Nigeria both on the short run and long run.

This study therefore, recommends that the government should maintain a strong institution at all cost so as to ensure constant inflow of foreign direct investment in the country.

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