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Analysis of government policies, institutions, and inward foreign direct investment: evidence from sub-Saharan Africa

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Abstract

This paper examines the effects of government policies and institutions on foreign direct investment (FDI) inflows in sub-Saharan African context using both quantitative and qualitative approaches. On the quantitative approach, we analysed the effects of institutions on FDI using two statistical techniques: CCR and FMOLS over the period of 1984–2012. We find that political instability, democratic accountability and investment risk have significant impact on inward FDI in Nigeria. Using a trend analysis, our results provide evidence to suggest that liberal government investment policies have positive influence on FDI inflows. Our qualitative analysis over the 1962–2012 period supports the results of the quantitative analysis.

Introduction

Foreign direct investment (FDI), its determinants and consequences on economic growth in both developed and developing countries have been extensively researched in the academic milieu (see Dunning, 1998; Buckley, Clegg and Wang, 2007). The mainstream theoretical perspectives explaining why multinational firms engage in FDI range from the industrial organisation theory which focuses on a firm's behaviour vis-à-vis its competitors (Caves, 1971; Hymer, 1976); internalisation models based on market imperfections and the transaction cost economics explanation of the boundaries of the firm (Buckley and Casson, 1976); to the electric paradigm (Dunning, 1988; Dunning, 1993) which provides a holistic approach to explain the levels and patterns of international production. In search for a more comprehensive understanding of what determines FDI, Dunning (1998) in his award winning article summarises the key antecedents of FDI and points out that while economic factors are important to FDI inflows, host country policies and institutions play more important role than they once did in the 1970s. Since Dunning's (1998) influential article, a number of studies have focused on the role of government and host country institutions (see Henisz, 2000; Boateng and Glaister, 1999; Mmieh and Owusu-Frimpong, 2004; Du, Lu, and Tao, 2008;

Cleeve, 2012). These authors argue that institutions and government policies play increasingly significant role in explaining the location strategies of MNEs. For example, Du et al. (2008) note that the economic reforms, liberalization of FDI policies and institutional reforms in the emerging countries, particularly, Brazil, Russia, India and China (BRIC) are widely seen as pivotal in attracting FDI inflows and constitute the driving force behind the economic development of these economies. Dunning (1998); Boateng et al. (2015) further contend that host country institutions and national policy environment may act as barriers to a firm's location choice.

The above argument is consistent with institutional theory which posits that a country's institutions influence a firm's strategic choices and competitiveness (North, 1990). Bad institutions and unfavourable government policies increase the cost of doing business in the host country while good institutions ensure effective functioning of market mechanisms and reduce risks (Meyer et al., 2009; Ang and Michailova, 2008). In order to attract foreign capital, many governments of sub-Sahara Africa (SSA) countries under the auspices of the International Monetary Fund (IMF) and World Bank have also changed their previous restrictive FDI policies to more liberal policies and embarked on massive reforms to attract FDI inflows. For instance, SSA countries have implemented Structural Adjustment Programme (SAP) which includes liberalisation of FDI regulatory framework, privatisation and rationalisation of state owned enterprises as a condition to obtain financial support from the IMF and World Bank to revitalise their economies (Mmieh and Owusu-Frimpong, 2004; Cleeve, 2012).

Despite the liberalisation of FDI policy environment coupled with abundance of natural resources such as oil, gold and other raw materials, SSA countries have attracted relatively

little FDI inflows compare to countries in Asia, America and Europe. According to the UNCTAD (2014), FDI inflows into SSA rose from US $1,689.7 million 1990 to US $42,371 million in 2014. In comparison, FDI inflows in South East Asia, Latin America and the Caribbean have increased from US $12,820.8 million and US $8,536.8 million to US $132,867.2 million and US $159,404.9 million respectively in the same period. Clearly, SSA is at the bottom of FDI league table and the question as to why SSA continues to attract low levels of FDI is an important one often asked by academics and policy makers.

The above is against the backdrop that relatively few studies investigate the effects of both government policies and institutions on FDI inflows in SSA (Boateng and Glaister, 1999; Asiedu, 2002; Cleeve, 2012; Ellis, Osabutey and Okoro, 2015). More importantly, with the exception of Boateng and Glaister (1999) in Ghana context, none of the above studies analyses directly the impact and effectiveness of specific government policies implemented over time and their association with FDI inflows. We believe that such qualitative analysis of government policies in conjunction with quantitative approach would provide a more insightful and inclusive account of what really attract FDI inflows to inform investment policy decisions in SSA. The goals of this study are two: (i) to analyse the impact and implications of government policies on the trends of FDI inflows; (ii) to examine the impact of home country institutions on FDI inflows. As the largest country in SSA with a huge market, Nigeria provides an ideal setting to demonstrate the impact of government policies and institutions on FDI. Nigeria is a major player in SSA and its population is over one-quarter of the Sub-Saharan Africa's population.

This paper contributes to the literature in two important ways. First, the examination of government policies on FDI inflows in SSA is under-researched yet important to policy makers as lack of capital provided through FDI is one of the evidences of African poverty

(Boateng and Glaister, 1999). To our knowledge, this is the first attempt to examine the impact of host institutions and government policies using both quantitative approach and trend analysis in qualitative tradition to analyse the effects of institutions and government policies over such a long period of time, i.e., 1962 to 2012. The uniqueness of our data enables us to completely and robustly assess the effect of the policies on FDI inflows and draw more insightful conclusions. Overall, we demonstrate how host country government policies and institutions influence foreign firms' decision to invest abroad thereby contributing to the institutional and location theories. Hoskisson, Eden, Lau and Wright (2000) note that the host country's institutional influences on FDI have become an important empirical issue because of the changing institutions in emerging countries and the changing extent, character and geography of MNE activity over the past three decades. MNEs are increasingly seeking locations that offer the best institutional environments for their core competencies to be utilized efficiently and help developed their global firm-specific advantages (Dunning, 1998; Rugman and Verbeke, 2005). This study therefore highlights that, in their attempt to attract FDI inflows, African governments should not place exclusive reliance on profitability and availability of natural resources but should pay more attention to host country institutions and policies as they play important role in FDI inflows.

The rest of the paper is structured as follows: Section 2 provides theoretical background, delineates the government policies implemented in Nigeria over the past five decades and develops hypotheses of the study. Section 3 presents the sample selection and method used in this study followed by an analysis of the institutional determinants of FDI and trends of investment policies on FDI analysis. The final section concludes the paper and discusses the implications of the study.

Theoretical Background: Government Reform Policies and Institutions

Prior literature highlights the importance of location as a source of comparative advantage for multinational companies (Dunning, 1998). It is well documented that location captures the advantages and properties of the host country which makes the country in question attractive to potential foreign direct investors (Hoskisson et al., 2000; Bevan, Estrin and Meyer, 2004). Specifically, researchers emphasise the host country factor endowment, policies and institutions which constitute immobile and created assets drive foreign investors in their location decisions. Despite this, the past empirical efforts have concentrated disproportionately on resource seeking and factor endowment (i.e., raw materials, labour costs, productivity and market size) aspects of host country location advantages of FDI (Dunning, 1998). However, it is argued that other than the relatively conventional 'natural assets', like raw materials or cheap labour, institutions and government policies now play increasingly significant role in explaining the location strategies of MNEs (Hoskisson *et al.,* 2000; Bevan, Estrin and Meyer, 2004). Studies that investigate the host government policies and institutions are relatively scant and disagreements abound regarding which government policies and institutions matter for FDI inflows and why (see Bevan, Estrin and Meyer, 2004). It is therefore not surprising that, scholars have begun to refocus international business literature on spatial aspects, (particularly home and host country institutions) of FDI (Boateng et al., 2015).

Institutions defined as 'the rules of the game' help shape the strategies, structures, and competitiveness of firms (North, 1990). Institutions reduce both transaction and information costs through minimizing uncertainty, ensures a stable structure that facilitates interaction and allows enterprises to move beyond institutional barriers (Oliver, 1991). Prior empirical studies support a view that government policies and regulative institutions in host countries

strongly influence on FDI inflows. For example, government policies and institutions which are 'friendly' towards foreign investors, such as the security of property rights, less ownership restriction, non-corrupt and less bureaucratic agencies, and low political risk are important in attracting FDI from MNEs (Bevan, Estrin and Meyer, 2004; Grosse and Trevino, 2005). In short, the overall thrust of the institution-based view is that a firm's internationalization strategy is shaped by the institutional framework of the host country. Thus, institutions provide a framework for assessing a country's strengths and weaknesses enabling foreign firms to capture the environmental complexity facing the MNCs for investment strategy formulation (Guisinger, 2001; Hoskisson et al., 2000). This is especially important because in developing countries, governments and institutions influences are stronger than in developed countries (Hoskisson et al., 2000; Du and Boateng, 2015).

On the empirical front, a number of studies have examined the relationship between policy-related variables and FDI inflows in advanced market and emerging countries, particularly, Brazil, Russia, India and China (BRIC). For example, Brunetti and Weder (1998) investigated the link between institutional uncertainty and FDI and found a negative relationship between institutional uncertainty and private investment. Similarly, Bevan, Estrin and Meyer (2004) examined the relationship between institutional development and FDI inflows in the transitional economies of Eastern Europe and documented that FDI is positively related to the quality of formal institutions. Other studies have examined corruption (Wei, 2000; Gastanaga, Nugent and Pashmova, 1998) and the influence of other policy-related variables of FDI such as political risk (Henisz, 2000); intellectual property protection (Lee and Mansfield, 1996); fundamental democratic rights (Jensen, 2003). In a more comprehensive treatment of the relationship between political risk, institutions and FDI inflows involving 83 developing countries over the 1984–2003 period, Busse and Hefeker

(2007) found government stability, internal and external conflict, corruption and ethnic tension, law and order, democratic accountability of government and quality of bureaucracy to be significant determinants of FDI. It is pertinent to point out that, the few studies which examine the influence of policy-related variables on FDI inflows in developing countries are based on cross-country studies with countries as diverse as China, Nigeria, Zimbabwe and Mexico being treated in an equal-weighted basis. It is argued that the results of these cross-country studies may reflect other non-measurable influences that are different across countries (see Gastanaga et al., 1998) and may not give the full picture of the effects of institutions on FDI. This paper is different from prior studies as it utilises both quantitative and qualitative data analysis to unpack the influences of government policies and institutions on FDI inflows in the largest SSA country, that is, Nigeria.

Table 1 delineates the development and changes in Nigerian government policies towards inward FDI over the period of 1962–2012 in five phases as follows.

---Insert Table 1 here please---

Hypotheses Development

Political instability

Prior studies have documented that political stability creates a climate of confidence for foreign investors and increase FDI inflows. For example, Busse and Hefeker (2007) and Sanchez-Martín, De-Arce and Escribano (2014) found that government stability is positively associated with inward FDI. On the other hand, politically unstable countries are perceived as risky locations or unfavourable business environment because political volatility creates business uncertainties, acts as a barrier to FDI and increases the cost of doing business (Butler and Joaquin, 1998; Chakrabarti, 2001). High political risk means investors have little protection against breach of contracts or outright theft (Jensen and McGillivray, 2005).

Asiedu (2006); Solomon and Ruiz (2012) have rendered some support for the negative relationship between political instability and FDI. In the light of the above, we expect the political instability to reduce FDI inflows. We hypothesised that:

Hypothesis 1: Political instability is negatively related to FDI inflows.

Corruption

Prior studies have broadly categorised the effects of corruption on firms' investment decisions into two competing hypothesis: the 'helping hand' theory (Lui, 1985; Saha, 2001) and the 'grabbing-hand' theory (Shleifer and Vishny, 1993; Aidt, 2003). The 'helping-hand' (efficiency enhancing) hypothesis contends that corruption could be an efficient tool against rigid economic regulations and red-tape (Lui, 1985; Saha, 2001). The argument here is that corruption has relatively low transaction costs compared to the benefits derived because corruption reduces delays involved in transacting businesses (Leff, 1964; Cuervo-Cazurra, 2006), and hence may increase FDI inflows. For example, Cuervo-Cazurra (2006) reported that corruption is beneficial in attracting FDI inflows in developing economies.

On the other hand, the 'grabbing–hand' theory argues that corruption distorts the allocation of resources, increases transaction costs and discourages FDI (Shleifer and Vishny, 1993; Barassi and Zhou, 2012). This argument supports the contention that corruption exerts a negative and significant impact on FDI inflows (Busse and Hefeker, 2007; Javorcik and Wei, 2009; Barassi and Zhou, 2012). However, Wheeler and Mody (1992) did not find a significant relationship between corruption and FDI inflows. The above arguments suggest that the effect of corruption on FDI remains an empirical question. Given that the Transparency International ranks corruption very high in most of the SSA countries, we expect corruption to exert a significant and negative impact on FDI. We therefore hypothesised that:

Hypothesis 2: Corruption is negatively associated with FDI inflows.

Democratic accountability

Several studies have examined the relationship between democratic accountability and FDI. It is argued that democratically accountable governments have mechanisms that reduce arbitrary interventions, lower the risk of policy reversals and protect foreign investors (North and Weingast, 1989; Li, 2008). Some studies that have examined the relationship between democratic accountability and FDI report that democratic accountability exerts positive influence on FDI inflows (Jensen and McGillivray, 2005; Busse and Hefeker, 2007). Despite reforms in recent years, governance systems in SSA countries remain weak and Boateng and Glaister (1999) note that in SSA key policies can change at random without the government being held to account. Consequently, we hypothesized that:

Hypothesis 3: The level of democratic accountability is negatively related to FDI inflows.

Rule of Law

Rule of law 'reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, particularly the quality of contract enforcement, property rights, the police and the courts, as well as likelihood of crime and violence' (Bannaga et al., 2013, p. 1247). Situations where the rules and regulations are enforced unpredictably and arbitrarily are a major concern for foreign investors (Drabek and Payne, 1999). Countries with better law and order tend to attract more FDI. Henisz and Zelner (2005) point out that rule of law tends to be relatively weak in many emerging economies. Uncertainties about law enforcement create a highly risky atmosphere for FDI (Bannaga et al., 2013).

In the context of SSA countries, law enforcement appears weak - a factor attributed to corruption. For example, the US State Department (2015); Adegbite (2015) point out that law

enforcement in most African countries are weak, limited, inefficient, and remain a major challenge. Accordingly, we hypothesis that:

Hypothesis 4: Weak *rule of law is negatively associated with FDI inflows.*

Bureaucracy

The quality of bureaucracy is closely associated with the institutional strength of a particular country. It is argued that low bureaucratic quality is expected to result in low FDI inflows (Busse and Hefeker, 2007). Thus, bureaucratic red tape increases transaction cost and adversely affect the relative competitiveness of firms operating in that country and deter FDI inflows (Ayal and Karras, 1996; Harding and Javorcik, 2011). In the context of SSA, the past 20 years has seen several reforms in terms foreign investment approval processes, including the establishment of the Investment Promotion Centres to liberalise the foreign investment procedures and the adoption of structural adjustment programmes. For example, many SSA countries such as Ghana and Nigeria have replaced multiple agencies charged with foreign investment registration with one-stop-shop investment centre to facilitate the processing and issuing of necessary licenses/permits for business establishments (UNCTAD, 2009). We expect such reforms to reduce transaction costs associated with setting a business, thereby providing favourable environment for FDI inflows. Accordingly, we hypothesise that:

Hypothesis 5: The bureaucratic quality is positively associated with FDI inflows.

Investment risk

Investment risk is a measure of the factors affecting the risk to investments that are not covered by other political, economic and financial risk components (Sethi and Luther, 1986). It includes the threats of nationalisation or expropriation, changing the terms of agreements; threats of national government preventing a firm's repatriation of profits and capital and

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imposition of import and export controls (Jensen, 2008; Baek and Qian, 2011). Investment risk creates uncertain business environments for foreign investments (Butler and Joaquin, 1998; Baek and Qian, 2011). Baek and Qian (2011) showed that, investment risk is a significant determinant of FDI in both industrialised and developing countries. Chan and Gemayel (2004) demonstrated that investment risk is crucial in explaining the levels of FDI inflows into Middle East and North Africa regions. According to Henisz and Delios (2001) where policy credibility is low (high investment risk), firms minimize commitments to a market, or avoid investment and the reverse is the case.

However, Busse and Hefeker (2007) showed that investment risk is less of a significant determinant of inward FDI. This is in line with the argument that firms having relevant international experience will be less deterred by uncertain policy such as those that affect investment risk (see, Delios and Henisz, 2003). This is further supported by the fact that international expansion in the stages model is rooted in uncertainty reduction through the accumulation of relevant experience (Delios and Henisz, 2003). Thus, MNCs may with the passage of time, develop a strategy and ability to circumvent investment risk (see: Henisz, 2000). The high-risk–high-return principle would suggest that experienced foreign investors can internalize their strategic assets around managing risk in countries with high investment risk to expand over the long term (Oh and Oetzel, 2016).

The partnership option of the indigenisation policy in Nigeria and other African countries mitigates the threats of nationalisation in the host countries (see Williamson, 1985). Moreover, the bilateral investment promotion and protection agreements (IPPAs) with many countries provide guarantees against expropriation, arbitrary change of the terms of contracts and a ban on repatriation of capital and profits (See, Spiller and Tommasi, 2005). Most SSA governments have committed themselves to attract foreign investment and have entered into bilateral and multilaterial agreements to safeguard FDI in their respective host countries

(UNCTAD, 2009). Therefore, we expect a reduction in investment risks to attract more FDI inflows in SSA and this leads to our sixth hypothesis.

Hypothesis 6: Low investment risk is positively associated with FDI inflows.

Control variable

We control the inflation rate, total oil export and total oil trade. Inflation rate have been found to have a significant bearing on FDI inflows (Boateng et al., 2015). On the other hand, Nigeria depends mainly on revenue from the sale of natural resources (petroleum and gas product). While oil export and oil total revenue too have significant impact on the economy particularly that some of the investment policy changes were made at the time when revenue earning from sale of petroleum and gas changed. More so, natural resources have been found to have significantly positive relationship with FDI (Asiedu, 2002).

Data and Methodology

Data and Measurement of Variables

We draw our data on institutional variables from International Country Risk Guide (ICRG) index of the Political Risk Service (PRS) group. The description of the institution variables in this study follows. Political stability measures how stable a government is, based on its ability to carry out declared program(s), and its ability to stay in office. The risk rating assigned is the sum of three sub-components - government unity, legislative strength and popular support, each with a maximum score of four points and a minimum score of 0 points. Thus government stability is 0 (high risk) -12 (low risk) scale (PRS group, 2012). Bureaucratic quality is a shock absorber that tends to minimise revisions of policy when governments change. The rating range from 12 (low-risk: where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services)

to 0 (high-risk: lack of cushioning effect of a strong bureaucracy because a change in government tends to be traumatic in terms of policy formulation and day-to-day administrative functions) (PRS group, 2012).

The rule of law variable measures the impartiality of the legal system and the extent it is enforced. The rating range from 0 - 6, a high rating implies impartiality and it is relatively reliable (PRS group, 2012). Corruption is an assessment of corruption within the political system, a threat to foreign investment for several reasons: it distorts the economic and financial environment; it reduces the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability; and, lastly introduces an inherent instability into the political process. The rating is from 0 (high-risk) to 6 (low-risk) (PRS group, 2012). Democratic accountability is a measure of how responsive government is to its people, on the basis that the less responsive it is, the more likely it is that the government will fall peacefully in a democratic society, but possibly violently in a non-democratic one. In general, the high score is assign to low risk and low score is assigned to high-risk. The rating is from 0-12 scale (PRS group, 2012). Investment risk measure assesses factors affecting the risk to investment that are not covered by other political, economic and financial risk components. The risk rating assigned is scale on 0 (high risk) -12 (low risk) (PRS Group, 2012).

The dependent variable, FDI are the inflows of investment to acquire a lasting management interest (10 per cent or more of voting stock) in an enterprise in a foreign country. It is the sum of equity capital, reinvestment of earnings, rights and other long-term capital as shown in the balance of payments (UNCTAD, 2015). FDI inflows in US dollars were extracted from the World Investment Report. The control variables: total oil export in billions of Naira and oil total revenue in billions of Naira was extracted from the Central Bank of Nigeria Statistical Bulletin and NIBS; inflation rate is the consumer price index (annual %) from

World Development Indicator. Regarding the government's regulatory policies towards FDI, we draw the information from the relevant decrees including NIPC decree, companies' code, National development Plan; Nigeria Enterprises Promotion Decree (NEPD) of 1972/1977 and various World Investment Reports produced by UNCTAD.

Methodology

To examine the effects of government policies and institutions on FDI, we utilise both quantitative and qualitative approaches. The quantitative approach employ co-integration regression, namely, canonical co-integration regression (CCR) and fully modified ordinary least square (FMOLS). The approaches modify the least squares to account for serial correlation effects and the endogeneity in the regressors. FMOLS and CCR estimators are obtained by transforming the regressors and regressand and then the ordinary least square procedures are applied (Wang and Wu, 2012). The estimators are asymptotically unbiased and have fully efficient normal asymptotic, allowing for standard Wald tests using asymptotic chi-squared statistical inference free from nuisance parameters (Park, 1992; Phillips, 1995). The models use all variables as endogeneous and minimise endogeneity bias (Park, 1992, Wang and Wu, 2012). They produce estimates of a unit root in time series regression that are hyper-consistent in the sense that their rate of convergence exceeds that of the OLS estimator (Phillip, 1995). However, due to dearth of data, the quantitative analysis is limited to the period from 1984 to 2012.We use the Augmented Dickey-Fuller (ADF) to test the level of stationarity. A time series data that are non-stationary tends to have a long-run stable/equilibrium relationship between the variables and can be co-integrated (Gujarati and Porter, 2010). To avoid co-integrating a non-stationary data, we use the Johansen tests for co-integration to test the null hypothesis ($r = 0$) of having no co-integrating vector against the alternative hypothesis ($r = 1$) of having, at least, one co-integrating vector. We also use the

trace tests and where the trace statistics (λ trace) are larger than their respective critical values at 5%, we reject the null hypothesis of no co-integration vector and accepts the alternative hypothesis of, at least, one co-integrating vector (rank 1), indicating that there is a long run relationship among the variables.

The qualitative approach involves examining the trends and patterns of FDI inflows in relationship with the investment policy at the specific investment policy phase. The trend analysis enables us to relate the various policies to the rise and fall of FDI inflows in terms of their annual growth rate and cumulative annual growth rate over a long period of time. A number of studies including Boateng and Glaister (1999); Tripathy, Yadav and Sharma, (2011); Zheng, (2013) have used such approach to analyse the FDI inflows. We compare the results from the qualitative approach to the result of the quantitative approach to draw our conclusions.

Estimation model

Our estimation model is:

$$LFDI_{1i} = \beta_0 + \beta_1 PolS + \beta_2 Cor + \beta_3 DemA + \beta_4 Law + \beta_5 Bur + \beta_6 InvR + \beta_7 InfR + \beta_8 LOEx + \varepsilon \qquad (1)$$

$$LFDI_{1i} = \beta_0 + \beta_1 PolS + \beta_2 Cor + \beta_3 DemA + \beta_4 Law + \beta_5 Bur + \beta_6 InvR + \beta_7 InfR + \beta_8 LOTr + \varepsilon \qquad (2)$$

Where: $LFDI_{1i}$ and $LFDI_{1i}$ = log of FDI, β_0 = constant term, β_1 to β_6 are independent variables, β_7 to β_8 are the control variables and ε = error term. PolS = Political stability, Cor = corruption, DemA = democratic accountability, Law = rule of law, Bur = Bureaucratic quality, InvR = investment rate, InfR = inflation rate, LOTr = log of total oil trade and LOEx = log of total oil export. FMOLS and CCR will be separately used to analyse each model.

The model for annual growth rate in the qualitative approach is estimated as follows:

$$g = \sqrt[(n-1)]{\frac{lv}{ev}} - 1$$

Where in each investment policy phase; g = annual growth rate, n = number of years, lv = latest value of FDI inflows and ev = earliest value of FDI inflows.

Results and Discussion

Unit root and co–integration test

Unit root test

The unit root test (ADF and Philip Perron tests) results are reported in Table 2. The table indicates that except bureaucratic quality which is stationary using Philip-Perron test, the rest of variables are not stationary. At first difference, all variables are stationary, and thus are integrated at order 1. Therefore, there is a possibility of co-integration among the variables and co-integration regression.

---Insert Table 2 here please---

Co-integration test

First, we assessed the optimal lags length that would give normal error terms to be included in the Johansen co-integration test using trace (λ trace) statistics. In model 1, except Schwarz Bayesian Information Criterion (SBIC) which favours the inclusion of 2 lags in Johansen co-integration test, the other information criteria favour the inclusion of 1 lag in Johansen co-integration test. In model 2, all information criteria favour the inclusion of 2 lags in Johansen co-integration test.

---Insert Tables 3 & 4 here please---

Table 4 presents the Johansen tests for co-integration results using lag 1 in all model. Starting with the null hypothesis that there are no co-integrating vectors (r = 0), the results show that at 5% significance level, the trace statistics (λ trace) are larger than their respective critical values up to rank 2 in both models. This suggests that the variables are co-integrated with up

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to rank 3 in both models. The models reject the null hypothesis of no co-integration vector and we accepts the alternative hypothesis of at least one co-integrating vector (rank 1), indicating there is a long-run relationship among the variables.

Regression results

Having confirmed long-run/equilibrium relationships among the variables, CCR and the FMOLS models were used for the analysis. The results are shown in table 5. The independent and control variables in the models have similar signs and relationships with FDI.

---Insert Table 5 here please---

Table 5 shows that the institutional factors in both models (FMOLS and CCR) explain about 94 per cent of the variation of FDI inflows in Nigeria. The results indicate that political instability (β = -0.3103452; $p<0.00$) and democratic accountability (β = -0.1866218; $p<0.05$) have negative and significant relationship with FDI inflows while low investment risk (β = 0.38066127; $p<0.00$) exerts positive and significant effect on FDI inflows. Thus the results of both FMOLS and CCR models provide support for hypotheses 1, 3 and 6. However, the results indicate that the coefficients for corruption, rule of law and bureaucratic quality are not significant and therefore hypotheses 2, 4 and 5 are not supported. Regarding the control variables, the coefficient for inflation appears not to have a significant impact on FDI inflows while oil exports and oil revenue have significant positive impact on FDI.

The negative and significant relationship between political instability and FDI inflows appears consistent with our expectation and is in line with the results of Solomon and Ruiz (2012) who found that political instability reduces FDI inflows. The results also show that democratic accountability has a negative and statistically significant effect on FDI inflows.

The results suggest that democratic accountability is important for explaining FDI inflows. The results, however, appear inconsistence with previous studies of Jensen (2003); Busse and Hefeker (2007) which that shows democratic accountability exert positive influence on FDI inflows. Regarding the relationship between investment risk and FDI inflows, our results are in line with that of Baek and Qian (2011) and Chan and Gemayel (2004) who found investment risk to be a significant determinant of FDI. Perhaps the promulgation of the NIPC Decree 16 of 1995 and adoption of SAP which reversed the indigenisation policy and abolished exchange foreign controls, threats of nationalisation and expropriation of foreign investments in Nigeria may explain the results. It was expected that corruption, rule of law, and bureaucratic quality would exert negative and significant effect on FDI but this appears not to be the case.

Qualitative Results: Investment policies and trends of FDI (1962–2012)

The results regarding the impact of the foreign investment policy changes on trends of FDI inflows are reported in table 6. Using the nature of the foreign investment policies implemented in Nigeria from 1962-2012, we classified the policies into three phases, namely the limited promotion investment policy (1962–1969); the restrictive foreign investment policy (1970–1985); and the liberal investment policy phase (1986-2012), implemented over time periods of (1986–1994) representing the first investment policy reforms through the introduction of Structural Adjustment Programme (SAP); and (1995–2012) represents the second stage of investment reforms aimed at reversing completely indigenisation policies; privatisation, adoption of good corporate governance practices and fiscal responsibility. The table shows that the liberal policy phase has the highest cumulative growth over the period of 1986-2012 of 32.43%. A further analysis of the period of 1986-2012 sub-divided into two time periods of 1986-1994 and 1995-2012, indicate that, a cumulative growth of 53.12% and

16.98% were recorded in 1986-1994 and 1995-2012 periods respectively. In comparison to the limited promotion and restrictive periods of 1962-1969 and 1970-1985, the cumulative growth rates of FDI were 13.63% and 8.45% respectively. The results may be explained by the fact that, FDI transactions under the liberal policy phase are less associated with cumbersome regulation and delays in approval procedures (Uche, 2012; World Bank, 1994). This suggests that liberal phase led to economic efficiency by increasing market access, reduced tariff barriers and non-friendly policies imposed on foreign investments. The reforms allowed free movement of capital and retention of exporters' earnings in foreign currencies thereby increasing FDI inflows. In contrast, restrictive and limited promotion regimes hindered FDI inflows. Overall, the results of this study suggest that liberal government policies increase FDI inflows irrespective of the nature of government (military or civilian government).

Policy Implications

Our findings have important practical and policy implications for senior managers and policy makers. First, the results of this study imply that government policies and host country institutions play an important role in shaping not only foreign investors' international expansion strategies but also their location decisions in the host country. More importantly, the study demonstrates that FDI inflows are partly a function of the level of government policies and institutions in the host country. Therefore, in order to attract foreign capital into African countries, governments in SSA should look beyond the sheer endowment and abundance of natural resources such as oil, gold and other raw materials and pay equal attention to the policies and the quality of their institutions. This is because poor institutions and bad government investment policies increase the cost of doing business in the host country while good institutions ensure effective functioning of market mechanisms and

reduce risks. Therefore we suggest that SSA governments should take further steps to improve accountability, minimise bureaucracy, create stable political institutions and reduce investment risk to attract more FDI inflows. Another important area that policy makers in SSA need to pay more attention is to improve further the overall legal environment, particularly the law enforcement to help reduce transaction costs and encourage personal/private investors seeking opportunities to grow in SSA countries.

Second, the findings of this study also imply that senior managers charged with the responsibility of making international expansion decisions should not focus on the availability of natural resources but should also pay attention to the host country investment policies and institutions that enable their firms to reduce cost and gain competitive advantage. Overall, the findings of this study suggest that host country government policies can influence MNE investment decision making and strategies thereby supporting the political economy view and institutional theory of FDI which indicate that government and host country policies environment matter for a firm's investment strategies.

---Insert Table 6 here please---

Concluding Remarks

The study has analysed the impact of government policies and home country institutions on FDI inflows in Nigeria. The study is one of the first attempts to examine the trends and effect of government policies on FDI in sub-Saharan Africa using a data which spans from 1962-2012 and employing both qualitative and quantitative approaches. First, the impact of institutions on FDI inflows was examined by adopting the CCR and FMOLS regression models. The study shows that the institutions constitute important determinants of inward FDI in Nigeria. Specifically, the results of the study show that political instability and

democratic accountability exert negative and significant impact on inward FDI in Nigeria while investment risk has positive and significant bearing on FDI in Nigeria. However, the impact of corruption, rule of law and bureaucratic quality on FDI are negative and insignificant. Second, the foreign investment policies employed in Nigeria from 1962 were grouped into three phases: the limited promotion investment policy (1962–1968), the restrictive practice investment policy (1970–1985), and the liberal investment policy (1986–2012). The impact and implications of the government investment policies were analysed by relating the investment policies to the trends of FDI inflows. Our results indicate that the liberal investment policy phase attracted more FDI inflows compared to other phases. This is followed by the limited promotion investment policy phase with the restrictive investment policy phase being the one which brings in the least FDI inflows.

Although this study focuses on Nigeria, the findings have implications for other SSA countries given the similarity of institutions and government policies in Africa. While this study contributes to the growing stream of research on developing and emerging countries, this study has a limitation in respect of the use of unbalanced data for our analysis. While the qualitative analysis of government spans from 1962-2012 due to unavailability of data, the quantitative analysis is for a period of 1984-2012. Further research appears warranted if more data becomes available. Future studies should also examine comparative data involving a cross section of African and Asian countries to provide insightful comparisons between the effects of institutions and government policies on FDI inflows.

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Table 1. FDI-related Policy changes in Nigeria

Phases	Reform policy
First Phase: Limited Promotion Investment Policy (1962–1969)	● This was during the First National Development Plan (NDP) in 1962–1968 aimed at developing infrastructural facilities to enhance foreign investments, broaden the base of the economy and limit the risk of over-dependence on foreign trade and to put the economy on fast growth path. It was majorly affected by the Nigerian civil war from 1967-1970. The major features are: ● Establishment of Exchange Control Act of 1962: Imposed restrictions on the amount of foreign exchange that can be repatriated by foreign investors. ● Expatriate Quota Allocation Board was established in 1966. The board was charged to ensure greater indigenous participation in the control, development and management of certain economic resources in Nigeria. Protection of local investments and industries through tariffs, quotas and licensing. ● Implementation of investment incentives such as: pioneer certificates which allowed foreign investors to enjoy numerous tax reliefs, custom and excise duty reliefs (import duty relief) on imported industrial machineries, spare parts and raw materials. ● Custom tariff structure were deliberately biased in favour of capital goods and raw materials while luxury goods were either purposely put on import prohibition list or had very high import tariffs on them
Second Phase: Restrictive Practices Investment Policy (1970–1985)	● Nigeria had three development plans during this phase. The second National Development Plans (1970-1974) was launched primarily to reconstruct and rehabilitate infrastructure damaged during the civil war; the third National Development Plan (1975-1980) which was designed under the era of World oil prices boom; and fourth National Development Plan (1981-1985) which was affected by the collapse of World oil prices and decline in oil generated revenue. Government introduced Economic Stabilization Act to ameliorate the impact of oil price fall aimed at reducing government expenditure. Its features include: ● Foreign exchange and trade barriers such as import licensing controls intensified in 1971–1972 to support import substitution industrialisation policy. In between this phase, 1975-1980, exchange control was reduced and restrictions on import payment were abandoned and additional incentives for fast depreciation allowance on capital goods were granted to foreign firms. ● Nigeria Enterprises Promotion Decree (NEPD) of 1972 also known as indigenisation policy, which limited equity ownership of foreign investors to a maximum of 60 per cent and reserve some business sectors for Nigerians while the foreign entrepreneurs were left with businesses requiring higher technology and capital outlays. It was aimed to accelerate indigenisation, by restricting activities of foreign investors. ● 1977: The indigenisation policy decree amended to further limit foreign equity participation in Nigeria business, and expanding the list of activities exclusively reserved to Nigerian investors; lowering permitted foreign participation in the FDI-restricted activities from 60 to 40 per cent, and adding new activities restricted to 40 per cent foreign ownership and creating a second list of business activities were permitted foreign investments was reduced from 100 to 60 per cent ownership.
Third Phase: Liberal Investment Policy (1986–1994)	● Prior to 1986, Nigeria has been adopting medium term development plans as framework for development. The policy features during the era were: ● Introduction of Structural Adjustment Programme (SAP) in 1986 under the auspices of IMF. The SAP simplified the regulatory environment and attempted removing cumbersome administrative controls and create market friendly environment. SAP introduced liberalisation such as: the elimination of import tariffs, export taxes and import quotas, liberalisation of prices and trade, and privatisation of public enterprises.

| | ● | Started the removal of the ownership limitations on foreign investment under the 1972 and 1977 indigenisation policy decrees, reduced corporate tax rates, and introduced a debt-equity conversion programme in Nigeria. |

● Creation of the Industrial Development Coordinating Committee (IDCC) in 1988: Established the one-shop agency to facilitate foreign investors' registration and their investments into Nigeria. IDCC replaced the NEPD of 1972 and 1977.

● The National Office for Technology Acquisition and Promotion (NOTAP) Decree No. 82 of 1992. Established to coordinate FDI involving technology transfer contracts with local firms in the areas of industrial property rights, technical assistance, and other commercial technology transactions. Agreements on technology transfer to submit to NOTAP for evaluation before such agreements could be implemented in Nigeria.

Fourth phase: First reforms investment policies.(1995-2002)

● This era relaxed the indigenisation policy of 1972 and 1977 and with the return of democracy in 1999, there were reforms aimed to address the distortion in the economy. Some of its major features were:

● Decree 16 of 1995 established the Nigerian Investment Promotion Commission (NIPC) and repealed the IDCC decree No. 36 of 1988 and the indigenisation policy. Reversed the restrictions on foreign investment equity ownership limit. NIPC provided for foreign investors to set up a business in Nigeria in all sectors (except for a short negative list: including drugs and arms) up to 100 per cent ownership rights with exception of the petroleum sector where foreign investment is limited to JV. NIPC guaranteed foreign investments from nationalisation or expropriation, streamlined registration procedures by providing one-stop-shop.

● Decree 17 of 1995 established the Foreign Exchange (Monitoring and Miscellaneous Provision) Act. The decree permitted free repatriation of dividends accruing from such investment or of capital in an event of sales or liquidation of business (net of taxes). The decree allows foreign investors to bring in or take out their capital through an authorised dealer who issues a certificate of capital importation to the investors as evidence of the funds that have been brought into the country to qualify for repatriation and permitted foreign investor to open a foreign currency domiciliary account with any authorised dealer for investment purposes.

● Decree, No. 28 of 1999 form the legal framework for the privatisation of Public Enterprises (Privatisation and Commercialisation).

● ICPC was created in 2000 to assist in fighting corruption.

Fifth phase: Second reforms investment policies.(2003-2012)

● Nigeria adopted the National Economic Empowerment and Development Strategy (NEEDS) in 2003. NEEDS made FDI attraction an explicit goal for the government. Further policy reforms from 2003 saw the need to fight corruption; enshrine a culture of transparency, good governance and fiscal responsibility, and to protect foreign investment.

● Privatisation of public enterprise, tax reform to reduce tax burden, trade liberalisation and the abandonment of trade regulation, free determined exchange rate and security of property rights.

● EFCC was established in 2004 to assist in fighting corruption.

Notes: Compilation by authors based on various laws/decrees and literature from Analogbei (2000); Ukaegbu (1991); Banjoko *et al.* (2012); Uche (2012); Coker *et al.* (2012); (Ismaila, 1985; Ogbuagu (1982); UNCTAD (2009). Okigbo (1989); Okejiri (2000); Okezie and Amir (2011).

Table 2: Unit Root Test

Variable	ADF		Philip Perron		Order of Integration
	Level	First Difference	Level	First Difference	
Log of FDI	-2.029	-11.440*	-1.940	-11.018*	I(1)
Political stability	-1.060	-3.621*	-1.379	-3.647*	I(1)
Corruption	-1.060	-3.621*	-1.379	-3.647**	I(1)
Democratic Accountability	-2.196	-5.137*	-2.140	-5.184*	I(1)
Rule of law	-1.572	-3.186**	-1.789	-3.183**	I(1)
Bureaucratic quality	-2.535	-4.763*	-2.657***	-4.783*	I(1)
Investment risk	-2.281	-5.830*	-2.355	-5.809*	I(1)
Inflation, CP (annual %)	-2.482	-4.635*	-2.457	-4.610*	I(1)
Log of oil export and re-export	-1.473	-6.134*	-1.929	-6.301*	I(1)
Log of total oil revenue	-1.533	-6.212*	-2.037	-6.356*	I(1)
Notes: * = 1%; ** = 5 % and *** = 10 % level of significance respectively					

Table 3: Selection-order criteria

Lag	LL	LR	df	P	FPE	AIC	HQIC	SBIC
					Model 1			
0	−295.784				0.051612	−3.63096	−3.63096	−3.63096
1	−85.7573	420.05*	81	0.000	5.1e^{-06}	−13.1885*	−12.0325*	−9,30099*
2	.	.	81	.	-8.2e^{-23}*	.	.	.
	Endogenous: LFDI PolS Cor DemA Law Bur InfR InvR LOEx; Exogenous: _cons							
					Model 2			
0	-295.685				0.051234	-3.63832	-3.63832	-3.63832
1	-83.8305	423.71	81	0.000	4.4e^{-06}	-13.3312	-12.1753	-9.44372
2	563.087	1293.8*	81	0.000	4.3e^{-23}*	-55.251*	-52.9391*	-47.476*
	Endogenous: LFDI PolS Cor DemA Law Bur InfR InvR LOTr; Exogenous: _cons							

Table 4: Result of Johansen tests for co-integration

		MODEL 1			MODEL 2			
	PARMS	LL	Eigenvalue	Trace statistics	LL	Eigenvalue	Trace statistics	*5 % Critical value*
r = 0	*9*	-235.01515	.	266.5484	-223.54774		266.8356	*192.89*
r ≤ 1	*26*	-189.63286	0.96090	175.7838	-187.37028	0.96306	174.4807	*156.00*
r ≤ 2	*41*	-165.48718	0.82177	127.4925	-162.8054	0.82703	125.3509	*124.24*
r ≤ 3	*54*	-147.51208	0.72305	91.5423*	-145.04679	0.71874	89.8337*	*94.15*
r ≤ 4	*65*	-132.08988	0.66766	60.6978	-129.78432	0.66384	59.3087	*68.52*
r ≤ 5	*74*	-120.46425	0.56413	37.4466	-118.51753	0.55281	36.7752	*47.21*
r ≤ 6	*81*	-109.50483	0.54288	15.5278	-107.59093	0.54181	14.9220	*29.68*
r ≤ 7	*86*	-104.95957	0.27723	6.4372	-103.19864	0.26929	6.1374	*15.41*
r ≤ 8	*89*	-102.69717	0.14922	1.9124	-100.99129	0.14587	1.7227	*3.76*
r ≤ 9	*90*	-101.74095	0.06602		-100.12995	0.05967		

.

Table 5: Co-integration regression result

Log of FDI	FMOLS						CCR					
	Model 1 (Equation 1)			Model 2 (Equation 2)			Model 1 (Equation 1)			Model 2 (Equation 2)		
	Coef	Srd Err	z	Coef	Std Err	z	Coef	Std Err	z	Coef	Std Err	z
Political stability	-0.3103452 (0.000)	0.065273	-4.75	-0.3027108 (0.000)	0.0648089	-4.67	-0.3049376 (0.000)	0.0644809	-4.73	-0.2970191 (0.000)	0.0641581	-4.63
Corruption	-0.0222227 (0.908)	0.1923499	-0.12	-0.0187752 (0.922)	0.1919697	-0.10	-0.0180639 (0.926)	0.1931824	-0.09	-0.0141794 (0.941)	0.1928104	-0.07
Democratic Accountability	-0.1866218 (0.023)	0.0823358	-2.27	-0.1766238 (0.030)	0.081618	-2.16	-0.1846891 (0.027)	0.0835987	-2.21	-0.1748524 (0.035)	0.0830031	-2.11
Rule of law	-0.0250859 (0.739)	0.0753963	-0.33	-0.0355497 (0.637)	0.0753225	-0.47	-0.0270126 (0.721)	0.0755448	-0.36	-0.0376869 (0.618)	0.0754686	-0.50
Bureaucratic quality	-0.1302625 (0.264)	0.1165561	-1.12	-0.103425 (0.371)	0.1155221	-0.90	-0.1083799 (0.293)	0.1031573	-1.05	-0.0801865 (0.433)	0.1023389	-0.78
Investment risk	0.3806127 (0.000)	0.0577375	6.59	0.3767198 (0.000)	0.0576183	6.54	0.3772824 (0.000)	0.0584599	6.45	0.3729899 (0.000)	0.0583191	6.40
Inflation, CP (annual %)	0.000947 (0.757)	0.0030608	0.31	0.0003283 (0.914)	0.0030538	0.11	0.0008822 (0.775)	0.0030868	0.29	0.000262 (0.932)	0.0030798	0.09
Log of oil export and re-export	0.5382365 (0.000)	0.0344531	15.62				0.5395763 (0.000)	0.0354255	15.23			
Log of total oil revenue				0.5312655 (0.000)	0.0339742	15.64				0.5328186 (0.000)	0.0349478	15.25
_cons	4.741637 (0.000)	0.6724318	7.05	4.657676 (0.000)	0.6680552	6.97	4.67258 (0.000)	0.6460183	7.24	4.589113 (0.000)	0.6426294	7.14
R^2	0.958641			0.9599232			0.9596502			0.9601425		
Adj. R^2	0.9412267			0.9417697			0.9426608			0.9433603		

Note: p-values in parenthesis

Table 6: Relationship between Investment Policy Phases and Inward FDI in Nigeria

Investment Policy		Oil Sector (%)	Non-Oil Sector (%)	Total (%)
Limited Promotion (1962-1969)		*	*	13.63
Restrictive Practices (1970-1985)		5.30	9.40	8.45
Liberal and Reforms	1986-2012	32.84	31.77	32.43
	1986-1994	*59.69*	*37.18*	*53.12*
	1995-2012	*15.69*	*20.23*	*16.98*

Notes: Source: Compiled by Authors based on CBN database.

*=No disaggregated data for FDI inflows for the period.