VARIATIONS IN OIL PRICES AND FOREIGN DIRECT INVESTMENT INFLUX IN NIGERIA

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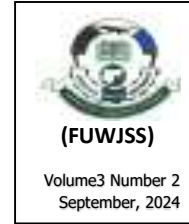
Abstract

This study analyzed the effects of variations in oil prices on the influx of foreign direct investment (FDI) in Nigeria. The study employed the Johansen cointegration and Vector Error Correction Model (VECM) techniques to analyzed data covering the period 1990-2021. The study used secondary data sourced from the World Development Indicators. The study results revealed that in the short term, an increase in oil price variations led to a decrease in FDI. This suggests that oil price fluctuations do not favour FDI in Nigeria in the short run. On the other hand, the study observed a positive and significant relationship between oil price variations and FDI in the long term. This implies that as oil prices change, there is a corresponding positive and significant impact on foreign direct investment in Nigeria over an extended period. The study concludes that there is need for the Nigerian government to ensure consistent implementation of effective measures to maintain competitive oil prices. This not only positively and significantly influences the inflow of FDI into the country but also generates more revenue for the economy. The study recommends the implementation of appropriate policies to diversify the Nigerian economy, reducing its excessive dependence on oil exports. This diversification is crucial for achieving sustained economic growth in Nigeria.

Keywords: Oil Price, variations, export, FDI, trade, revenue

Introduction

Variations in oil prices have become a significant source of concern for many oil-exporting countries, including Nigeria, as these price changes play a pivotal role in determining their overall revenue. This impact is especially pronounced in the case of emerging oil-exporting nations, as they often lack financial stability and are vulnerable to various external economic shocks, as noted by Sek, Teo and Wong (2015). Consequently, the study of how oil price fluctuations influence investment decisions has garnered substantial attention among researchers in different countries. Nevertheless, oil is widely recognized as one of the most critical commodities in modern industrial economies (Muhammad, 2021). It is essential for various purposes, including generation of electricity, powering transportation, and the production of petroleum-based products such as gasoline, diesel, and kerosene (Maruping & Mongale, 2017). However, the connection between foreign direct investment and oil price fluctuations as determinants of economic growth remains unclear due to the disparate findings in the existing literature.

In summary, the variation in oil prices is a significant concern for oil-exporting countries, particularly emerging economies like Nigeria, where the impact of such variations on revenue is substantial. Despite the acknowledged importance of oil in industrial economies, the relationship between FDI and oil price fluctuations in driving economic growth remains uncertain, given the divergent findings in the literature.

Studies like Michael, Salako, and Temilade (2015), Quero-Virlaa (2016) and Al-Al-Mihya (2017) have collectively confirmed the existence of a connection between FDI and variations in oil prices. This relationship can take on a positive or negative character. A positive correlation between FDI and oil price fluctuations emerges when the price of oil rises. An increase in oil prices leads to enhanced economic growth, a decrease in unemployment rates, and lower inflation levels (Quero-Virlaa, 2016). This positive change in oil prices attracts foreign investors. Building on this, Ademakinwa & Omokanmi (2017) underscore the significant impact of oil price shocks on FDI and domestic investment levels, which, in turn, have substantial contributions to the overall growth of the Nigerian economy.

On the other hand, FDI has captured the attention of both well-established and emerging nations over the past few decades, highlighting the fact that foreign capital inflows complement domestic savings in an open economy, fostering capital formation and stimulating economic

growth, as noted in Mohamed & Mohammed (2020). The link between FDI and oil price fluctuations as drivers of economic growth remains uncertain due to divergent findings in the existing literature. Nevertheless, various studies have been conducted on different aspects of the crude oil market and investor sentiment. The global decline in oil prices per barrel during 2014/2015, according to Wagner (2016), eroded investor confidence and was expected to take longer to recover than the rebound of oil prices. Adejumobi & Julius (2017) argued that oil price volatility had undermined years of investment-friendly policy reforms, with the global oil price having a substantial impact on FDI inflows. Similarly, Afiefa (2016) posited that crude oil price shocks could impede an economy's growth momentum and negatively affect investors' risk appetite, thereby slowing down inflows of FDI. Furthermore, Michael, Salako, & Temilade (2015) asserted that there exists a negative relationship between world oil prices and foreign direct investment in Nigeria. Additionally, Al-Mihya (2017) observed that FDI inflows are adversely affected by economic crises and that a reduction in oil prices significantly reduces investment inflows while weakening the currencies of oil-exporting nations.

Given that oil accounts for up to 90% of Nigeria's total exports, contributes to 25% of the Gross Domestic Product (GDP), and generates over 80% of government revenue, it becomes evident that even slight changes in oil prices can exert a significant influence on the country's economy (Rotimi & Ngalawa, 2017; Sala-i-Martin & Subramanian, 2003). This is supported by the example of a one-dollar increase in oil prices in the early 1990s, which led to a substantial boost in Nigeria's foreign exchange earnings, amounting to over 650 US Dollars. During this period, Nigeria's annual public revenues surged to more than 320 million US Dollars (Sala-i-Martin & Subramanian, 2003). Consequently, Nigeria's heavy reliance on oil as a primary source of revenue carries substantial economic implications, especially during periods of global oil price decline. Such conditions have triggered adverse effects on the Nigerian economy, including the ongoing devaluation of the Naira, resulting in higher overall price levels for goods and services, as well as a decrease in FDI. Furthermore, Rotimi & Ngalawa (2017); Chugan & Mehta (2014) argue that negative oil price fluctuations hinder investment decisions in an economy by influencing the cost of inputs. In contrast, Dal Bianco & Nguyen (2017) dispute the existence of a connection between oil price fluctuations and FDI, asserting that human capital and trade openness are the defining economic variables that determine FDI.

This study aims to investigate the relationship between oil price variations and the influx of FDI in Nigeria, utilizing time series data. The primary objective of the study is to assess the impact of oil price fluctuations on FDI influx in Nigeria over the past thirty two years and quantify the extent of these impacts.

In oil-exporting countries such as Nigeria, where oil exports play a pivotal role in the economy, the influence of oil price variations on Foreign Direct Investment (FDI) is a subject of ongoing concern and debate. For instance, Ademakinwa & Omokanmi (2017) argued that fluctuations in oil prices do not necessarily correspond proportionally with an increase in FDI. They highlighted the significant impact of oil price shocks on FDI and domestic investment levels, which, in turn, contribute substantially to the overall economic growth of Nigeria. However, this study falls short in quantifying the precise relationship between oil prices and the overall investment flow into an economy.

Taking a different perspective, Michael, Salako, & Temilade (2015) contended that there is a negative relationship between global oil prices and FDI in Nigeria. They proposed that factors such as gross domestic product, exchange rates, inflation rates, trade openness, and global oil prices collectively account for 88% of the variations in FDI in Nigeria. Hence, this study endeavors to investigate whether fluctuations in oil prices indeed impact the influx of FDI into Nigeria and to gauge the magnitude of this relationship. In doing so, it aims to address the following questions: what is the relationship between oil price variations and FDI influx in Nigeria? To what extent do variations in oil prices influence the flow of FDI into oil-exporting countries, with a specific emphasis on Nigeria, and what are the implications of these fluctuations for economic stability and growth?

This inquiry is particularly pertinent because Nigeria possesses a competitive advantage in crude oil production among other nations and derives more than 50% of its annual Gross Domestic Product from this industry (NBS, 2021). Consequently, understanding the effect of crude oil price changes on FDI inflows into the country is crucial for enabling policymakers to make informed decisions regarding the influence of their actions on oil prices. To the best of our knowledge, only a limited number of studies have explored this aspect in the context of Nigeria. Among these, Ademakinwa and Omokanmi (2017) used Structural Vector Auto Regression (SVAR), while Udoh (2014) employed Ordinary Least Squares (OLS) to examine the relationship between FDI and oil price fluctuations in Nigeria. Differing from these approaches, this study

utilizes Johansen cointegration techniques to establish a cointegrating relationship in the model, which, in turn, suggests Vector Error Correction Model (VECM) techniques to explore the short-run and long-run behavior of the variables within the model with the hope that findings from the study offer a different view on oil price variations and FDI nexus.

Oil Price Fluctuations, Foreign Direct Investment and Macro-economic Growth in Countries of the Global South

The extent of FDI[1] within a nation can serve as an indicator of how potential investors perceive the attractiveness of that country for investment. The primary aim of such investments is to secure a lasting stake and effective control over the management of the enterprise or firms in which the direct investment occurs. Incorporating the influence of oil prices on South Asian countries using Ordinary Least Squares regression, it is evident that oil price fluctuations impact various macroeconomic variables in these countries. Muhammad (2021) found that rising oil prices correlate with increased FDI and inflation rates. In contrast, Chugan and Mehta (2014) suggests that oil price fluctuations negatively affect investment in Pakistan, resulting in a decline in economic growth due to their role in promoting inflation, which, in turn, raises the cost of investments in the country.

In Thailand, Wadud and Huson (2014) employed SVAR and GARCH methods to explore the relationship between oil price volatility and investment responses. Their findings confirm that oil price fluctuations have an adverse impact on the overall real investment within the economy.

In the context of Singapore, an investigation into the interplay between FDI, the global financial crisis, and oil prices reveal a close short-term relationship between external shocks and foreign direct influx, as determined through the Lagrange Multiplier (LM) unit root test. Wong, Goh, and Lean (2015) attribute the external shocks in foreign direct investment to events such as the Mexican crisis, the global fund crisis, the Asian financial crisis, and high oil prices.

An exploratory study focused on examining the impact of oil price volatility on Nigeria's economic growth employs a review of conceptual

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[1] Anochie, Ude, and Mgbemena (2015) defined FDI according to the World Bank as investments made with the intention of obtaining a long-term management interest in a company or enterprise operating in a country different from that of the investor, determined by residency.

and empirical literature. The findings align with various empirical studies, indicating a positive correlation between oil price volatility and economic growth in Nigeria. This signifies that fluctuations in oil prices exert an influence on government expenditure, inflation rates, and unemployment levels, ultimately impacting the growth of the Nigerian economy. Consequently, recognizing the destabilizing effects of oil price fluctuations on economic activity and government spending, the paper recommends that Nigeria diversify its revenue sources by reducing its reliance on crude oil and other petroleum products, transitioning towards agriculture, practicing fiscal prudence, and encouraging domestic savings (Donwa, Mgbame & Ekpulu, 2015).

In a study examining the impact of crude oil price volatility on Nigerian economic growth from 1980 to 2014, it was discovered that there exists a significant and positive relationship between oil prices and economic growth. Consequently, the research team concluded that oil price volatility adversely affects the economy. As a solution, it was suggested that Nigeria should diversify its sources of export revenue to reduce its dependence on crude oil and petroleum products. This could be achieved by rejuvenating the non-oil sector, diversifying exports, and reforming budget allocations, as proposed (Nwanna & Eyedayi, 2016).

Equally, Majavu & Kapingura (2016) examined the determinants of FDI inflows in South Africa. The study utilized a Johansen cointegration test, utilizing quarterly data from 1980 to 2012. In their findings, they confirmed a significant and positive correlation between GDP, corporate tax, inflation, and openness, with FDI as the dependent variable. In the context of analyzing the impacts of an economic crisis on FDI, in the Kurdistan region, Al-Mihya (2017) found that the economic crisis had a negative impact on FDI inflows. Additionally, a reduction in oil prices significantly affected the volume of FDI inflows in the country. The study also noted that currency volatility in the country contributed to decreased investment flows, with foreign investment constituting a smaller portion of total investments in the country.

To ascertain the impact of crude oil price shocks on FDI inflows in Nigeria between 1980 and 2014, Adejumobi & Julius (2017) employed a Structural Vector Autoregression model. The study concluded that up to 10.7% of the variance in FDI inflow could be attributed to crude oil prices, making it particularly relevant to an oil-exporting nation. Buttressing this claim, Ademakinwa & Omokanmi (2017) assert that oil price shocks did not directly result in a proportionate increase in FDI. Instead, these shocks exerted a substantial influence on FDI and domestic

investment levels, which, in turn, significantly contributed to overall economic growth in Nigeria. The study, however, did not provide a specific quantification of the relationship between oil prices and overall investment flows into an economy. From a different standpoint, Michael, Salako, & Temilade (2015) contended that there is a negative association between world oil prices and FDI in Nigeria. They also discovered that GDP, exchange rates, inflation rates, trade openness, and world oil prices jointly explained 88% of the variations in FDI in Nigeria.

In the context of Saudi Arabia, Mahmood, Tawfik, & Alkhateeb (2018) utilized the ARDL methodology to investigate the nexus between FDI, domestic investment, and oil prices. Their analysis revealed a positive but insignificant impact of economic growth on FDI inflows, both in the short and long run. On the other hand, rising oil prices and favorable market developments positively influenced FDI inflows into the country.

Yang, Chou, Yang & Nguyen (2018) highlighted that stock market fluctuations can serve as an economic indicator and a measure of business cycles. The study noted a positive relationship between stock price fluctuations and macroeconomic performance. This, in turn, could affect investment motivation and capital availability, potentially leading to negative impacts during market downturns. Conversely, an increase in oil prices, along with effective management practices, positively influenced investment flow. Thus, monitoring oil price fluctuations can offer insights into future market trends, adding value and reducing losses (Caldecott, Holmes, Fruitage, Orozco & Tomlinson, 2018). In an examination of the effect of oil price volatility on the business cycle in Nigeria, Agheyisi (2018) employed the ARDL bounds approach to cointegration using time series data from 1970 to 2015. The results suggested that oil price volatility had a positive and significant short-term impact on GDP, but no significant long-term effect. This outcome may be attributed to the country's heavy reliance on oil exports.

Umoru, Ohiomu & Akpeke (2018) used Vector AutoRegressive (VAR) econometric techniques to study the effect of volatile oil prices. They found that such price fluctuations had detrimental effects on government expenditure, exchange rates, external reserves, and real GDP. Their study recommended diversifying revenue sources in the country and addressing excessive dependence on crude oil exports through agricultural reformation, mining and mineral development, and industrial policy initiatives to achieve sustained economic growth and development in Nigeria.

Considering Van Der Berg, Mazibuko, & Rootman (2021) recent study on the determinants of FDI inflow in South Africa, the analysis revealed that both internal and external stakeholder interventions positively influenced FDI. This underscores the importance of stakeholder engagement in motivating multinational corporations to engage in FDI. Additionally, the study found a positive relationship between FDI and government considerations in South Africa, assuming that the government supplies most of the resources available to FDIs.

Theoretical Framework

The theoretical connection between FDI and fluctuations in oil prices is established through various economic theories that consider both FDI and oil price variations as critical factors in fostering economic growth through technological development and research. One such theory is the Solow growth model. The Solow model places its focus on the elements that drive increased production and assesses to what degree heightened production can be attributed to greater inputs, enhanced productivity, or a combination of both. The fundamental conclusion drawn from this model is that the accumulation of physical capital alone cannot fully explain the substantial long-term growth in output per person. Rather, sustained growth is achieved primarily through advancements in technology. According to this theory, a continual increase in capital investment temporarily boosts the growth rate, as it results in an increased capital-to-labor ratio.

Research Methodology

The study uses secondary data spanning from 1990 to 2021 and data was sourced from the World Development Indicators. The choice of the commencement and end date is based on data paucity. FDI is proxy as FDI net inflows (% of GDP), oil price is proxy as Pump price for gasoline (US$ per liter), exchange rate is captured as real exchange rate (% of GDP) and trade (% of GDP). The choice of FDI and oil prices is influenced by the objective of the study, seeking to examine how FDI respond to variations in oil prices. The exchange rate is included following the literature (see Rotimi and Ngalawa, 2017).

This study leans on the augmented Solow (1956) growth model which embodied technology, capital and labour strength, and human capital as an important factor of growth determinant in the economy. However, following these studies, the model for this study is specified as:

$$FDI_t = \zeta_0 + \zeta_1 OP + \zeta_2 RER + \zeta_3 TRD + \zeta_t$$
$$(1)$$

Where FDI is Foreign Direct Investment, OP is pump price for gasoline (US\$ per liter), RER is real exchange rates and TRD is trade.
ζ_0 is the constant parameter, $\zeta_1 - \zeta_3$ are parameters of the independent variables in the model and ζ is the error term.
To estimate the model, the study adopts VECM since all variable in the model are integrated of order one I(1). Hence, to test the long-run equation, we specify the model as:
$$\Delta FDI_t = \zeta_0 + \zeta_1 OP + \zeta_2 RER + \zeta_3 TRD + \zeta_t$$
$$(2)$$
Where Δ is difference operator.
Moreover, in the process of constructing a short-term model with an error correction term, the long-term model served as the basis for generating residuals. Consequently, when a long-term relationship exists among the variables within the model, it necessitates the creation of a corresponding adjustment model. As a result, the short-term error correction model is defined as:
$$\Delta FDI_t = \zeta_0 + \zeta_1 \Delta OP + \zeta_2 \Delta RER + \zeta_3 \Delta TRD + \zeta_t \Delta TRD + \varphi_t$$
$$(3)$$
The symbol Δ represents the first difference operator, while ECT_{t-1} denotes the lagged error correction term. The objective of using ECT is to determine the dynamics and the speed at which the oil price adjusts towards equilibrium.

Results and Discussions
Stationarity tests

Table 1: ADF unit root test

Variables	5% Critical values	ADF t-statistic	Outcome
FDI	-3.580623	-33.23162	I(1)
OP	-3.568379	-5.881524	I(1)
EXCHR	-3.562882	-5.236425	I(1)
TRD	-3.562882	-6.821715	I(1)

Source: author's computation (2023).

The Augmented Dickey Fuller (ADF) was used to determine the order of stationarity of the data used. The decision rule of the unit root test states that if the ADF t-statistic is greater than the critical values, then, we do

not reject the null hypothesis. Thus, Table 1 shows the unit root test of the variables and the model. This result indicates that at 5% critical value, all the variables in the model are stationary after first differencing. Therefore, the study concludes that there is no unit root and the variables are stationary.

The Johansen Cointegration test

Table 2: Cointegration Result

No of Cointegrating Equations	Engen –value	Trace-Statistics	0.05 critical value	Prob. Value
None *	0.852016	75.46751	47.85613	0.0000
At most 1	0.430725	27.70120	29.79707	0.0856
At most 2	0.406467	13.61642	15.49471	0.0941
At most 3	0.022733	0.574876	3.841466	0.4483

Source: author's computation (2023).

The Johansen cointegration test is used to examine the presence of long-run relationship among the variables in the model and the result is presented on Table 2. From the results, the trace test indicates the existence of one cointegrating equation at 5% critical value. This therefore indicates that long-run relationship exists between the variables in the model.

Table 3: Normlized cointegrating coefficients

FDI	OP	RER	TRD
1.000000	-2.663551	-0.019689	-0.072095
	(0.84348)	(0.00602)	(0.01405

Source: eviews10-author's computation.

When interpreting the normalized cointegrating equation, it is essential to reverse the signs of the coefficients. Table 3 suggests that in the long run, there is a positive and significant correlation between a change in OP and FDI. Additionally, both the RER TRD exhibits a positive relationship with FDI, although their coefficients are not statistically significant at a 5% level of significance. Consequently, an increase in OP, RER, and TRD is likely to result in an increase in FDI inflows to Nigeria in the long run, and vice versa. This suggests an economic growth. This discovery aligns with the findings of Adejumobi and Julius (2017), who argued that 10.7% of the variations in FDI inflow can be attributed to the price of crude oil in Nigeria.

Table 4: VECM Estimates

Error Correction	D(FDI)	D(OP)	D(EXCHR)	SSD(TRD)
CointEq1	-0.681253	0.041234	12.93017	3.090195
	(0.20011)	(0.02230)	(1.77635)	(1.60350)
	[-3.40444]	[1.84896]	[7.27908]	[1.92715]
D(FDI(-1))		-0.000740		
	0.160591	(0.02304)	-5.590088	-2.646739
	(0.20669)	[-	(1.83482)	(1.65629)
	[0.77695]	0.03214]	[-3.04667]	[-1.59800]
D(OP(-1))		-0.870240		
	-0.659832	(0.07229)	15.72359	2.760274
	(0.64870)	[-	(5.75847)	(5.19816)
	[-1.01716]	12.0374]	[2.73051]	[0.53101]
D(REXCHR(1))		-0.000753		
	0.000752	(0.00063)	-0.009335	-0.094388
	(0.00569)	[-	(0.05054)	(0.04562)
	[0.13202]	1.18679]	[-0.18473]	[-2.06907]
D(TRD(-1))		0.001636		
	0.007004	(0.00277)	0.068046	-0.224521
	(0.02484)	[	(0.22050)	(0.19904)
	[0.28196]	0.59096]	[0.30860]	[-1.12801]
C		-0.002788		
	-0.044937	(0.02328)	7.180919	-0.695975
	(0.20888)	[-	(1.85419)	(1.67377)
	[-0.21514]	0.11978]	[3.87281]	[-0.41581]

Source: Author's computation (2023.

Based on the VECM estimates as shown in Table 4, the adjustment coefficient is negative, indicating that there is a convergence from short-term dynamics toward the long-term equilibrium, and this negative coefficient is statistically significant. Therefore, the deviation from the long-term equilibrium in the previous year is corrected in the current period at an average adjustment rate of 0.68%, cateris paribus. The results also indicate that a short-term increase in OP corresponds to a 0.65% decrease in FDI, on average, holding all other factors constant. This aligns with the findings of Michael, Salako and Temilade (2015), who also observed a negative relationship between world oil prices and FDI in Nigeria.

Conversely, a percentage change in the RER results in a 0.0075% increase in FDI in the short term. Similarly, a percentage change in TRD

leads to a 0.007% increase in FDI in the short run, ceteris paribus. This is therefore in line with Ademakinwa and Omokanmi (2017) who in their study contributed that OP shocks have a great influence on FDI and the level of domestic investment which therefore has large contributions on the level of growth in the Nigerian economy. Since their study lacks a measurement for the relationship between OP and the general investment flow into the economy, this study therefore employed the use of VECM to measure both the long and short-run relationship between OP and the flow of FDI into Nigeria.

Diagnostic tests

To test the stability of the model specified in this study, diagnostic tests consisting of RAMSEY RESET tests, heteroscedasticity test, and serial correlation analysis were carried out.

Table 5: Autocorrelation test

Lag	LRE* stat	Df	Prob.	Rao F-stat	Df	Prob.
1	14.44087	16	0.5659	0.899986	(16,43.4)	O.5739
2	13.34198	16	0.6476	0.822076	(16,43.4)	O.6547

Source: Author's computation (2023).

The outcome of the autocorrelation test has been detailed in Table 5. This test was carried out to examine the potential presence of serial correlation within the model. The criterion for this diagnostic test entails failing to reject the null hypothesis if the probability value exceeds a significance level of 5%. As indicated in Table 5, the model exhibits no evidence of serial correlation because the probability value surpasses the 5% significance level, even in the cases of lag 1 and lag 2. Consequently, we do not reject the null hypotheses suggesting the absence of serial correlation.

Table 6: Heteroskedasticity test

Chi-sq	Df	Prob.
108.3378	100	0.2674

Source: Author's computation (2023).

Table 6 presents the findings obtained from the heteroskedasticity test. The criterion for this test involves considering whether the probability value is below a predetermined significance level (alpha). If it is, the null hypothesis can be dismissed. However, the results indicated that the p-

value exceeds the chosen significance level, thereby indicating that the model does not exhibit heteroskedasticity.

Conclusions and Recommendations

This study aimed to examine the influence of oil price (OP) variations on the influx of foreign direct investment (FDI) in Nigeria. Based on the findings presented above, it can be concluded that the research questions posed have been effectively addressed. The results demonstrate a positive and substantial correlation between OP variations and the inflow of FDI in Nigeria. This substantiates the assertion that OP variations do indeed affect the influx of FDI in Nigeria. Consequently, this suggests that foreign investors exhibit greater confidence in investing in countries where commodity prices consistently rise, leading to an increased flow of FDI into oil-exporting nations like Nigeria. This finding further implies that the factors influencing OP also exert an impact on FDI inflows into the country's economy.

Hence, drawing from the conclusions, the following recommendations are proposed that the Nigerian government should consistently implement effective measures that will significantly contribute to the rise in oil prices. This will have a dual benefit, positively and significantly impacting the inflow of FDI into the economy, while also increasing revenue generation for the nation; two, the government should enact suitable policies to diversify the economy, thereby addressing the overreliance on oil exports. This strategy will lead to the attainment of consistent economic growth in Nigeria. Additionally, it will contribute to the revitalization of the non-oil sector and serve as a valuable complement during periods of declining oil prices.

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