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STUDIA UNIVERSITATIS ECONOMICS SERIES
"Vasile Goldiş" Western University of Arad
SUES
2019 - 29(2) DOI: 10.2478/sues-2019-0008

EFFECT OF CORRUPTION ON FOREIGN DIRECT INVESTMENT INFLOWS IN NIGERIA

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(Received: February 2019; Accepted: April 2019; Published: June 2019)

Abstract: This study investigates the effect of corruption on foreign direct investment inflows in Nigeria, by using some control variables. The study covers a period from 1996 to 2017 and employs Ordinary Least Squares method to perform the multiple regression analysis with the aid of SPSS version 20. The findings indicate that corruption has a significant positive influence on FDI. Though the influence of inflation is significantly negative but exchange rate and Nigeria's corruption ranking position have insignificant positive impact on FDI. The implication is that the poor legal framework and institutional qualities in Nigeria are helping corruption to thrive in all areas of Nigeria's economy and might ruin the young generation if nothing is done urgently. The study finds support for helping hand theory of corruption and FDI and also establishes that inflation has a significant negative influence on FDI inflows in the country. Therefore, the study recommends establishment of strong institutional and legal system to curtail the prevailing situation in order to save the future of the country.

Keywords: Foreign direct investment, corruption, inflation rate, exchange rate, Nigeria.

JEL Codes: D73, F21, F3, O55

1. Introduction

Foreign direct investment (FDI) inflows have been seen as a vital source of external funding among the developed, transition and developing economies. International Monetary Fund (1993) defines FDI as a foreign investment made to gain a permanent interest in a resident entity of an economy that is different from the economy of the investor which means that the investor must have a minimum of 10% of the outlay in the overseas company. Foreign direct investment (FDI) is also defined as an investment in equity with a least verge of 10% beside an

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ownership intention and long-term management interest (Hasan, Rahman & Iqbal, 2017). FDI fills three gaps in developing countries which includes: provision of funds for investment, availability of foreign currency and generation of tax revenues for the government (Quazi, Vemuri & Soliman, 2014). The recent negative FDI trend got the entire global investment community worried as to what could be the major cause of the sharp decline of FDI by 23% in 2017. UNCTAD (2018) reported that in 2016 FDI was $1.87 trillion but dropped to 1.43 trillion in 2017 with the transition economies contributing $47bn (decrease by 27.07%), developing economies contributed $671bn (decrease by 0.07%) and the developed economies contributed $712bn amounting to a decrease by 37.14%. The negative trend was a long-term concern for policymakers globally, with more emphasis on developing countries where FDI is highly needed for sustainable economic and industrial development. FDI inflows has many implications for developing countries especially in providing foreign currency and capital required for investment, as well as transfer of managerial skills and development of human capital. It increases local market competition, creates job opportunities and facilitates access to global market for export commodities among others (Quazi, 2014, Bayar & Alakbarov, 2016).

Foreign direct investment inflows in countries are determined by macroeconomic variables and institutional quality such as control of corruption and rule of law. Corruption is one of the institutional qualities that can determine FDI inflows in a country. Studies have shown that countries with good regulatory framework attract more FDI inflows while those with poor legal structure cannot safeguard investment (Peres, Ameer & Xu, 2018) and so foreign investors are scared of investing in such countries. Corruption includes bribery and any other activities of people, having obligation in the public or private sector, who disrupt their responsibilities for selfish gains (Gasanova, Medvedev & Komotskiy, 2017). The menace of corruption especially on young generation led to the OECD Anti-Bribery convention which mandated OECD member countries to enforce criminal actions against any form of bribery noticed among foreign public officials in international business transactions and to ensure effective monitoring at its implementation stage (Blundell-Wignall & Roulet, 2017).

Debates on the relationship between corruption and FDI inflows have been on the public domain. Some scholars have found support for the "helping hand" theory of corruption where it is believed that corruption enhances FDI inflows in countries with weak governance structure while others are of the opinion that it increases transaction cost and reduces investment returns. However, corruption has been found to have negative impact on FDI in studies such as (Woo, 2010; Samimi & MonFared, 2011; Alemu, 2012; Pupovic, 2012; Brada, Drabek & Perez, 2012; Quazi, 2014; Tosun, Yurdakul & Iyidogan, 2014; Gasanova, Medvedev &

Komotskiy, 2017; Tristan, 2017) while in some other studies (Bellos & Subasat, 2011; Helmy, 2013; Bayar & Alakbarov, 2016) corruption did not have any impact on FDI, but the findings of (Barassi & Zhou, 2012; Gutierrez, 2015) provided a proof that corruption influenced FDI positively and significantly. Bellos and Subasat (2011) believe that corruption can influence FDI positively because it jettisons all regulatory issues in developing and emerging economies where FDI inflows are seen as an indispensable tool for economic development, in which case most rules are relaxed and the economic setting transformed to reach the desires of foreign investors (Bayar & Alakbarov, 2016). In countries with a low quality of governance, corruption possibly promotes resource allocation and increase output (Borlea, Achim & Miron, 2017).

Irrespective of the benefits of corruption in this present time due to globalization, corruption is a prevalent universal challenge that destabilizes countries' political, social, and economic progress, thereby stealing the prospect of young children (Blundell-Wignall & Roulet, 2017; Gribincea, 2017). The corruption perception index is an index employed by Transparency International to categorize nations by their level of misuse of authority for selfish benefits among governmental institutions and the integrity of persons in power (Raluca, 2015). The government bureaucracy in most countries with high profile of corruption like Nigeria, provides an avenue for corrupt practices such that the government itself, through its legislative arms perpetrate corruption in its highest order (Erhieyovwe & Onokero, 2013). The presence of corruption in almost every facet of the Nigerian economy has negatively affected both foreign and local investments in Nigeria, such that it has become a natural phenomenon in everyday business transactions (Omodero & Dandago, 2018). Based on this background, the aim of this study is to determine the impact of corruption on foreign direct investment inflows in Nigeria. Other macroeconomic factors that their effect on FDI will be considered alongside include inflation and exchange rate.

2. Literature review

2.1. Theoretical framework

This study adopts the 'grabbing hand' and 'helping hand' theory of corruption that determine FDI inflows in a nation. Bardhan (1997) submits that the 'grabbing hand theory' refers to increase in transaction costs for foreign investors. Grabbing hand theory is associated with paying bribe to local officials for licenses, permits, security, taxes, utilities as well as commissions to politician for huge contracts. All these extra costs increase the cost of the overall foreign direct investment and by implication the returns are reduced. One of the qualitative costs of corruption is loss of a country's reputation in the international business space (Zhao, Kim & Du,

2003) especially with the current indexing pattern introduced by Transparency International to rank corrupt countries according to the level of corruption found among international business participants and government officials in a country. Another one is the distortion of normal market procedures which allows entrance to lucrative markets for only corrupt firms (Habib & Zurawicki, 2002). Lastly, existence of graft in an economy affects its growth (Mauro, 1995), government capital investments and provision of basic amenities (Tanzi & Davoodi, 1997) such as health care system and education (Gupta et al., 2000). Therefore, grabbing hand theory emphasizes that corruption increases the financial cost of FDI and at the same has inherent qualitative costs such as loss of integrity on the part of the country involved and violation of legal procedures of the nation concerned.
Similarly, corruption also has a 'helping hand' potentials which help in "greasing the wheels of commerce" in an economy where there is a porous and feeble legal system (Bardhan, 1997). Corruption provides quick money which makes due process ineffective and enables investors to jump legal protocols in businesses (leff, 1964; Huntington, 1968). According to Houston (2007) corruption improves economic growth in nations where frail legal system exists especially the countries that have remarkable economic liberty (Swaleheen & Stansel, 2007). Another benefit of corruption found is that bribes are used to augment low wages and taxes paid to the government are low in order to attract FDI (Tullock, 1996). In the presence of corruption, there is productivity and worrisome government regulations are evaded to enhance quick business decisions (Lui, 1985). Therefore, Gribincea (2017) has submitted that corruption comprises an implicit arrangement among companies, pressure groups and citizens who are making effort to satisfy their selfish interests and exploit private benefits by paying bribes, as well as government officials and politicians that also tend to maximize their revenue by unlawful means using their positions and the authority they possess.

2.2. Empirical review

2.2.1. Studies with mixed findings on corruption and FDI inflows in a country

Jong and Bogmans (2011) examined the impact of corruption on international trade by measuring the magnitude of corruption in an importing economy and comparing it with the level of corruption found in an exporting economy. The two scenarios were interesting and vital, however, the study found that the existence of corruption was more pronounced in an importing countries that have inefficient customs owing to the fact that prolonged waiting time at the border had significant adverse effect on international trade.
Buchanan, Le and Rishi (2012) investigated the impact of institutional quality of FDI inflows in 164 countries. The study employed panel data ranging from 1996-

2006 and the result indicated that institutional quality had a significantly positive influence on FDI. Godinez and Liu (2015) evaluated the relationship between corruption distance and FDI inflows into Latin America. The major finding of the study is that firms that are resident in countries with high corruption profile are usually not affected by the level of corruption prevailing in the host countries where they find investment opportunities. This is because they are coming from the same background and have the capability to manage the situation.
Hasan et al. (2017) studied the impact of corruption and FDI inflows using China and India as case studies. The results for the two countries differed though there are views that corruptions aids FDI inflows in an economy, but for India the effect was negative while for China it was positive. Blundell-Wignall and Roulet (2017) examined the impact of corruption on FDI inflows especially with the application of OECD Anti-Bribery Convention guidelines. The effect of corruption on FDI using the general population was positive, but in countries that adhere strictly to the OECD anti-bribery convention guidelines, the impact of corruption on FDI was absolutely negative.
Peres et al. (2018) measured the impact of institutional quality on FDI inflows in both developed and developing countries. The study used rule of law and control of corruption pointers to determine the degree of institutional quality existing in the countries covered by the study. The findings revealed that institutional quality existing in the developed countries significantly and positively influenced FDI inflows while that of the developing countries showed the reverse due to poor influence of their regulatory system.

2.2.2. Studies evidencing that corruption does not have influence on FDI inflows in a nation

Bellos and Subasat (2011) applied panel gravity model to consider the interface between FDI inflows and corruption in 15 transition economies from 1990 to 2005, and the study revealed that corruption did not have any statistical significant impact on FDI inflows. Helmy (2013) used panel regression to study the impact of corruption on FDI inflows in 21 Middle East and North Africa (MENA) countries from 2003 to 2009. The study provided evidence that corruption did have any significant influence on FDI inflows in MENA.
Bayar and Alakbarov (2016) employed Westerlund-Durbin-Hausman co-integration test to examine the impact of corruption on foreign direct investment inflows in 23 emerging economies from 2002 to 2014. The result of the overall panel data revealed that corruption and role of law had no significant impact on FDI inflows.

2.2.3. Studies supporting that corruption has negative impact on FDI inflows in a country

Woo (2010) applied panel regression to evaluate the impact of corruption on FDI inflows in 90 countries from 1984 to 2004 and the result indicated that corruption had a negative influence on FDI inflows. Samimi and Monfared (2011) used panel regression to evaluate the effect of corruption on foreign direct investment inflows in 16 Organizations of Islamic Cooperation countries from 2002 to 2008, the findings indicated that corruption has negative correlation with FDI inflows.

Alemu (2012) used panel regression to examine the effect of corruption on FDI inflows in 16 Asian countries from 1995 to 2009, the findings showed that corruption exerted negative influence on FDI inflows. Brada et al. (2012) studied the influence of corruption on FDI inflows in 84 countries from 2000 to 2003 and discovered that corruption impacted on FDI inflows negatively. Pupovic (2012) employed primary source of data through questionnaire to investigate the impact of corruption on FDI in Montenegro and the findings revealed that corruption had negative effect on FDI inflows in the country.

Tosun et al. (2014) employed co-integration and Error Correction techniques to examine the relationship between corruption and FDI inflows in Turkey from 1992 to 2010. The findings revealed that corruption has a negative impact on FDI in Turkey both in the long and short run. The result of the study confirmed that 'helping hand' corruption is not in existence in Turkey. Quazi (2014) employed Generalized Least Squares (GLS) to investigate the impact of corruption on FDI in 14 East and South Asia countries using panel data from 1995 to 2011. The findings revealed that corruption exerted negative and significant influence on FDI. Gasanova et al. (2017) assessed the impact of corruption on FDI inflows by dividing countries into 4 categories. The results of the study revealed that countries with low level of corruption and favourable economic environment attract FDI inflows while countries with high level of corruption and unfavourable economic environment do not attract FDI inflows. In the study Brazil, China, India and Russia fell into the category of countries with high level of corruption and high FDI inflows due to cheap labour, large domestic market and endowment of natural resources.

Tristan (2017) used the Arellano-Bound difference Generalized Method of Moments (GMM) methodology to assess the effect of corruption on foreign direct investment (FDI) inflows in the Asia and the Pacific region using panel data of 46 countries from 2006 – 2013. The findings indicated that corruption had a negative influence on FDI inflows. The study also found no significant association between FDI inflows and corruption among the low and middle income nations.

2.2.4. Studies substantiating that corruption has positive impact on FDI inflows in a country

Barassi and Zhou (2012) used both parametric and non-parametric techniques to investigate the effect of corruption on Multinational Enterprises' (MNEs) incentives to embark on Foreign Direct Investment (FDI) in a certain nation, the findings of the study had some backing for 'helping hand' role of corruption in a country. Quazi et al. (2014) used the dynamic system Generalized Method of Moments to analyze the impact of corruption on FDI in 53 African countries from 1995 to 2012. The study confirmed the helping hand theory of corruption, that is, by implication corruption accelerated FDI inflows in Africa.

Gutierrez (2015) examined the impact of corruption in attracting FDI in Argentina. The study was motivated by the rating of Argentina as one of the highly corrupt countries in South America. However, the findings of the study indicated that the high level of corruption in Argentina did not have negative impact on FDI since the focus was on exploration of natural resources.

3. Methodology

This study adopts a causal research design which connects the use of historical and secondary form of data that are not under the control of the researcher. Foreign Direct Investment (FDI) inflows in Nigeria is the response variable, while Corruption Perception Index (CPI), Nigeria's Corruption Ranking (NCR), Exchange Rate (EXG) and Inflation Rate (INF) are the explanatory variables. FDI data were sourced from the International Monetary Fund, CPI and NCR were extracted from Transparency International annual corruption index reports, while exchange and inflation rates were obtained from the World Bank website. All the data collected on both the dependent and independent variables ranged from 1996-2017. Due to disparity in the values, all the data were expressed in logarithm form in order to bring them at the same base. Ordinary Least Squares (OLS) technique was used to carry out the multiple regression with the aid of Statistical Package for Social Sciences (SPSS) version 20.

The multiple regression model adopted for the study is:

$$FDI = \beta 0 + \beta_1(CPI) + \beta_2(NCR) + \beta_3(EXG) + \beta_4(INFL) + \varepsilon$$

Where,

FDI = Foreign Direct Investment
CPI = Corruption Perception Index
NCR = Nigeria's Corruption Ranking
EXG = Exchange Rate
INFL = Inflation Rate

$\beta 0$ = Constant
β_1-β_4 = Regression Coefficients
ε = error term

A Priori economic expectation:

$\beta_1, \beta_2 < 0$
$\beta_3, \beta_4 > 0$

The a priori economic expectation is that CPI and NCR should be less than zero while EXG rate and INF should be greater than zero.

4. Data analysis and interpretation

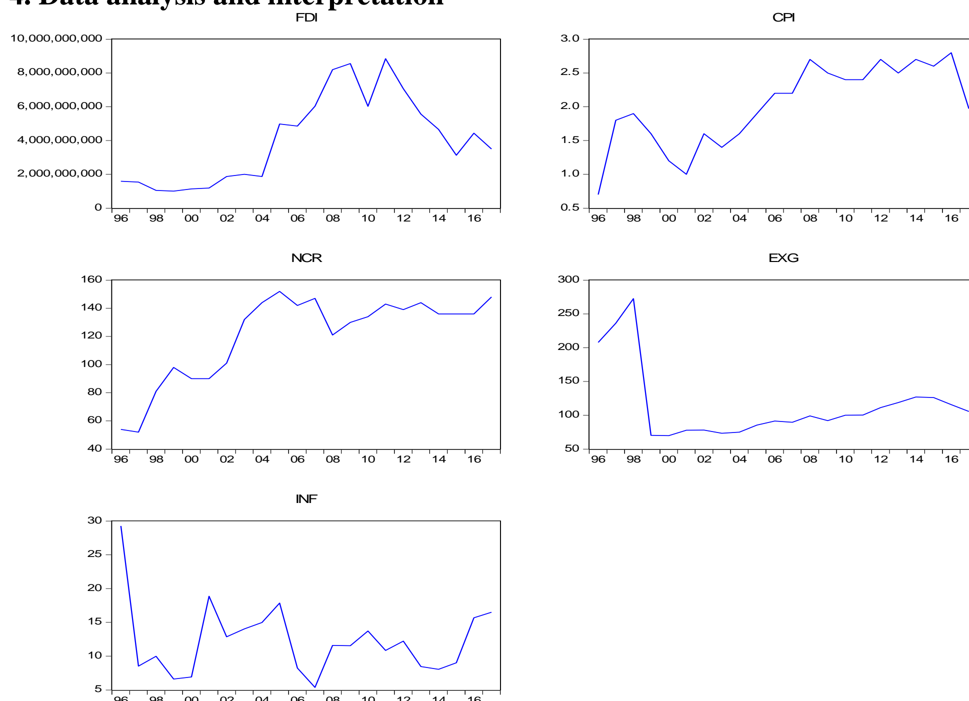

Figure 1. Trend of data for all the study variables from 1996 - 2017

Sources of Data: Transparency International annual reports, World Bank website and International Monetary Fund

Table 1. Model Summary of results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.886	.785	.734	.167114034	1.126

a. Predictors: (Constant), LOGINFL, LOGCPI, LOGEXG, LOGNCR
b. Dependent Variable: LOGFDI
Source: Author's computation, 2019

Table 1 above shows the model summary of results of the study. The correlation (R) of 88.6% indicates a strong relationship between FDI and the predictor variables (CPI, NCR, EXG and INFL) while the coefficient of determination (R Square) shows that all the independent variables explain up to 78.5% of the changes in FDI, thus, it is only 21.5% of the variation that is attributable to other variables the model did not consider. The Durbin-Watson of 1.12 falls within the limit that does not give cause for concern

Table 2. ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.729	4	.432	15.475	.000
	Residual	.475	17	.028		
	Total	2.203	21			

a. Dependent Variable: LOGFDI
b. Predictors: (Constant), LOGINFL, LOGCPI, LOGEXG, LOGNCR
Source: Author's Computation, 2019

From table 2 above, the result of the F test is 15.475 with the p-value of $0.000 < 0.05$. This result implies that the independent variables collectively influence FDI significantly and positively. The result also implies that the model is suitable for the study. Therefore, F test which measures the joint effect of predictor variables on dependent variable proves that corruption as well as Nigeria's position in the corruption ranking, the exchange rate and the inflation rate affect FDI inflows in Nigeria. By implication, corruption is not a stand-alone factor that influences FDI inflows in Nigeria, exchange rate is directly involved as well as the inflation rate. These are the major macroeconomic variables that determine FDI inflows in a country. They invariably have both negative and positive influences depending on the ability of the government in the country to exercise control over them and check their excesses timely.

Table 3. Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	8.944	1.109		8.064	.000
	LOGCPI	1.104	.327	.534	3.381	.004
	LOGNCR	.053	.467	.022	.114	.910
	LOGEXG	.238	.104	.336	2.290	.035
	LOGINFL	-.240	.067	-.642	-3.596	.002

a. Dependent Variable: LOGFDI

Source: Author's Computation, 2019

From table 3 above, the various independent variables have been tested individually using T test to determine their individual influence on FDI in Nigeria. The T test value for CPI is 3.381 with the p-value of 0.004 < 0.05 level of significance, this result shows that CPI has significant positive impact on FDI thereby providing support for helping hand theory of corruption and FDI. This statistical evidence is line with findings of (Barassi & Zhou, 2012; Quazi et al., 2014; Gutierrez, 2015) who found proofs that corruption influenced FDI positively and significantly. Though the study conflicts with the negative findings of (Woo, 2010; Samimi & MonFared, 2011; Alemu, 2012; Pupovic, 2012; Brada et al., 2012; Quazi, 2014; Tosun et al., 2014; Gasanova et al., 2017; Tristan, 2017) among others.

The NCR and EXG have insignificant positive influence on FDI, meaning that Nigeria's position in the countries' corruption ranking and exchange rate do not have any substantial effect on FDI inflows in Nigeria. On the contrary, inflation rate (INF) has significant negative impact on FDI. This implies that the higher the rate of inflation, the more adverse effect on FDI inflows. This economic situation reduces foreign investment inflows and inhibits growth in the country. FDI inflows is one the major elements that sustains economic development in the developing countries such as Nigeria and factors such as inflation does not have favorable effect on them.

5. Conclusion and recommendations

Corruption is both ethically and morally wrong even though some studies including this study have provided statistical evidences and supports for the helping hand theory of corruption on FDI. The regression results of this study shows that corruption facilitates FDI inflows in Nigeria; due to weak legal framework since the government itself uses its legislative arm to execute corrupt practices with impunity. Therefore, the study recommends proper structuring of the legislative

system and other arms of the government to ensure there is a stronger legal system in place to prevent corrupt activities. When you take a look at figure l above, FDI was declining at the same rate with CPI, that means when institutional qualities are stronger in Nigeria, FDI responds negatively.

However, the acceleration of economic activities through corruption is not a guarantee to encourage such an evil practice in the country, otherwise the young generation will be ruined. Thus, it a clarion call for all and sundry to rise up and condemn it while the government will do all it can to strengthen the legal system in the country in order to make corrupt activities difficult in Nigeria.

The study is also suggesting that the government should endeavor to keep the inflation rate at equilibrium to avoid the negative effects on FDI. The monetary authority has the responsibility through the support of the government to ensure price stability in the economy. This function should be handled with all diligence in order to encourage FDI inflows in the country. The same effort should also be made to stabilize exchange rate that keeps fluctuating, because the higher the exchange rate, the lower the profitability on the part of the host country while the foreign investors get the higher benefit with their foreign currency that exchanges a high volume of domestic currency with just a little amount.

Acknowledgements

I thank the World Bank, IMF and Transparency International for regular publication of data that gave boost to this study. The author thanks the anonymous reviewers and editors of Studia Universitatis "Vasile Goldis" Arad, Economic Series for their valuable contribution.

Funding

This research received no specific grant from any funding agency in the public, commercial, or not – for – profit sectors.

Author Contributions

The author conceived the study, carried out the literature review section and was responsible for the design, data collection, data analysis and interpretation.

Disclosure Statement

The author does not have any competing financial, professional, or personal interests from other parties.

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