**TITLE PAGE**

**THE IMPACT OF EXCHANGE RATE ON FOREIGN DIRECT INVESTMENT (FDI) IN NIGERIA**

**BY**

**EZE, CHUKWUEBUKA CHIWENITE**

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**SUPERVISOR**

**MR. ODO AUGUSTINE**

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**DECLARATION**

I, Eze, Chukwuebuka Chiwenite with the registration number U13/MSS/ECO/010 is a student in the Department of Economics under the Faculty of Management and Social Sciences in Godfrey Okoye University. I declare that the research work submitted in partial fulfillment of the requirement for the award of Bachelor of Science (B.Sc) in Economics is my original work and has not been submitted either in part or full for any other degree or diploma either in this or any other tertiary institution.

**………………………. …………………**

**Eze, Chukwuebuka C. Date**

**APPROVAL PAGE**

This is to certify that this research work “The Impact Of Exchange Rate On Foreign Direct Investment (FDI) In Nigeria” by Eze, Chukwuebuka C. in the Department of Economics has been examined and approved as meeting the requirements for the award of Bachelor of Science (B.Sc) Degree in Economics, Faculty of Management and Social Sciences, Godfrey Okoye University, Enugu.

…………………………. …………………..

**Mr. Odo Augustine Date**

(Supervisor)

…………………………. …………………..

**Okorie George C. Date**

Head of Department

…………………………. …………………..

**Prof. Ocheoha Onyema Phd.(mni) Date**

Dean of Faculty

…………………………. …………………..

**External Examiner** **Date**

**DEDICATION**

This research work is dedicated to Almighty God for His grace upon me during this research and having made the journey successful and to my parents and brothers for their love and support towards my education and for believing in me.

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I give all the glory, honour and thanks to God Almighty for his infinite mercy, grace, guidance upon my life, he is the only reason why I am where I am today.

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**ABSTRACT**

This study was undertaken to evaluate the impact of exchange rate on foreign direct investment. Three objectives and three research questions were formulated to reflect how variables like exchange rate and inflation influences the economic activities of foreign direct investment in Nigeria covering a period of 1980 to 2014 using Ordinary Least Squares (OLS) technique. The literature review was structured in thematic format to reflect the objectives. The finding derived from the result of the research showed Exchange rate has a significant impact of foreign direct investment in Nigeria. Inflation has no significant impact of foreign direct investment in Nigeria. However, the study recommends among other thing that, Nigeria should maintain a high and sustainable growth patterns to attract more foreign investment in the country. There should be conscious effort by government to ensure that the ministry of Trade and Investment collaborates with our foreign policy designers and local content developers to enable free flow of investments

***Keyword:*** *exchange rate, Inflation and FDI*

**CHAPTER ONE**

**INTRODUCTION**

**1.1 Background of the Study**

The power of the exchange rate policy under the structural Adjustment programme are to discourage imports and promote agricultural production, encourage local sourcing of raw materials something they had considered impossible before the introduction of structural adjustment programme. One cannot fail to notice that importation has decreased, exports other than crude oil has increase over the months.

Problems crisis in international transactions is because of the inefficiency in our financial system, which introduce “lag” between the time the importer and the time of the fund are actually remitted to the exporter. The remittance lag as we call it, introduces exchange rates risk into the transaction. For example the rate prevailing at the time of payment by imports may differ from the rate of which the commercial banks will use in remitting the funds.

The 1980s witnessed increased flows of investment around the world. Total world outflows of capital in that decade grew at an average rate of almost 30%, more than three times the rate of world exports at the time, with further growth experienced in the 1990s (Kosteletou and Liargovas, 2000). Despite the increased flow of investment, especially, to developing countries, Sub-Saharan Africa

(SSA) countries still lag behind other regions in attracting foreign direct investment. The uneven dispersion of FDI is a cause of concern since FDI is an important source of growth for developing countries. Not only can FDI add to investment resources and capital formation, it can also serve as an engine of technological development with much of the benefits arising from positive spillover effects. Such positive spillovers include transfers of production technology, skills, innovative capacity, and organizational and managerial practices.

Given these significant roles of FDI in developing economies there have been several studies that tried to determine the factors that influence FDI inflows into these economies. One of such factors that recently have been a source of debate is exchange rate and its volatility. The existing literature has been split on this issue, with some studies finding a positive effect of exchange rate volatility on FDI, and others finding a negative effect. A positive effect can be justified with the view that FDI is export substituting. Increases in exchange rate volatility between the headquarters and the host country induce a multinational to serve the host country via a local production facility rather than exports, thereby insulating against currency risk (Foad 2005).

In economic analysis, Foreign Direct Investment (FDI) is a direct investment by a corporation in a commercial venture in another country. Mallampally and Sauvant (2009) define FDI as an investment by multinational corporations in foreign countries in order to control assets and manage production activities in those countries. It plays an extraordinary and growing role in global business by providing a firm with new markets and marketing channels for their products. For a host country or the foreign firm which receives the investment, it provides a source of new technologies, capital, process, products, organizational technologies and modern management practices.

Foreign direct investment (FDI) not only provides developing countries (including Nigeria) with the much needed capital for investment, it also enhances job creation, managerial skills as well as transfer of technology. All of these contribute to economic growth and development. To this end, Nigerian authorities have been trying to attract FDI via various reforms. The reforms included the deregulation of the economy, the new industrial policy of 1989, the establishment of the Nigeria Investment Promotion Commission (NIPC) in early 1990s, and the signing of Bilateral Investment Treaties (BITs) in the late 1990s. Others were the establishment of the Economic and Financial Crime Commission (EFCC) and the Independent Corrupt Practices Commission (ICPC). However, FDI inflows to Nigeria have remained low compared to other developing countries (CBN, 2010).

Nigeria has over the years been a beneficiary of Foreign Direct Investment (FDI) inflow. For instance, FDI inflows increased from N786.40 million in 1980 to N2193.40 million in 1982, but soon dropped to N1,423.50 million in 1985. The value of FDI rose from N6,236.70 million in 1988 to N10,450.0 million and N55, 999.30 million in 1990 and 1995, respectively. However, the value of FDI fell drastically to N5,672.90 million in 1996 and further to N4,035.50million in 1999. The inflows of FDI has continued to rise since the year 2001, moving fromN4937.0 million to N13531.2 million in 2003 and N20,064.40 million in 2004. The FDI inflows stood at N41734.0 million in 2006 (CBN, 2006). In terms of growth rate, FDI inflows increased by 182.68 percent in 1986, the value soon fell by -24.76 percent in 1989 and further to -89.87 percent in 1996. Since the year 2000 the growth of FDI has remained positive except in 2001 when the value was -70.00 percent but since recently, 2010, 2011, 2012, 2013, and 2014 the values have been 1.09552, 2.236095, 0.668744, 7.953192 and 2.261765 respectively and they are all positive. The recent surge in FDI inflows to the country is attributable to the reduction in the nation’s debt profile (through debt arrangements with London club and Paris club) and the renewed confidence of foreign investors in the Nigerian economy (CBN, 2006).

**1.2 Statement of the Problem**

Justification for a negative impact of exchange rate on FDI can be found in the irreversibility literature pioneered by Dixit and Pindyck (1994). A direct investment in a country with a high degree of exchange rate will have a more risky stream of profits. As long as this investment is partially irreversible, there is some positive value to holding off on this investment to acquire more information. Given that there are a finite number of potential direct investments, countries with a high degree of currency risk will lose out on FDI to countries with more stable currencies (Foad 2005).

One of the countries that fall into this category (countries with a high degree of currency risk) is Nigeria. With a population of about 130 million people, vast mineral resources, and favourable climatic and vegetation features, Nigeria has the largest domesticmarket in Sub-Saharan Africa. The domestic market is large and potentially attractive to domestic and foreign investment, as attested to by portfolio investment inflow of over N1.0 trillion into Nigeria through the Nigerian Stock Exchange (NSE) in 2003 (Central Bank of Nigeria, 2004). Investment income, however, has not been encouraging, which was a reflection of the sub-optimal operating environment largely resulting from inappropriate policy initiatives.

Except for some years prior to the introduction of the Structural Adjustment Programme (SAP) in 1986, gross capital formation as a proportion of the GDP was dismally low on annual basis.

It was observed that aggregate investment expenditure as a share of GDP grew from 16.9% in 1970 to a peak of 29.7% in 1976 before declining to an all-time low of 7.7% in 1985. Thereafter, the highest was 11.8% of GDP in 1990, before declining to 9.3% in 1994. Beginning from 1995, investment/GDP ratio declined significantly to 5.8% and increased marginally to 7.0% in 1997 and remained there about till 2004 when 7.1% was recorded. On the average, about four-fifth of Nigeria’s national output was consumed annually.

The sub-optimal investment ratio in Nigeria could be traced to many factors including exchange rate instability, persistent inflationary pressure, low level of domestic savings, inadequate physical and social infrastructure, fiscal and monetary policyslippages, and low level of indigenous technology as well as political instability. A major factor was exchange rate instability, especially after the discontinuation of the exchange rate control policy. The high lending rate, low and unstable exchange rate of the domestic currency and the high rate of inflation including government expenditure made returns on investment tobe negative in some cases and discouraged investment, especially when financed with loans.

The Naira (Nigerian currency, N) exchange rate witnessed a continuous slide in all the segments of the foreign exchange market (that is, official, bureau de change and parallel markets). In the official market, the exchange rate depreciated progressively from N8.04 per US dollar in 1990 to N81.02 per dollar in 1995 and further to N129.22 in 2003 and N133.00 in 2004. Similarly, it depreciated from N9.62 and N9.61 per dollar in 1990 to N141.36 and N141.07 per dollar in 2003 in the bureau de change and parallel market, respectively. Consequently, the premium between the official and parallel market remained wide throughout the period.

This high exchange rate volatility in Nigeria, among others, led to a precarious operating environment which can be attributed to the reason why Nigeria was not only unable to attract foreign investment to its fullest potentials but also had a limited domestic investment. As such, despite the vast investment opportunities in agriculture, industry, oil and gas, commerce and infrastructure, very little foreign investment capital was attracted relative to other developing countries and regions competing for global investment capital.

**1.3 Research Questions**

In this research, the following research questions will be addressed:

1. To what extent does exchange rate impact on Foreign Direct Investment (FDI) in Nigeria?
2. To what extent doesinflation impact on Foreign Direct Investment in Nigeria?

**1.4 Objectives of the Study**

The broad objective of this study is to ascertain the determinants of foreign direct investment in Nigeria. In line with this, the following specific objectives will be actualized:

1. To determine the impact of exchange rate on foreign direct investment in Nigeria.
2. To determine the impact of inflation on foreign direct investment in Nigeria.

**1.5 Hypotheses of the Study**

In carrying out this study, the following hypotheses will be tested:

1. Ho: Exchange rate has no significant impact on foreign direct investment in Nigeria.
2. Ho: Inflation has no significant impact on foreign direct investment in Nigeria..

**1.6 Significance of the Study**

A research draws its relevance from the present and prospective beneficiaries and its contribution(s) to academia at large. The pertinence of this research is justified on the grounds that it will reveal the significant determinants of foreign direct investment in Nigeria for the years under review; and thus provides a framework for policy prescriptions and interventions.In furtherance to the above, this research will find its relevance as made evidence in the following:

**Government:** The federal government will find this study highly relevant as it will provide a picture of the relative determinant and impact of selected macroeconomic variables on foreign direct investment and thus motivate relevant policy reforms or sustenance. This research will also find its relevance in the coffers of financial variable analysts given that the subject under study is purely a monetary phenomenon.

**Subsequent Analysts:** This investigation will also serve as a stepping stone for researchers who develop interest in carrying an empirical analysis on the concept of foreign direct investment and relative determinants in Nigeria.

**Scholars:** Students will find this piece highly relevant as it will undeniably increase their knowledge and horizon on the concept of foreign direct investment and corresponding determinants.

**The Academia:** The education sector is also considered as one of the significant beneficiaries because it is believed that this research will be an addition to the existing stock of knowledge.

**Researchers:**This study would enable the researchers to investigate and understand trendsand relationships of variables involved in this study and probably build on it in their studieson FDI determinants.

**1.7 Scope of the Study**

The subject scope of this study is anchored on carrying out an empirical analysis of the impact of exchange rate and inflation on foreign direct investment in Nigeria. This will encompass the period 1980-2014.

**1.8 Definition of Terms**

**Exchange Rate:** In the context of this study, this is defined as the price of a local/domestic currency at the international foreign exchange market. In this research, the exchange is the relative price of naira to U.S Dollars.

**Inflation:** This is the measure of price level in the economy. By definition, it is the rate at which general level of prices of goods and services is rising and consequently, the purchasing power of currency is falling.

**Foreign Direct Investment:** This is the investment made by a foreigner in a given country for the sole purpose of maximizing profit. Most Multinational Companies (MNCs) in a given country are foreign direct investments.

**CHAPTER TWO**

**LITERATURE REVIEW**

**2.1The Conceptual Literature**

**2.1. 1 Exchange Rate Levels**

Exchange rate movements and exchange rate uncertainty appear to be important factors investors take into consideration in their decision to invest abroad. Much of the literature on exchange rate movements and FDI concentrates on two issues: the level of the exchange rate, and the volatility of the exchange rate.

Froot and Stein (1991) claimed that the level of exchange rate may influence FDI. This is because depreciation of the host country currency against the home currency increases the relative wealth of foreigners thereby increasing the attractiveness of the host country for FDI as firms are able to acquire assets in the host country relatively cheaply. Thus a depreciation of the host currency should increase FDI into the host country, and conversely an appreciation of the host currency should decrease FDI.

Against this argument, it is often claimed that the price of assets should not matter but only their rate of return. When the host country currency depreciates relative to the home country currency, not only the price, but also nominal return of the assets in the host country currency goes down. Since the prices of assets and returns on assets both go down exchange rate movements should not affect FDI.

Froot and Stein (1991) counter this argument with the claim that when capital markets are subject to information imperfections, exchange rate movements do influence foreign investment.

Information asymmetry causes a divergence between internal and external financing, making the latter more expensive than the former, since the lenders incur monitoring costs and thus lend less than the full value of the asset. In this environment should foreign investors hold their wealth in foreign currency, the depreciation of the local currency will increase the wealth position of foreign agents relative to domestic agents, thus leading foreign investors to bid more aggressively for domestic assets?

Froot and Stein (1991) use industry level data on US inward FDI for the 1970s and 1980s to support their hypothesis (Jayaratnam, 2003).

Campa (1993), however, puts forward a different argument for the relationship between exchange rate level and FDI. In his model, the firm’s decision whether or not to invest abroad depends on the expectations of future profitability. In such a case, the higher the level of the exchange rate (measured in units of foreign currency per host currency) and the more it is rising, the higher will be expectations of future profits from entering a foreign market.

Therefore, Campa’s model predicts that an appreciation of the host currency will increase FDI into the host country, ceteris paribus, which is contrary to the prediction of Froot and Stein (1991). His empirical results analyzing the number of foreign entrants entering the US provide evidence to support his model (Gorg and Wakelin2001).

Gorg and Wakelin (2001) made a significant contribution.This is because unlike other studies that have considered either inward or outward FDI, it considered both. The paper investigated empirically both direct investment from US to 12 countries and investment from these 12 countries to the US. The empirical estimations yielded different results for US outward and inward FDI, which appear contradictory. They found a positive relationship between US outward investment and appreciation in the host country currency while there is a negative relationship between US inward investment and appreciation in the dollar.

In another contribution, Blonigen (1997), using data on Japanese acquisitions in the US from 1975 to 1992, suggested that exchange rates can affect acquisition of FDI as this involves purchasing firm specific assets in the foreign currency that can generate returns in another currency. The argument that real dollar depreciations increase foreign acquisitions that is put forth by Blonigen differs from the argument put forth by Froot and Stein (1991), although they both have the same outcome. Froot and Steinshow that exchange rate movements are important because capital markets are imperfect. On the other hand, Blonigen shows that exchange rate movements matter because while domestic and foreign firms may have the same opportunities to purchase firm specific assets in the domestic market, foreign and domestic firms do not have the same opportunities to generate returns on these assets in foreign markets. Due to the unequal level of access to markets, exchange rate movements may affect the relative level of foreign firm acquisitions.

Regarding the exchange rate, there is a statistically significant and positive relationship with Japanese acquisition activity, which is in line with Blonigen’s prediction. However, despite showing such a result, it remains unclear whether the correlation between exchange rate movements and Japanese acquisition FDI is due to the presence of firm specific assets (Blonigen’s claim) or due to the hypothesis put forth by Froot and Stein (1991), which is an imperfect capital market. To test this question, Blonigen separates acquisitions into those in the manufacturing industry and those in the non-manufacturing industry.

The reason for this is that firm-specific assets are said to be more important in the manufacturing industry. Indeed, Blonigen finds that the co-efficient on the real exchange rate for non-manufacturing industries is statistically insignificant while the co-efficient for the manufacturing industries is significant. Afterwards, Blonigen divides acquisitions within the manufacturing industry into those involving high R & D expenditures, as a percentage of sales, and those involving low R & D expenditures. Since Japanese firms may be particularly interested in technology related, firm specific assets, where high R & D expenditures are important, exchange rate movements should influence acquisition FDI more in industries with high R & D expenditures. The result of running regressions on high and low R & D manufacturing industries showed that the coefficient on the real exchange rate variable is insignificant for the low R & D sample and significant for the high R & D sample. Thus, it can be seen that through separating Japanese acquisitions into those in the manufacturing and non-manufacturing industries, and then further splitting the ones within manufacturing into high and low R & D samples, Blonigen is able to support his claim that exchange rate movements influence FDI due to firm specific assets.

**2.1.2 Concept of Inflation on Foreign Direct Investment**

Rate of inflation is a crucial factor in influencing the inflow of foreign investment. A high rate of inflation signifies economic instability associated with inappropriate government policies, especially the monetary fiscal policy mix (Macpherson, 2013). Khan &Mitra (2014) opine that high rates of inflation distort the economic activities, leading to lesser inflow of capital. A low and stable inflation rate acts as a sign of internal economic stability. This is because it reduces uncertainty and boosts the confidence of people and businesses for making investment decisions. On the other hand high inflation rate signifies the inability of the central bank to set appropriate monetary policies. A high inflation rate also impacts capital preservation of foreign investment. It affects profitability as higher prices can lead to increased costs and lower profits. So, stable inflation rate is desirable to attract foreign capital (Aijaz, Siddiqui, &Aumeboonsuke, 2014).

**Trends in inflation rate over the years**

Inflation in an economy is a measure of the degree of stability. In India there are different price indexes by which inflation rates can be measured such as Wholesale Price Index (WPI) and Consumer Price index (CPI). Until recently in India Wholesale Price Index was used to measure the inflation rate for all policy purposes. However after the UrjitR.Patel Committee’s recommendation, the Reserve Bank of India adopted the  Consumer Price index as key measure of Inflation in 2014 (The Hindu, 2014). Consumer price index accounts for the cost of day to day living.

**2.1.3 The Concept of Foreign Direct Investment**

Foreign Direct Investment is an investment that involves the injection of foreign funds into an enterprise that operates in a different country of origin from the investor.FDI has further been explained as the long term investment reflecting a lasting interest and control by a foreign direct investor or parent enterprise of an enterprise entity resident in an economy other than that of the foreign investor (International Monetary Fund, 1999).

**2.1.2 Origin and Distribution Foreign Direct Investment in Nigeria**

There is little information on the geographic origin of foreign investors in Nigeria. Most FDI inflows into Nigeria are reinvested earnings from the oil multinationals. Reinvested earnings have averaged two-thirds of overall FDI inflows in recent years, with the bulk directed towards the energy sector. There has been a modest surge in non-oil sector foreign investment in Nigeria in recent years, after it became clear that the previous regime, of Olusegun Obasanjo, was firmly established and that economic growth was picking up. Although much of the investment was by large multinational companies that were already operating in the country, there have been some new European entrants since the beginning of this decade, and South African companies have also strongly increased their presence in recent years, particularly in the mobile phone sector. Nigeria the second largest FDI recipient has more of it concentrated in the extractive industry but a veritable non-oil sector, manufacturing sectorthat recorded 47% of FDI stock in 1992 has been a great source of FDI to the country. The recent banking consolidation exercise also boosted FDI (and portfolio inflows) into Nigeria as existing foreign banks increased the capitalization of their subsidiaries to meet the new minimum capital requirements (Kolawole and Henry, 2009).

**2.1.3 Determinants of Foreign Direct Investment in Nigeria**

Foreign Direct Investment determinants have been discussed in a widely read literature. Foreign Direct Investment is classified into two types: - market oriented and export-oriented FDIs. And in these two categories, there are a lot of factors that determine the inflow of FDI into a particular country. These factors can be classified into micro determinants and macro determinants. Krugell (2005) and Wang& Swain (1997) have explained the micro determinants of FDI as FDI that are mainly concerned with those location specific factors that have an impact on the profitability of FDI at firm’s or industry level. The host country characteristics that influence productivity and cost at this micro level include market size and growth, labour costs, tariffs, host government policies and trade barriers. The macro determinants of FDI are the factors that influence profitability and the choice to invest at an economy-wide level (Krugell, 2005). Some of the major determinants of FDI in Nigeria are discussed below;

First, market size and growth has been said to have positive effect on FDI because it directly affects the expected revenue of the investment (Sun, et.al., 2002), thus it is one of the important determinants that have been used in empirical studies to explain the inflow of FDI to a host country. It has been observed that host countries with larger market size, faster economic growth and higher degree of economic development will provide more and better opportunities for these industries to exploit their ownership advantages and therefore, will attract more market-oriented FDI.

Nigeria is the most populous country in Africa with a population of over 150million.The annual percentage in the population resulting from a surplus (or deficit) of births over deaths and the balance of migrants entering and leaving a country. Wheeler and Moody (1992) in their study indicated that a large market size of a region has a significant and positive effect on attracting FDI. FDIs are likely to be attracted by large market size which allows them internalize profits from sales within the host countries. FDI in some selected countries like Hong Kong, Macao, Taiwan, Singapore and other Asian countries are included by market size, (Zhao and Zhu, 2002).

Second, Natural and Human Resource Endowments; Nigeria has rich resources of labour with average salaries of workers remaining at a relatively low level. With Nigeria’s large population, automatically translating to market, skilled manpower, abundant natural resources and a surfeit of entrepreneurial spirit , which are the basics differentiating Nigeria from many other markets in Africa, investors can achieve a whole lot, Corporate Nigeria (2010 /2011). It is often argued that the labour cost in determining FDI inflows should be the efficiency wage rate, which is adjusted in line with productivity rather than the absolute wage especially if FDI is export-oriented. In terms of the efficiency wage rate, Nigeria has good advantage as confirmed by empirical research. In terms of oil, Nigeria is rich but in energy (power) Nigeria is experiencing shortage problem. Other major natural resources such as land, iron, coal and other minerals are economically available. In respect to Nigeria’s natural and human resource endowment, it has been observed empirically that with the globalization of the world economy and liberalization ofinternational trade and the giant stride in technological innovation, the advantage of a cheaplabour force has become less important for investors. On the other hand, cheap labour hasbeen said to be one of the determinants of FDI inflow into a country especially in the SouthEast Asian economies (Young 2000; and Majumdar 1980; Tsai, 1995). At the same time, onthe other hand, several researchers have also found negative correlation between labour costand FDI (Sun, et.al; 2002). The quality of human resources endowments is what is requiredfor FDIs inflow in the country.

Third, openness to international trade and access to international markets; Chakrabarti(2001) defines openness to trade as intensity which refers to the ease with which capital canbe moved in or out of a country by investors. Since economic liberalization in 1995, Nigeriahas had one of the most open regimes in Africa for foreign investors, The Business Tradeand Investment Guide (2010). Openness to international trade induces FDIs inflow but at thesame time, may have negative influence on domestic industry in terms of competition.

Fourth, Development of the regulatory framework and economic policy coherence; Nigeria has been working hard to improve its reputation abroad, and it has made substantialprogress in addressing the issues that have worried outside investors in the past. They havealso formulated and implemented a series of preferential policies to encourage internationaltrade. These policies range from restoring the rule of law, and challenging corruption andgratification. Also on ground at the moment is the issue of security. The present governmentis working hard to handle this with the help of the international community. In 1995, theNigeria investment promotion commission Act laid out the framework for Nigeria’sinvestment policy under the act, 100% foreign ownership is allowed in all industries exceptfor oil and gas, where investment is constrained to existing joint ventures or new productionsharingagreements investment from both Nigeria and foreign investors is prohibited in afew industries crucial to national security, the production of arms and ammunition andmilitary uniforms. Investors can repatriate 100% of profit and dividend. The Act set up theNigeria Investment promotion commission (NIPC) to facilitate and promote investment in Nigeria.

Fifth, Inflation Rate: Asiedu (2002) notes that the inflation rate is used as a measure ofoverall macroeconomic stability of a country. A low inflation rate serves as FDIdeterminants in a country while a high inflation rate can serve as a disincentive on FDI to acountry as it increases the user’s costs of capital. Inflation reduces private investment byincreasing risk, reducing average lending maturities, distorting the informational content ofrelation prices, and indicating macroeconomic instability (Dornbusch, 2001). In Nigeria, the inflation rate is high. This is one of the measures of FDIdeterminants in a country. Schneider and Frey (1995) submit that inflation is frequently usedas an indicator of macro-economic instability reflecting the presence of internal economictension and of the inability or unwillingness of the government and central bank to balancethe budget and to restrict the money supply.

Sixth, Exchange Rate: The exchange rate of Nigeria also goes a long way to determine the level of FDI in the economy. It is justified in economic analysis that most foreign investors take delight in investing in countries that have relative weaker currency. This is because a weaker currency in relation to the investor’s currency ensures and guarantees profit potentials for the foreign investor.

Finally, Investment Incentives: Investment incentives in form of cheaper land cost or lowertax rate are also FDI determinants in a country. FDI inflow in countries with investmentincentives could enable investors to achieve low operation cost and high efficiency. In thecase of taxation, (Friendman, 2001)

**2.2 Theoretical Literature**

The theories relevant to the study will be reviewed in this section.

**2.2.1 The Eclectic Theory of FDI**

This theory was developed by John Dunning which is called OLI paradigm. O, L and Irefer to ownership advantage, location advantage and internalization conditions,respectively. Operating in a foreign country market has many costs and these “costs” includefailure of knowledge about local market conditions, cultural, legal and many other costs.Therefore, foreign firms should have some advantages that can offset these costs. Ownershipadvantage is a firm specific advantage that gives power to firms over their competitors. Thisincludes advantage in technology, in management techniques, easy access to finance,economies of scale and capacity to coordinate activities. Location advantages are countryspecific advantages. Transnational Companies (TNCs) in order to fully reap the benefit offirm specific advantages, they should consider the location advantage of the host country.This includes accessibility and low cost of natural resource, adequate infrastructure, politicaland macroeconomic stability. As a consequence, the location advantage of the host countryis one essential factor that determines the investment decision of TNCs.

Internalization ismultinational companies’ ability to internalize some activities to protect their exclusive righton tangible and intangible assets, and defend their competitive advantage from rival firms.All these three conditions must be met before transnational companies open a subsidiary in aforeign country (Soderstein (1992), Laar(2004).

**2.2.2 Internalization Theory of FDI**

Some transactions are “internalized” to reduce transaction costs and hence increaseprofitability. This theory answers the question why production is carried out by the samefirm in different locations. One of the reasons of internalization is market imperfection.Market imperfection is anything that interferes with trade. This includes two dimensions ofimperfections. First, imperfections cause a rational market participant to deviate fromholding the market portfolio. Second, imperfections cause a rational market participant todeviate from his preferred risk level. Market imperfections generate costs which interferewith trades that rational individuals make (or would make in the absence of theimperfection).Marketing and pricing are what operates here. The difficulty of marketing andpricing know how forces multinational companies to open a subsidiary in a foreign countryinstead of selling the technology. In addition, a number of problems may arise if an outputof a firm is an input to other firm in other country. For instance,” if each has a monopolyposition, they may get into a conflict as the buyer of the input tries to hold the price downwhile the firm that produces input tries to raise it”. Nevertheless, these problems can beavoided by integrating various activities within a firm rather than subcontracting theactivities (Krugman and Obstfeld, 2003).

**2.2.3 The Product Life Cycle Theory of FDI**

This theory was first developed by Vernon in 1966. The Vernon’s product life cycle theoryis a dynamic theory because it deals with changes overtime. However, it seems that thetheory is not confirmed by empirical evidence, as some multinational companies start theiroperations at home and abroad simultaneously (Chen, 1983). As the demand for a product ina home market increases, the product is standardized. Once the home market is saturated, theproduct will be exported to other countries. After some time, the firm starts to opensubsidiaries in locations where cost of production is lower, when the competition from therival firms intense and the product reaches its maturity, it automatically increasescompetition. Dunning, (1993) opines that FDI is a stage in the product lifecycle that followsthe maturity stage.

**2.3 Empirical Literature**

The concept of Foreign Direct Investment (FDI) has attracted some attention to the extent of culminating into some researchers carrying out studies to evaluate its impact on the level of the economy. Some studies which have been carried out on the concept of FDI will be reviewed in this section.

Lee and Johnson (2000) examined the effect of FDI on economic growth using data on FDI flows from industrial countries to 69 developing countries over the last two decades. Their regression results suggest that FDI is an important tool for technology transfer and it has contributed to growth more than domestic investment. However, the higher productivity of FDI can be realized more when the host country has a minimum threshold stock of human capital. In addition, FDI has the potentials of increasing total investment more than one for one

Alfaro and Mike (2006) analyzed the role of local financial markets in enabling FDI to promote growth through backward linkages. They asserted that to operate intermediate firms in the goods sector, the entrepreneurs require upfront capital investments. The more developed the local financial markets is, the easier it is for credit constrained firms to operate. The increase in the varieties and quantities of intermediate goods, leads to positive spillovers to the final goods sector. Due to this, the financial markets ensure the backward linkages between foreign and domestic firms to turn into FDI spillovers. Their calibration results indicate that holding foreign presence constant, financially well developed economies perform almost as twice as economies with poor financial markets in term of growth. FDI contributes more in an economy with well developed financial system than in an economy with less developed financial system. Lastly, local conditions such as market structure, human capital are also important to generate a positive effect of FDI on economic growth.

Tang, Selvanathan and Selvanathan (2008) explored the causal link between FDI, domestic investment and economic growth in China between 1988-2003 using the multivariate VAR and ECM. Their results indicate that there is a bi-directorial causality between domestic investment and economic growth, while there is a single-directional causality from FDI to domestic investment and to economic growth. They concluded that there is a higher level of complementarities between FDI and domestic resources.

Elijah and Festus (2008), examined the effect of exchanged rate volatility and inflationuncertainty on foreign direct investment in Nigeria for the period of 1970-2005. Using theGARCH model, the estimated results indicated that exchanged rate volatility andinflation uncertainty exerted significant negative effect on foreign investment during theperiod. In addition, the results show that infrastructure development, appropriate size ofthe government sector and international competitiveness are crucial determinants of FDIinflow to the country.

Olajide, (2010),using OLS Estimation in examining foreign direct investment and itsdeterminants in an open economy – Nigeria, found out that Nigerian’s potential market size,the degree of export orientation human capital, providing enabling environment through theprovision of infrastructural facilities, and macroeconomic stability are important determinantof FDI flows. Also, government consumption expenditure, openness to international tradeand human capital are complementary to economic growth.

Akinlo (2004) investigates the impact of FDI on economic growth in Nigeria using data for the period 1970 to 2001. His error correction model (ECM) results show that both private capital and lagged foreign capital have small and insignificant impact on economic growth. This study however established the positive and significant impact of export on growth. Financial development which he measured as M2/GDP has significant negative impact on growth. This he attributed to capital flight. In another manner, labour force and human capital were found to have significant positive effect on growth.

Lahiri and Ono (2008) in their investigation on foreign direct investment (FDI), local content requirement and profit taxation in developing countries posited that host countries must strike a balance between costs and benefits of FDI in formulating appropriate policies. The efficiency level of domestic firms must play a role and that a host country should make use of non-tax instruments such as specification on local content of inputs to enhance benefits from FDI.

Oseghale and Amenkhienan (2007) examined the relationship between oil export, foreign borrowing and direct foreign investment in Nigeria on one hand and economic growth on the other hand, and the impact of these on sectoral performance between 1960 and 2005. They concluded that foreign borrowing and FDI impacted negatively on over-all GDP but positively on three principal sectors (manufacturing, transport, communication and finance and insurance).

Vu and Noy (2009) carried out a sectoral analysis of foreign direct investment and growth in developed countries. They focused on the sector specific impacts of FDI on growth. They found that FDI has positive and no statistically discernible effects on economic growth through its interaction with labour. Moreover, they found that the effects seem to be very different across countries and economic sectors.

Addison and Heshmati (2003), in their study of FDI determinants in 182 countries exploredthe determinants of FDI flows in developing countries using estimation method and pooledOLS. They found that both democracy and ICT have significant and positive effects onFDI, leading them to conclude that developing countries should receive more support todemocratize and set up ICT equilibrium trap. They also find that the impact of thevariance of inflation is weekly significance for a pooled model. In Europe and central Asiaand MENA countries, it shows negative sign but shows positive sign for Latin America.

Adelegan (2000) explored the Seemingly Unrelated Regression model (SUR) to examine the impact of FDI on economic growth in Nigeria and found out that FDI is pro-consumption, pro-import and negatively related to gross domestic investment.

Ayanwale (2007) investigated the empirical relationship between non-extractive FDI and economic growth in Nigeria and also examined the determinants of FDI inflows into the Nigeria economy. He used both single-equation and simultaneous equation models to examine the relationship. His results suggest that the determinants of FDI in Nigeria are market size, infrastructure development and stable macroeconomic policy. Openness to trade and human capital were found not to be FDI inducing. Also, he found a positive link between FDI and growth in Nigeria.

**2.4 Limitations of Previous Studies**

Evidence from the above reviewed literature reveals that there has been avalanche of studies on the concept of FDI. However, it can be deduced from the above that majority of the studies focused on analyzing the impact of FDI on economic growth and other macroeconomic variables. However, in empirical terms, FDI is also influenced by other macroeconomic variables. In summary, other studies treated FDI as an exogenous variable and to carry out an extensive and comprehensive analysis, this research will ascertain the impact of the selected macroeconomic variables on FDI in Nigeria.

**CHAPTER THREE**

**RESEARCH METHODOLOGY**

**3.0 Methodology**

This study makes use of econometric procedure in estimating the impact of exchange on FDI in Nigeria. The Ordinary Least Square (OLS) technique is employed in obtaining the numerical estimates of the coefficients in different equations. The OLS method is chosen because it possesses some optimal properties: its computational procedure is fairly simple and it is also an essential component of most other estimation techniques. Secondly, this technique has been adopted by many other researchers and has yielded optimal results. Thirdly, the OLS technique possesses the feature of simplicity as it is not complex in computation. Finally, the data requirement of this technique is not excessive as compared with other techniques and methods.

**3.1 Theoretical Framework**

The theoretical anchor of this study is the eclectic theory of FDI. According to this theory, operating in a foreign country market has many costs and these “costs” include failure of knowledge about local market conditions, cultural, legal and many other costs. Therefore, foreign firms should have some advantages that can offset these costs. Ownership advantage is a firm specific advantage that gives power to firms over their competitors. This includes advantage in technology, in management techniques, easy access to finance, economies of scale and capacity to coordinate activities.

**3.2 Model Specification**

In this research, exchange rate, government expenditures andinflation rateare specified as the independent variables while Foreign Direct Invest is specified as the dependent variable. The model is thus specified as:



Where:

FDI = Foreign Direct Investment

EXR = Exchange Rate

GEXP = Government Expenditures

INF = Inflation Rate

U = Stochastic Error Term

* 1. **Method of Data Evaluation**

**3.3.1 Economic Criterion Test (A priori Test)**

The a priori test of the analysis will be based on the regression coefficient based on the coefficient of the algebraic signs of the parameters. It is a test that will be based on evaluating the conformity of the relationship between the variables on economic theory.

**3.3.2 Statistical Test of Significance**

**3.3.2.1 Test for Goodness of Fit**

This test involves the test of the goodness of fit. To evaluate the working hypothesis of this study, R2 the co-efficient of determination is used to test the explanatory power of the variable. R2 lies between zero and one (0 < r2< 1). The closer r2 is to 1 the greater the proportion of the variation in the dependent variables attributed to the independent variables.

**3.3.2.2 T-Test of Significance**

To test for the statistical significance of individual regression co-efficient, t-statistic is used. A two-tailed test will be conducted at 5% level of significance. The null hypothesis Ho will be tested against the alternative hypothesis H1.

**Decision Rule (T-Test)**

If t0.025< t\* Ho will be rejected and the H1 accepted. Otherwise, the alternative hypothesis H1 will be rejected and the null hypothesis Ho be accepted.

**3.3.2.3 f-TEST of Significance**

To Test the statistical significance of the entire regression, the f-ratio is used. The test will be conducted at 5% level of significance.

**Decision Rule (F-Test)**

If f\* > (f0.05), we say the regression is statistically significant but if otherwise, it implies that it is statistically insignificant

Note: t\* = computed t – value

t0.025 = tabulated t – value

f\* = Computed f-value

f0.05 = tabulated f – value

**3.3.3 Econometrics Test of Significance**

**3.3.3.1 Autocorrelation Test**

To evaluate the reliability of the expected numerical estimates, the Durbin – Watson (D-W) statistics at 5% will be used to test for the presence of autocorrelation problem. The region of no or zero autocorrelation remains:

du < d\* < (4-du)

Where:

du = Upper Durbin – Watson

d\* = Computed Durbin-Watson

**Decision Rule (Autocorrelation Test)**

If the computed value of Durbin-Watson lies within the region, it means there is no presence of autocorrelation problem. But if the Durbin-Watson computed value lies outside the regions there is the presence of autocorrelation problem and a remedial measure like the use of first difference equation will be adopted.

**3.4 Data Required and Sources**

The data required for this research are time series secondary data on foreign direct investment, exchange rate, government expenditures and inflation. The data to be used in the research will be extracted primarily from the Central Bank of Nigeria Statistical Bulletin, and the National Bureau of Statistics (NBS).

**CHAPTER FOUR**

**PRESENTATION AND ANALYSIS OF RESULTS**

The study utilized time series data annual data on Foreign Direct Investment (FDI), exchange rate, government expenditures and inflation. Given the application of the Linear Regression with the application of Ordinary Least Squares (OLS) technique, the following results were derived. However, the main regression output and raw data used can be found in appendix I and 2 respectively.

**4.1 Empirical Results**

FDI = 8.062079 - 0.034126EXR + 0.001796GEXP + 0.003059INF

S.E = (0.244339) (0.008975) (0.000232) (0.007541)

t\* = (32.99546) (-3.802318) (7.723085) (0.405648)

R=Squared (R2) = 0.860126

Adjusted R-Squared (2) = 0.846590

F\* = 63.54281

Durbin-Watson = 0.914903

By definition:

S.E = Standard Errors

du = Durbin Watson Upper Limit

**4.2 Unit-Root Tests**

It is ideal to carry out the unit root test on time series data. This is carried out so as to avoid the estimation of spurious data. Below is the summary table for the Unit-Root test.

**Table 4.2**

|  |  |  |  |
| --- | --- | --- | --- |
| **VARIABLE** | **ADF STATISTICS** | **CRITICAL VALUE @ 5%** | **ORDER OF INTEGRATION** |
| EXR | -4.677469 | -1.951332 | I(1) |
| FDI | -9.239279 | -1.951687 | I(2) |
| GEXP | -7.859985 | -1.952066 | I(2) |
| INF | -5.570024 | -2.957110 | I(1) |

*Source: E-views ADF Computation*

It can be clearly seen from the above that Exchange Rate (EXR) and Inflation (INF) are stationary ay first difference and Foreign Direct Investment (FDI) and Government Expenditures (GEXP) are stationary at second difference.

**4.3 Co-integration Analysis [Engel-Granger Method]**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Null Hypothesis: RESID01 has a unit root | | | |  |
| Exogenous: Constant | | |  |  |
| Lag Length: 0 (Automatic - based on SIC, maxlag=1) | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | t-Statistic | Prob.\* |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller test statistic | | | -3.425185 | 0.0169 |
| Test critical values: | 1% level |  | -3.639407 |  |
|  | 5% level |  | -2.951125 |  |
|  | 10% level |  | -2.614300 |  |
|  |  |  |  |  |
|  |  |  |  |  |
| \*MacKinnon (1996) one-sided p-values. | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller Test Equation | | | |  |
| Dependent Variable: D(RESID01) | | | |  |
| Method: Least Squares | | |  |  |
| Date: 07/17/17 Time: 09:37 | | |  |  |
| Sample (adjusted): 1981 2014 | | |  |  |
| Included observations: 34 after adjustments | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| RESID01(-1) | -0.500589 | 0.146149 | -3.425185 | 0.0017 |
| C | 0.044043 | 0.097162 | 0.453291 | 0.6534 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.268269 | Mean dependent var | | 0.053461 |
| Adjusted R-squared | 0.245402 | S.D. dependent var | | 0.651935 |
| S.E. of regression | 0.566320 | Akaike info criterion | | 1.757709 |
| Sum squared resid | 10.26300 | Schwarz criterion | | 1.847495 |
| Log likelihood | -27.88106 | Hannan-Quinn criter. | | 1.788329 |
| F-statistic | 11.73189 | Durbin-Watson stat | | 2.123095 |
| Prob(F-statistic) | 0.001704 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

The co-integration test was carried out using the Engel-Granger cointegration method. Since at 5 percent, the ADF statistic which yielded -3.425185 is greater than the corresponding critical value which yielded -2.951125 at level form, it entails that the variables are cointegrated, hence, there exists a long run relationship among the variables namely; exchange rate, foreign direct investment, government expenditures and inflation.

**4.4 Error Correction Model Analysis**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Dependent Variable: LOG(FDI) | | |  |  |
| Method: Least Squares | | |  |  |
| Date: 07/17/17 Time: 09:46 | | |  |  |
| Sample (adjusted): 1981 2014 | | |  |  |
| Included observations: 34 after adjustments | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| C | 8.382164 | 0.192834 | 43.46824 | 0.0000 |
| EXR | -0.010572 | 0.008168 | -1.294321 | 0.2058 |
| GEXP | 0.001189 | 0.000210 | 5.676312 | 0.0000 |
| INF | -0.001167 | 0.005681 | -0.205488 | 0.8386 |
| ECM(-1) | 0.772778 | 0.164956 | 4.684754 | 0.0001 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.923107 | Mean dependent var | | 9.634464 |
| Adjusted R-squared | 0.912502 | S.D. dependent var | | 1.768015 |
| S.E. of regression | 0.522981 | Akaike info criterion | | 1.676512 |
| Sum squared resid | 7.931779 | Schwarz criterion | | 1.900976 |
| Log likelihood | -23.50070 | Hannan-Quinn criter. | | 1.753061 |
| F-statistic | 87.03734 | Durbin-Watson stat | | 1.978905 |
| Prob(F-statistic) | 0.000000 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

Since it has been established that there exists a long-run relationship among the variables, it was needful to estimate the speed at which the short-run disequilibrium is corrected. This was achieved through the estimation of the error correction model. The estimation above shows that the ECM coefficient yielded 0772778. This entails that the speed at which the short-run disequilibrium is corrected to achieve a long-run equilibrium is 77.2 percent. This is indeed high and significant.

**4.5 Examination of the Algebraic Signs of the Parameter Estimates**

The estimated regression line above shows that the coefficient of exchange rate yielded a negative value. It empirically shows that a 1% increase in exchange rate will decrease FDI inflow by 0.034126 and vice-versa. This finding conforms to economic a priori expectation because an increase in exchange rate will cause the price of foreign or imported goods to increase and thus discourage foreign investment to the domestic country. Increase in exchange rate weakens the currency power of the domestic economy and vice-versa. The regression line also shows that the numerical coefficient of government expenditures is positive at the magnitude of 0.001796. This result conforms to economic a priori expectation because increase in government expenditures encourages economic activities and stability and thus encourages foreign direct investment. Finally, it can be seen from the regression line that the coefficient of inflation yielded a positive value at the magnitude of 0.003059. This entails that an increase in inflation compels an increase in foreign direct investment into the country. On the framework of business profit, this result conforms to economic a priori expectation because inflation entails rising prices and foreign investors maximize more profit during inflationary periods. Unlike the counterpart of inflation which is deflation.

**4.6 Statistical Test of Significance**

The table below is a tabular representation of the computed and tabulated values of the t-statistics, f-statistics and the coefficient of determination.

**Table 4.6**

|  |  |  |  |
| --- | --- | --- | --- |
| **VARIABLES** | **t\*Computed** | **t0.0025** | **Test Result** |
| EXR | -3.802318 | 2.021 | S.S |
| GEXP | 7.723085 | 2.021 | S.S |
| INF | 0.405648 | 2.021 | Not significant |

|  |  |  |
| --- | --- | --- |
| **F\*-Computed** | **F0.05** | **Test Result** |
| 63.54281 | 2.84 | S.S |

|  |  |  |
| --- | --- | --- |
| **R-Squared (R2)** | **R-Squared %** | **Level** |
| 0.860126 | 86% | High |

Where:

**S.S =** Statistically Significant

**4.7 Evaluation of the Working Hypothesis**

In this research, three hypotheses were specified to be tested.

**Hypothesis One**

Ho: Exchange rate is not a significant determinant of foreign direct investment in Nigeria.

H1: Exchange rate is a significant determinant of foreign direct investment in Nigeria.

**Decision:** From table 4.6, it can be clearly seen that the computed t-statistics for exchange rate which yielded -3.802318 is absolutely greater than its corresponding tabulated t-statistics which is 2.021 at 5% level of significance. This compels the rejection of the null hypothesis (Ho) and the acceptance of the alternative hypothesis (H1). Hence; exchange rate is a significant determinant of foreign direct investment in Nigeria.

**Hypothesis Two**

Ho: Inflation is not a significant determinant of foreign direct investment in Nigeria.

H1: Inflation is a significant determinant of foreign direct investment in Nigeria

**Decision:** From table 4.3, it can be clearly seen that the computed t-statistics for inflation which yielded 0.405648 is absolutely less than its corresponding tabulated t-statistics which is 2.021 at 5% level of significance. This compels the acceptance of the null hypothesis (Ho) and the rejection of the alternative hypothesis (H1). Hence; inflation is not a significant determinant of foreign direct investment in Nigeria.

**Hypothesis Three**

Ho: Government expenditures is not a significant determinant of foreign direct investment in Nigeria.

H1: Government expenditures is a significant determinant of foreign direct investment in Nigeria.

**Decision:** From table 4.6, it can be clearly seen that the computed t-statistics for government expenditures which yielded 7.723085 is absolutely greater than its corresponding tabulated t-statistics which is 2.021 at 5% level of significance. This compels the rejection of the null hypothesis (Ho) and the acceptance of the alternative hypothesis (H1). Hence; government expenditures is a significant determinant of foreign direct investment in Nigeria.

**F-Statistics Analysis**

The F-Statistics which measures the statistical significance of the entire regression plane yielded a computed value of 63.54281 with a corresponding tabulated value of 2.84 entails that the test is statistically significant at the entire regression plane. Hence; exchange rate, government expenditures and inflation jointly determine and influence FDI significantly.

**Coefficient of Determination (R2)**

The statistical function of R-Squared is to measure the goodness of fit and to ascertain the explanatory power of the independent variables over the variations of the dependent variable. From table 4.3, it can be clearly seen that the R-Squared yielded 0.860126 and this entails that approximately 86% of the variations in the dependent variable is explained by the changes in the independent variable. This entails that the explanatory of the independent variables is high and significant.

**4.8. Second Order Test (Autocorrelation Analysis)**

At 5% level of significance, the presence of autocorrelation problem will be ascertained with the application of Durbin-Watson statistics. The region of no autocorrelation is recalled to be:

du < d\* < (4-du)

where:

du = 1.653

d\* = 0.914903

The region thus becomes:

1.653 >0.914903< 2.347

Since the computed Durbin-Watson did not fall into the no-autocorrelation region, it entails that there is the presence of autocorrelation in the model.

**4.9 Implications of the Study**

This study has been able to carry out an empirical analysis of the impact of exchange rate on Foreign Direct Investment (FDI) in Nigeria covering the period 1980-2014. The regression analysis carried out on the analysis shows that exchange rate, and government expenditures are significant determinants of FDI in Nigeria while inflation is not a significant determinant of FDI in Nigeria. The implication of this finding is that Nigeria can experience a tremendous increase in FDI when exchange rate and government expenditures are well managed. The implication of this result is also that other macroeconomic variables aside these two have insignificant influence on FDI inflow into Nigeria. This is also informed by the R-Squared with yielded 86%.

**CHAPTER FIVE**

**SUMMARY, CONCLUSION AND RECOMMENDATIONS**

**5.0 Summary of Findings**

The essence of this study has been to carry out an empirical analysis of the determinants of foreign direct investment in Nigeria covering the period 1980-2014. The primary motivation of the study was driven by the quest to ascertain the likely exogenous macroeconomic variables that determine the level of FDI in the economy. In the course of the research, the methodology employed is the linear regression with the application of Ordinary Least Squares (OLS) technique. The major findings of the study are summarized thus:

1. Exchange rate has a significant impact of foreign direct investment in Nigeria.
2. Inflation has no significant impact of foreign direct investment in Nigeria.

**5.2 Conclusion of the Study**

This study has been able to carry out an empirical analysis of the determinants of foreign direct investment in Nigeria covering the period 1980-2014. Based on the findings of study it can be concluded that the major macroeconomic variables that determine the level of FDI are government expenditures and exchange rate. It thus entails that the level of FDI can be influenced at optimal levels using these macroeconomic variables.

**5.3 Recommendations**

Based on the findings of the study, the following recommendations are suggested:

1. Nigeria should maintain a high and sustainable growth patterns to attract more foreign investment in the country. There should be conscious effort by government to ensure that the ministry of Trade and Investment collaborates with our foreign policy designers and local content developers to enable free flow of investments.
2. Nigeria can attract greater FDI inflows by removing artificial barriers and controls on exports and imports. An open and export oriented policy can be promoted by lowering tariffs and allowing the free flow of capital.
3. Policies should be set up against the repatriation of profit by the existing multinational companies which are the foreign investors.
4. The federal government should aggressively pursue the stabilization of exchange rate and inflation rates in the economy. This will go a long way in attracting more FDI and increasing economic growth for the country.
5. Other determinants of FDI aside the ones highlighted in this study should also be harnessed. These include macroeconomic variables like trade openness, availability of bank credit and interest rate.

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**Appendix I**

FDI and GEXP are calculated in Billions of Naira while INF is measured in percentages

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **YEAR** | | **FDI**  **(Billion)** | **EXR**  **(Rate)** | **GEXP**  **(Billion)** | **INF**  **(%)** |
| 1980 | 1003.200 | | 0.714300 | 11.66500 | 9.900000 |
| 1981 | 1322.800 | | 0.695500 | 11.41000 | 20.90000 |
| 1982 | 1571.100 | | 0.657900 | 11.92000 | 7.700000 |
| 1983 | 1763.700 | | 0.657900 | 9.640000 | 23.20000 |
| 1984 | 1812.100 | | 0.629900 | 9.930000 | 39.60000 |
| 1985 | 2287.500 | | 0.615900 | 13.04000 | 5.500000 |
| 1986 | 2339.000 | | 0.626500 | 16.22000 | 5.400000 |
| 1987 | 2531.400 | | 0.646600 | 22.02000 | 10.20000 |
| 1988 | 2863.200 | | 0.606000 | 27.75000 | 38.30000 |
| 1989 | 3153.100 | | 0.595700 | 41.03000 | 40.90000 |
| 1990 | 3620.100 | | 0.546400 | 60.27000 | 7.500000 |
| 1991 | 3757.900 | | 0.610000 | 66.58000 | 13.00000 |
| 1992 | 5382.800 | | 0.672900 | 92.80000 | 44.50000 |
| 1993 | 5949.500 | | 0.724100 | 191.2300 | 57.20000 |
| 1994 | 6418.300 | | 0.764900 | 160.8900 | 57.00000 |
| 1995 | 6804.000 | | 0.893800 | 248.7700 | 72.80000 |
| 1996 | 9313.600 | | 2.020600 | 337.2200 | 29.30000 |
| 1997 | 9993.600 | | 4.017900 | 428.2200 | 8.500000 |
| 1998 | 11339.20 | | 4.536700 | 487.1100 | 10.00000 |
| 1999 | 10899.60 | | 7.391600 | 947.6900 | 6.600000 |
| 2000 | 10436.10 | | 8.037800 | 701.0600 | 6.900000 |
| 2001 | 12243.50 | | 9.909500 | 1018.030 | 18.90000 |
| 2002 | 20512.70 | | 17.29840 | 1018.160 | 12.90000 |
| 2003 | 66787.00 | | 22.05110 | 1225.970 | 14.00000 |
| 2004 | 70714.60 | | 21.88610 | 1426.200 | 13.45000 |
| 2005 | 119391.6 | | 21.88610 | 1822.100 | 13.72500 |
| 2006 | 122600.9 | | 21.88610 | 1938.000 | 8.500000 |
| 2007 | 128331.9 | | 21.88610 | 2450.900 | 6.600000 |
| 2008 | 152410.9 | | 21.88610 | 3240.820 | 15.10000 |
| 2009 | 154190.4 | | 92.69340 | 3452.990 | 13.90000 |
| 2010 | 157508.6 | | 102.1052 | 4194.580 | 12.70000 |
| 2011 | 161441.6 | | 111.9433 | 4712.060 | 13.80000 |
| 2012 | 166631.6 | | 120.9702 | 4605.390 | 14.90000 |
| 2013 | 178478.6 | | 129.3565 | 5185.320 | 15.32000 |
| 2014 | 249220.6 | | 133.5004 | 4587.390 | 14.21000 |

**Source:***Central Bank of Nigeria (CBN) Statistical Bulletin*

**Appendix II**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Dependent Variable: LOG(FDI) | | |  |  |
| Method: Least Squares | | |  |  |
| Date: 07/05/17 Time: 19:52 | | |  |  |
| Sample: 1980 2014 | | |  |  |
| Included observations: 35 | | |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| C | 8.062079 | 0.244339 | 32.99546 | 0.0000 |
| EXR | -0.034126 | 0.008975 | -3.802318 | 0.0006 |
| GEXP | 0.001796 | 0.000232 | 7.723085 | 0.0000 |
| INF | 0.003059 | 0.007541 | 0.405648 | 0.6878 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.860126 | Mean dependent var | | 9.556649 |
| Adjusted R-squared | 0.846590 | S.D. dependent var | | 1.801630 |
| S.E. of regression | 0.705655 | Akaike info criterion | | 2.247829 |
| Sum squared resid | 15.43641 | Schwarz criterion | | 2.425583 |
| Log likelihood | -35.33701 | Hannan-Quinn criter. | | 2.309190 |
| F-statistic | 63.54281 | Durbin-Watson stat | | 0.914903 |
| Prob(F-statistic) | 0.000000 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

**Source:** E-views Statistical Software

**APPENDIX III**

**Unit-Root Tests**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Null Hypothesis: D(EXR) has a unit root | | | |  |
| Exogenous: None | | |  |  |
| Lag Length: 0 (Automatic - based on SIC, maxlag=1) | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | t-Statistic | Prob.\* |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller test statistic | | | -4.677469 | 0.0000 |
| Test critical values: | 1% level |  | -2.636901 |  |
|  | 5% level |  | -1.951332 |  |
|  | 10% level |  | -1.610747 |  |
|  |  |  |  |  |
|  |  |  |  |  |
| \*MacKinnon (1996) one-sided p-values. | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller Test Equation | | | |  |
| Dependent Variable: D(EXR,2) | | |  |  |
| Method: Least Squares | | |  |  |
| Date: 07/17/17 Time: 09:22 | | |  |  |
| Sample (adjusted): 1982 2014 | | |  |  |
| Included observations: 33 after adjustments | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| D(EXR(-1)) | -0.813721 | 0.173966 | -4.677469 | 0.0001 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.406038 | Mean dependent var | | 0.126142 |
| Adjusted R-squared | 0.406038 | S.D. dependent var | | 16.65759 |
| S.E. of regression | 12.83782 | Akaike info criterion | | 7.972503 |
| Sum squared resid | 5273.911 | Schwarz criterion | | 8.017852 |
| Log likelihood | -130.5463 | Hannan-Quinn criter. | | 7.987762 |
| Durbin-Watson stat | 2.051274 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Null Hypothesis: D(FDI,2) has a unit root | | | |  |
| Exogenous: None | | |  |  |
| Lag Length: 0 (Automatic - based on SIC, maxlag=1) | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | t-Statistic | Prob.\* |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller test statistic | | | -9.239279 | 0.0000 |
| Test critical values: | 1% level |  | -2.639210 |  |
|  | 5% level |  | -1.951687 |  |
|  | 10% level |  | -1.610579 |  |
|  |  |  |  |  |
|  |  |  |  |  |
| \*MacKinnon (1996) one-sided p-values. | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller Test Equation | | | |  |
| Dependent Variable: D(FDI,3) | | |  |  |
| Method: Least Squares | | |  |  |
| Date: 07/17/17 Time: 09:25 | | |  |  |
| Sample (adjusted): 1983 2014 | | |  |  |
| Included observations: 32 after adjustments | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| D(FDI(-1),2) | -1.653524 | 0.178967 | -9.239279 | 0.0000 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.732651 | Mean dependent var | | 1842.697 |
| Adjusted R-squared | 0.732651 | S.D. dependent var | | 31454.95 |
| S.E. of regression | 16264.02 | Akaike info criterion | | 22.26205 |
| Sum squared resid | 8.20E+09 | Schwarz criterion | | 22.30785 |
| Log likelihood | -355.1928 | Hannan-Quinn criter. | | 22.27723 |
| Durbin-Watson stat | 1.675849 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Null Hypothesis: D(GEXP,2) has a unit root | | | |  |
| Exogenous: None | | |  |  |
| Lag Length: 1 (Automatic - based on SIC, maxlag=1) | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | t-Statistic | Prob.\* |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller test statistic | | | -7.859985 | 0.0000 |
| Test critical values: | 1% level |  | -2.641672 |  |
|  | 5% level |  | -1.952066 |  |
|  | 10% level |  | -1.610400 |  |
|  |  |  |  |  |
|  |  |  |  |  |
| \*MacKinnon (1996) one-sided p-values. | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller Test Equation | | | |  |
| Dependent Variable: D(GEXP,3) | | |  |  |
| Method: Least Squares | | |  |  |
| Date: 07/17/17 Time: 09:31 | | |  |  |
| Sample (adjusted): 1984 2014 | | |  |  |
| Included observations: 31 after adjustments | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| D(GEXP(-1),2) | -2.770710 | 0.352508 | -7.859985 | 0.0000 |
| D(GEXP(-1),3) | 0.541863 | 0.200429 | 2.703514 | 0.0114 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.874477 | Mean dependent var | | -37.90548 |
| Adjusted R-squared | 0.870149 | S.D. dependent var | | 653.8217 |
| S.E. of regression | 235.6037 | Akaike info criterion | | 13.82452 |
| Sum squared resid | 1609764. | Schwarz criterion | | 13.91704 |
| Log likelihood | -212.2801 | Hannan-Quinn criter. | | 13.85468 |
| Durbin-Watson stat | 1.458299 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Null Hypothesis: D(INF) has a unit root | | | |  |
| Exogenous: Constant | | |  |  |
| Lag Length: 1 (Automatic - based on SIC, maxlag=8) | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | t-Statistic | Prob.\* |
|  |  |  |  |  |
|  |  |  |  |  |
| Augmented Dickey-Fuller test statistic | | | -5.570024 | 0.0001 |
| Test critical values: | 1% level |  | -3.653730 |  |
|  | 5% level |  | -2.957110 |  |
|  | 10% level |  | -2.617434 |  |
|  |  |  |  |  |
|  |  |  |  |  |
| \*MacKinnon (1996) one-sided p-values. | | | |  |
| Augmented Dickey-Fuller Test Equation | | | |  |
| Dependent Variable: D(INF,2) | | |  |  |
| Method: Least Squares | | |  |  |
| Date: 07/17/17 Time: 09:33 | | |  |  |
| Sample (adjusted): 1983 2014 | | |  |  |
| Included observations: 32 after adjustments | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| D(INF(-1)) | -1.347603 | 0.241938 | -5.570024 | 0.0000 |
| D(INF(-1),2) | 0.356117 | 0.169802 | 2.097253 | 0.0448 |
| C | 0.260565 | 2.678937 | 0.097264 | 0.9232 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.565867 | Mean dependent var | | 0.377812 |
| Adjusted R-squared | 0.535927 | S.D. dependent var | | 22.24317 |
| S.E. of regression | 15.15269 | Akaike info criterion | | 8.363293 |
| Sum squared resid | 6658.514 | Schwarz criterion | | 8.500706 |
| Log likelihood | -130.8127 | Hannan-Quinn criter. | | 8.408841 |
| F-statistic | 18.89994 | Durbin-Watson stat | | 1.912718 |
| Prob(F-statistic) | 0.000006 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

**Abstract**

This study was undertaken to evaluate the impact of exchange rate on foreign direct investment. Three objectives and three research questions were formulated to reflect how variables like exchange rate and inflation influences the economic activities of foreign direct investment in Nigeria covering a period of 1980 to 2014 using Ordinary Least Squares (OLS) technique. The literature review was structured in thematic format to reflect the objectives. The finding derived from the result of the research showed Exchange rate has a significant impact of foreign direct investment in Nigeria.Inflation has no significant impact of foreign direct investment in Nigeria. However, the study recommends among other thing that, Nigeria should maintain a high and sustainable growth patterns to attract more foreign investment in the country. There should be conscious effort by government to ensure that the ministry of Trade and Investment collaborates with our foreign policy designers and local content developers to enable free flow of investments

**Keyword:**exchange rate, Inflation and FDI