

Effect of Trade Openness and Political Stability on Foreign Direct Investment in Nigeria

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Abstract

Foreign Direct Investment (FDI) is a key source of external financing to developing economies, impacting economic growth and development. A nation's inability to foster trade openness and political stability can result in an unintended consequence of deterring FDI. The objectives of this study were to examine how trade openness and political stability influence FDI inflows in Nigeria between 2006 and 2023. ARDL Model was used to analyze annual secondary data of specific trade openness and political stability constructs obtained from the World Bank, UNCTAD, and EIU for the period of 18 years. Trade openness was measured by trade share, connectivity, and trade governance; and political stability through political violence, corruption, and democratic stability. Employing a quantitative design, principal component analysis (PCA) was used to construct composite indices of trade openness and political stability. All trade openness constructs examined in the study significantly enhanced FDI inflows, while political violence and corruption exerted negative effects, and democratic stability positively influenced FDI. By jointly analyzing disaggregated measures of trade openness and political stability within a single framework, this study made a novel contribution to the Nigerian FDI literature. The study recommended trade-facilitating reforms, improved connectivity and governance, and decisive measures against insecurity and corruption to strengthen Nigeria's investment climate in order to boost inward FDI.

Keywords: *Trade, Openness, Political, Stability, Foreign, Investment*

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Background to the Study

Foreign Direct Investment (FDI) is critical facilitator of capital transfer around the globe (Organization for Economic Co-operation and Development [OECD], 2024). The diverse conceptualizations of the term FDI reflect its dynamism. Typically, FDIs comprise equity stakes, plough-back profits, and parent-affiliate institution loans, all of which increase (deepen) the ownership stakes of the investing entity, providing increased control (decision-making capabilities) through voting power. A cursory look at the United Nation Conference on Trade and Development (UNCTAD), world investment reports for almost half a decade confirms a diminishing pattern in global FDI flows, with the outlier being the one-off 2021 increase - 64% higher than the 2020 figure, which largely reflected a return to pre-pandemic levels rather than a genuine surge in new investment. For three years in a row starting 2022, global FDI has decreased by 12%, 2% and 11% respectively, though minimal compared to the 32% decline in global FDI caused by COVID 19 in 2020, UNCTAD's forecast for 2025 global FDI turning negative is still a matter of great concern (UNCTAD, 2021, 2022, 2023, 2024, 2025). Fluctuations in global FDI figures are not an anomaly given the diverse factors that influence FDI flows including differences in national foreign policies, global unrest like the Russia-Ukraine and Israel-Gaza conflicts; as well as the recent US-China trade war which has distorted the status quo of FDI flows globally.

This distortion has had far-reaching multiplier effects, altering the normal financial flows to both the global south and the global north, and resulting in mixed outcomes closely monitored by international organizations. UNCTAD's Global Investment Trend Monitor reveals interesting insights: in 2023, FDI to developed economies fell by 2%, while that of developing countries dropped by 7%, although regional dynamics were not uniform, developing countries collectively accounted for nearly two-thirds of global FDI inflows (UNCTAD, 2025). At the same time, the International Monetary Fund (IMF) Coordinated Direct Investment Survey reported a record \$41 trillion in global FDI stock (IMF, 2025). However, World Bank data for the same period puts this into perspective: inflows to emerging economies declined to an 18 year low of \$435 billion, while developed economies recorded a 27 year low of \$336 billion (World Bank, 2025). Thus, although cumulative past investments plus plough back earnings and reduced divestment increased overall stock as expected, new FDI is clearly declining. This is because growth in FDI stock does not directly reflect the scale of new inflows; rather, it represents the accumulation of past investment commitments. The World Bank's statistics showing historic lows in fresh inflows therefore highlight a singular truth: while IMF stock figures showed accumulated historical commitments, the decline in new inflows suggests the weakening of investor confidence and reluctance for fresh capital investments in the global economy at large. Regrettably, the decline in FDI seems to be a common denominator in every region of the global economy, including the African continent.

Africa's FDI inflow over time has been volatile, dropping by 3% in 2023 (UNCTAD, 2024); despite the introduction of the Africa Continental Free Trade Area (AfCFTA) in 2021, which had several objectives including fostering an improved investment climate. In 2024, Africa

recorded a 74% increase in FDI inflows; however, Egypt's El-Hekma urban development project accounted for 45% of that surge (UNCTAD, 2025) - similar to the situation observed in the OECD region, where gains in a few countries outweigh and conceal the weaker inflows in others (OECD, 2025). These weaker inflows can be attributed to several factors including political tensions, poor amenities and weak governance institutions, which are all factors not uncommon to the Nigerian economy. Nigeria is one of the top recipients of FDI in Africa (UNCTAD, 2024), however, the nation still battles similar encumbrances to improved inward-FDI flows including inconsistent economic policies, political instability, poor infrastructure, corruption, and weak macroeconomic frameworks (Oyegoke & Aras, 2021), which can be argued to be the key factors resulting in the erratic inflows of FDI into the country. It is well established that FDI plays a complementary role to the inadequate domestic saving needed to foster real sector development in developing climes such as Nigeria (Adewole et al., 2025). However, despite its large population, which should ordinarily translate into a sizable consumer market for foreign firms, FDI inflows into the country has been inconsistent.

Despite being one of Africa's top FDI recipients, Nigeria's ranking as largest recipient of FDI in Africa was more than a decade ago (UNCTAD, 2012), since then it has lagged behind some African counterparts including Egypt and South Africa despite its so-called "Giant of Africa" status. Several factors drive the flow of FDI, including trade openness and political stability, both of which have mixed implications for inward FDI (Liargovas & Skandalis, 2012). Trade openness refers to the degree to which a nation allows foreign investors to carry out international trading activities within its borders (Gupta et al., 2020 as cited in Abinabo and Abubakar, 2023). The benefits of trade openness include improved employment generation, increase in productivity, and accelerated adoption of new technologies, all contingent on a country's trade policies. Favorable trade policies, such as the creation of free trade zones, have historically boosted FDI inflows in certain Latin American economies. Similarly, increased trade openness in Nigeria could enhance technological adoption, production efficiency, and workforce productivity. However, trade openness has been found to have both positive and negative impacts on FDI. For example, Qamruzzaman and Karim (2020) found that trade openness negatively affected FDI inflows in Bangladesh, Pakistan, and Sri Lanka, despite its positive effects in India.

According to Soneye et al. (2024), Nigeria's trade policy has evolved through three main phases: restrictive protectionism, pragmatic realism, and a more recent mixed or semi-protectionist posture. Nigeria has in the past intermittently banned the importation of several commodities, placed high tariffs on certain imports, and even closed its borders between 2019-2020 (Nelson, 2020), which was geared toward reducing import-dependence and boosting local production of certain commodities including rice. Notwithstanding, the country has also experienced periods of trade liberalization including the Structural Adjustment Program (SAP) of 1986, the establishment of free trade zones, and its ratification of AfCFTA which commenced trade in 2021. Despite these formal commitments, one could argue that Nigeria has taken a semi-protectionist stance in recent times given the poor

implementation of trade policies and the attempted implementation of 4% free on board (FOB) charge promulgated through the Nigerian Customs Act, 2023 which was suspended by the Federal Ministry of Finance (Bethel, 2025).

Political stability is also a key determinant of inward FDI. Political instability manifests in various forms and can be detrimental to both domestic and foreign investments (FDI). Notable manifestations of political instability in Nigeria in recent times include unstable government policies (which could be a product of regime changes), civil unrest (resource-motivated/regional agitations for independence), and production disruption. These factors exacerbate uncertainty in the economy, diminishing investor confidence and further resulting in a decline in FDI inflows (Omodero, 2023). However, there is no consensus in literature regarding the nexus between political stability and FDI. Lucas (1990, as cited in Kim, 2010) postulated that developing economies such as Nigeria which are prone to political instability attract large FDI outflows from stable economies looking forward to maximizing market entry opportunities and the high-risk high-reward investment opportunities. This aligns with the risk-return maxim: the higher the risk the higher the potential return. On the contrary, Baklouti and Boujelbene (2020) assert that political instability diminishes production potential and leads to capital losses, thereby deterring inward FDI prospects (Kumari et al., 2023).

Though political stability and trade openness are key drivers of FDI, they are not sole determinants; several other factors influence FDI inflows including market size and macroeconomic conditions (Islam & Beloucif, 2024). Market-seeking investors searching for readily available consumers for the merchandise often target developing countries with large population like Nigeria. These climates grant expatriate firms access to a large customer base with minimal or zero competition from domestic firms which often lack the capacity to compete in terms of quality or scale. Thus, geographic locations that meet these criteria attract more FDI inflows than less populated regions, provided they have favourable macroeconomic environments. Macroeconomic indices including inflation rates, interest rates and exchange rates are also crucial factors that influence FDI decisions (Adewole et al., 2025), impacting foreign businesses through increased cost of inputs, high cost of capital and difficulty in repatriation or loss of value due to repatriation. Hence, this study incorporates gross domestic product (GDP) and Exchange rate to control for the effect of market size and macroeconomic factors in ascertaining the degree of interconnectedness between trade openness, political stability and FDI in Nigeria.

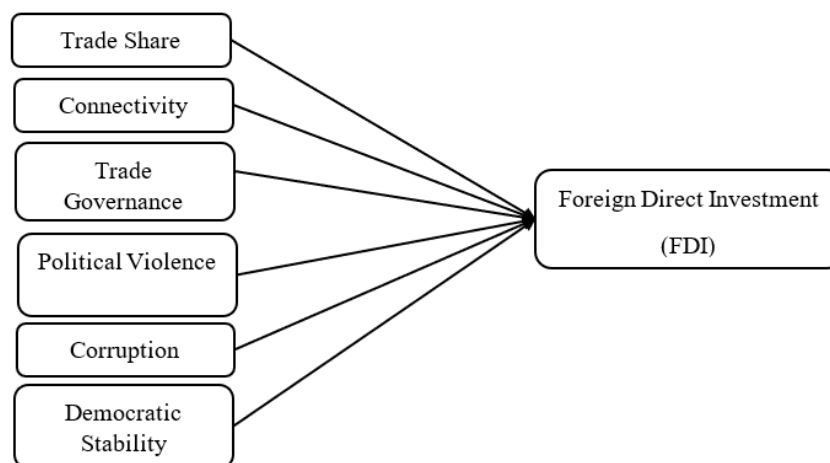
Several studies have examined the relationship between trade openness and economic growth (Ajayi et al., 2019; Moyo et al., 2017; Omoke & Opuala–Charles, 2021), as well as the link between political stability and FDI (Ajimobi, 2024; Callistus & Kalu, 2020; Kurecic & Kokotovic, 2017). Similarly, other scholars have investigated the nexus between trade openness, FDI, and economic growth (Ari et al. 2022; Okere et al., 2022; Omisakin et al. 2009). However, no study has explored the combined effect of trade openness and political stability on FDI in Nigeria. The lack of empirical literature in this area, coupled with frequent

policy changes and recent episodes of political instability amidst dwindling foreign direct investment figures in Nigeria, underscores the need to assess the interrelationship between these variables. It is against this backdrop that this study seeks to investigate the relationship between trade openness, political stability, and foreign direct investments assessing the influence of specific proxies of trade openness (Trade Share, Connectivity, and Trade Governance), and political stability (Political Violence, Corruption, and Democratic Stability) on FDI in Nigeria to contribute invaluable insights into the ongoing discourse on the subject matter, providing policymakers and investors alike with updated information for efficient decision making. The objective of this study is to determine the effect of trade openness and political stability on FDI in Nigeria. To achieve this objective, the study focused on the following specific objectives as stated below:

1. To examine the effect of Trade Share on Foreign Direct Investments in Nigeria.
2. To examine the effect of Connectivity on Foreign Direct Investments in Nigeria
3. To examine the effect of Trade Governance on Foreign Direct Investments in Nigeria
4. To examine the effect of Political Violence on Foreign Direct Investments in Nigeria.
5. To examine the effect of Corruption on Foreign Direct Investments in Nigeria
6. To examine the effect of Democratic Stability on Foreign Direct Investments in Nigeria

Literature Review

Figure 1: Conceptual Framework



Theoretical Review

The New Economic Geography (NEG) theory, first introduced by Krugman (1991) and further developed by Krugman (1993, 1995), Venables (1996), Martin and Ottaviano (1996), and Ottaviano and Puga (1997), postulates that certain geographical areas tend to attract more FDI than others due to the economic benefits (economies of scale) they offer. Expatriate firms make their location decisions based on proximity to markets and reduced overhead costs, and businesses tend to cluster because being close to other firms, skilled

workers, and suppliers give them a competitive edge, creating a self-reinforcing cycle of growth (Krugman, 1991; Venables, 1996). For emerging economies like Nigeria, with high population densities and abundant untapped natural resources, NEG suggests a strong potential to attract FDI (Ottaviano & Puga, 1997). Nigeria's strategic location and membership in ECOWAS position it as a potential hub for multinational enterprises aiming to penetrate the African market (Nwagu, 2023). However, without trade openness, the Nigerian market and its abundant natural resources would be fully or partially inaccessible to foreign investors; enacting policies that promote trade openness such as lower tariffs, improved and fully implemented trade agreements, and reduced regulatory barriers will encourage greater foreign investment (Su et al., 2019; Awadhi et al., 2022). The extent to which Nigeria can use these advantages depends heavily on its political stability, as political instability: frequent policy changes, governance difficulties, and security concerns, raises the risks involved in investing and discourages FDI (Dada & Abanikanda, 2022). Jasper (2021) and Gaspar (2021) criticize NEG for oversimplifying location choice by overlooking institutional, social, and political factors, which is particularly important in Nigeria and motivates the use of Institutional Theory.

Institutional Theory was developed to better understand the role that institutions have on the attraction of FDI, particularly in transition and emerging economies (North, 1990; Powell & DiMaggio, 1991; Scott, 1995; Awadhi et al., 2022). North (1990) postulated that good institutions (formal and informal rules) exert a positive effect on economic activities by reducing transaction costs, thereby increasing returns on investment, while poor institutions stifle economic activities through weak enforcement of contracts and poor protection of property rights (North, 1990, as cited in Sabir, 2019). FDI inflows into Nigeria have been found to be significantly influenced by the calibre of institutions: Dada and Abanikanda (2022) show that a strong institutional framework, including political stability, greatly increases Nigeria's appeal to international investors, whereas frequent policy changes and governance issues discourage FDI. Institutional Theory thus enhances the understanding of the relationship between trade openness, political stability, and FDI. While opening up trade by cutting down tariffs and non-tariff barriers is important for attracting FDI, trade liberalization only works if it is backed by strong institutions capable of enforcing contracts, protecting property rights, and providing consistent regulations (Su et al., 2019). Otherwise, foreign investors might still see Nigeria as too risky, no matter how open its trade policies are.

The eclectic theory approach, popularly known as the OLI (Ownership, Location, and Internalization) framework, propounded by Dunning (1976), posits that three key factors influence the decisions of expatriate firms engaging in FDI: firm-specific capabilities (ownership), the macroeconomic and structural conditions of host countries (location), and the preference for subsidiaries rather than third-party arrangements (internalization). Within the context of Nigeria, the location paradigm is particularly relevant for analysing how trade openness and political stability affect FDI inflows (Nwagu, 2023). Trade openness, measured by tariff and non-tariff barriers, makes cross-border investments easier because it increases the potential to access numerous markets (Su et al., 2019). In assessing host countries, political

stability is often a key consideration, as most expatriate investors prefer politically stable economies with comparatively low levels of political risks, uncertainty, and regulatory inconsistencies, which constitute a conducive business environment ensuring longevity in profitability and operational security (Ameyaw et al., 2022; Dada & Abanikanda, 2022). Ownership advantages such as cutting-edge technology, brand recognition, economies of scale, and managerial capabilities help firms compete favourably in foreign markets and are more likely to be fully exploited where trade openness lowers entry costs (Dunning, 1976; Ashiru & Oni, 2022). However, investing in a politically unstable but trade-open economy presents significant risks, as political instability undermines the long-term feasibility of FDI.

Given the diverse support and criticism of the OLI framework (Cruz et al., 2020; Evan & Bolotov, 2022; Luo, 2021; Urfa, 2021), this study aligns with Luo's (2021) perspective, advocating for an upgrade of traditional OLI variables to address contemporary globalization challenges by integrating institutional and political factors into the location component. In this context, the OLI framework, complemented by NEG and Institutional Theory, clearly explains the nexus between the dependent variable (FDI) and the independent variables (trade openness and political stability) in Nigeria.

Empirical Review

Trade openness is typically proxied by the trade-to-GDP ratio. Le et al. (2023) applied system GMM to an ASEAN panel of 25 countries (1990–2020), including institutional-quality controls, and found that trade openness significantly promotes FDI inflows and partially mitigates the adverse effect of political instability, though the multi-country regional focus constrains direct applicability to a single-country context such as Nigeria. Benabdennour et al. (2024), using a panel ARDL model for 124 countries (1996–2021), documented a positive long-run relationship and bidirectional Granger causality between trade openness and FDI, with stronger effects in developed economies and no significant short-run impact; however, the very broad coverage raises concerns about aggregation bias and the omission of explicit political-instability interactions, especially for resource-dependent settings. Albahouth and Tahir (2023) employed fixed-effects and GLS estimators for ASEAN (2000–2022) and showed that trade openness and disaggregated institutional-quality indicators (rule of law, regulatory quality, control of corruption, voice and accountability, and political stability) all exert positive effects on inward FDI, but the absence of a dynamic specification and the distinct export and political structures of ASEAN economies limit external validity for Nigeria.

Physical connectivity is another key conduit for attracting FDI. Using a gravity model with decomposed World Bank Logistics Performance Index data for 20 Asian economies (2007–2013), Halaszovich and Kinra (2020) found that a one-point improvement in overall logistics quality is associated with about a 6% rise in FDI, with maritime infrastructure contributing more strongly to trade than directly to FDI, while treating logistics performance as exogenous. Saidi and Mefteh (2020), applying two-step system GMM and a panel VECM to 46 developing countries (2000–2016), reported that a 1% increase in a multimodal

transport index raises FDI by 0.3% and that FDI itself stimulates infrastructure investment, though reliance on a single composite index for a heterogeneous sample may obscure country-specific dynamics. In an African context, Ayesu (2025) constructed a composite seaport-efficiency indicator for 32 countries (2018–2022) using PCA and GMM estimation and showed that a one-standard-deviation improvement in port efficiency increases FDI by about 0.4 percentage points, but the short post-COVID period limits insight into long-run adjustment, an important consideration for countries like Nigeria that are undertaking phased logistics reforms.

Trade governance which captures the depth and credibility of trade agreements and rules-based liberalization constitutes a distinct *de jure* channel through which openness shapes FDI. In a global gravity framework for 162 country pairs (2001–2012), Kox and Rojas-Romagosa (2020) showed that signing a preferential trade agreement raises bilateral FDI by around 30%, with very deep, wide-ranging agreements pushing gains above 50%, and EU Single Market membership and bilateral investment treaties yielding even larger boosts; however, reliance on aggregate depth scores, strong exogeneity assumptions about treaty formation, and the dominance of large, highly institutionalized blocs limit inference for smaller, less integrated economies such as Nigeria. Focusing on Africa, Obuobi et al. (2022) constructed tariff- and rules-based liberalization indices for 49 countries (2000–2017) and, using two-step system GMM, found that a one-point increase in a composite liberalization score raises FDI by about 12%, with customs and procedural reforms rather than tariff cuts alone, driving the effect and performing better where domestic institutions are stronger; yet index aggregation and potential instrument proliferation pose identification challenges. At a more structural level, Larch and Yotov (2025) combined DESTA-based RTA-depth measures for 89 countries (1990–2011) with a gravity-CGE framework and suggested that deepening RTAs can raise FDI modestly in partial equilibrium (2–3%) and substantially once general-equilibrium feedbacks are considered (up to roughly 55%), although these scenario-based simulations rest on stylized behavioural assumptions and abstract from country-specific institutional and political-risk conditions that are central to Nigeria's trade-FDI nexus.

Firm- and country-level evidence indicates that political violence operates as a distinct deterrent channel for FDI, especially in African settings. Using rare-events logistic regressions for 77 listed firms operating in 25 Sub-Saharan African countries (1995–2008), Doctor and Bagwell (2019) linked negative foreign fixed-capital expenditure (divestment) to ACLED electoral-violence data and showed that even a single violent electoral event more than doubles the probability of firm-level capital withdrawal in the following year; however, the focus on large, publicly listed firms means the responses of smaller or privately held investors remain unobserved. Barry (2024), analysing several thousand multinational firms' first-time foreign entries (1994–2018) with rare-events logit and fixed effects, combined UCDP, ACLED, and CIRI data to distinguish rebel violence, rogue-agent predation, and state repression, and found that rebel and rogue-agent violence significantly reduce the likelihood of market entry, whereas state-directed repression does not have a comparable deterrent

effect, underscoring that the identity and perceived “bargainability” of violent actors matter more for FDI than the mere presence of coercion; nonetheless, hand-coded rogue-agent events and the absence of external instruments limit causal interpretation. At the macro level, Thakur-Wernz et al. (2024) used Arellano–Bond GMM for a panel of 48 African countries (1997–2021) and showed that higher uncertainty in the frequency and lethality of violence against civilians which is measured from ACLED, systematically depresses FDI inflows, with firms apparently shifting toward export-based engagement rather than fixed capital when violence becomes too unpredictable, though the country-level design cannot capture subnational hotspots that are highly relevant in a large, regionally heterogeneous country like Nigeria.

Evidence on the corruption–FDI nexus is highly context dependent. Providing a global benchmark, Oliveira and Teixeira (2020) used random-effects logit and GLS models for 78 mostly better-governed countries (high-income OECD and Latin America/Caribbean, 2012–2017), distinguishing between the extensive margin (probability of attracting any greenfield FDI) and the intensive margin (FDI volumes). Once a composite World Bank governance index, GDP growth, and trade openness were controlled for, the Corruption Perceptions Index had no statistically significant effect on either margin, suggesting that in settings where minimum institutional standards are met, marginal changes in perceived corruption do not strongly influence FDI; however, the short horizon, compressed institutional variation, and lack of an explicit strategy to address endogeneity limit external validity for weaker-governance environments such as Nigeria. Focusing on 14 West African economies (1999–2018), Bekoe et al. (2022) estimated a PMG panel-ARDL with Hansen (1999) threshold effects and found a critical corruption-control score of 6.3 (WGI scale): below this level, corruption is statistically irrelevant for FDI, but once the threshold is crossed, additional perceived graft reduces FDI by about 0.35% of GDP, reinforcing that the corruption–FDI relationship is non-linear and governance-contingent, though the small country sample and measurement issues around ordinal governance indices constrain generalization. In a Nigeria-specific NARDL analysis (1984–2017), Zangina and Hassan (2020/2021) decomposed improvements and deteriorations in corruption control and showed that only reforms—improvements in control of corruption—raise FDI in the long run (by roughly 0.52 percentage points of GDP per unit improvement), whereas worsening corruption has no symmetric statistically significant effect; despite single-country scope and residual endogeneity concerns (e.g., omitted oil-price dynamics), their results align with the regional threshold evidence that corruption becomes a binding constraint where institutions are fragile and that positive institutional reforms matter more for FDI than marginal backsliding.

Empirical work increasingly suggests that it is the stability and consolidation of democracy, rather than regime labels alone, that matters for FDI. Gossel (2017) introduced the notion of “democratic capital”- the number of uninterrupted years of democracy in a fixed-effects panel for 42 Sub-Saharan African countries (1972–2014) and found that democratic capital has a positive and statistically significant effect on FDI inflows, whereas standard

contemporaneous democracy indicators (Polity, civil liberties) become insignificant once democratic capital is included, implying that investors reward durable, predictable democratic rules rather than short-lived episodes; however, the reliance on lagged variables rather than external instruments leaves residual endogeneity concerns about reverse causality between FDI and democratic stability. Complementing this large-N approach with a more micro-causal design, Goldsmith (2021) used a matched-pair difference-in-differences framework comparing four African democratizers with four carefully matched non-democratizing neighbours and found that regime transition per se has no clear effect on FDI, but periods of democratic consolidation—when competitive rules become stable—are associated with modest but statistically significant increases in inflows, reinforcing the idea that institutional durability, not one-off transitions, shapes investor responses; nonetheless, the very small sample and limited robustness checks (e.g., balance diagnostics, clustered errors) constrain generalizability. Taking a regional perspective, Zallé and Ouédraogo (2021) estimated a dynamic spatial-Durbin panel model for 43 Sub-Saharan African countries (1996–2018) and showed that higher domestic democracy scores raise a country's own FDI inflows in the long run and generate smaller but significant positive spillovers to neighbouring states, while corruption depresses FDI along both domestic and spatial channels; their results provide novel evidence that democratic progress creates cross-border FDI complementarities, though sensitivity to the choice of spatial-weights matrix and the absence of external instruments for democracy leave scope for bias from unobserved regional shocks.

Taken together, the empirical literature shows that trade openness, trade infrastructure, and institutional quality matter for FDI (Le et al., 2023; Benabdennour et al., 2024; Saidi & Mefteh, 2020; Ayesu, 2025), and that distinct forms of political risk: violence, corruption, and democratic consolidation, shape multinational entry and divestment decisions (Doctor & Bagwell, 2019; Barry, 2024; Bekoe et al., 2022; Zangina & Hassan, 2020/2021; Gossel, 2017; Zallé & Ouédraogo, 2021; Thakur Wernz et al., 2024). However, most of this evidence is based on large cross-country panels with heterogeneous institutional contexts, relies on aggregate trade-to-GDP measures that do not distinguish between trade share, physical connectivity, and rules-based trade governance, and treats political stability as a broad, undifferentiated index rather than decomposing it into political violence, corruption, and democratic stability. Existing studies that jointly model trade openness and political stability typically focus on other regions and do not deploy country-specific composite indices within a time-series framework that accounts for structural breaks. To the best of the researcher's knowledge, no study has examined, for Nigeria specifically, how multiple dimensions of trade openness (Trade Share, Connectivity, Trade Governance) and political stability (Political Violence, Corruption, Democratic Stability) combined through principal component analysis and estimated in an ARDL setting, jointly influence FDI against the backdrop of recent reforms such as the 2023 Nigerian Investment Policy, exchange-rate unification, and fuel-subsidy removal. This study is designed to fill that gap.

Methodology

The study employed a quantitative time-series design to examine the impact of trade openness and political stability on foreign direct investment (FDI) in Nigeria over 2006–2023. Annual

data on FDI, trade-related variables, political indicators, real GDP, and the official exchange rate are sourced from the World Bank, UNCTAD, and the Economist Intelligence Unit (EIU). FDI is measured as net inflows (% of GDP); market size is proxied by the logarithm of real GDP (LOG_GDP), and the official exchange rate (EXC) captures macroeconomic and external conditions. The sample period is dictated by the availability of consistent series for all variables, yielding 18 annual observations suitable for small-sample time-series analysis. Trade openness is proxied by trade share (TRS), connectivity (CONN), and trade governance (TGOV), while political stability is proxied by political violence (POV), corruption (COR), and democratic stability (DST). To address multicollinearity and capture the latent constructs, Principal Component Analysis (PCA) is applied separately to the trade and political indicators. This yields two composite indices: a Trade Openness Index (TO_INDEX) from TRS, CONN, and TGOV, and a Political Stability Index (PS_INDEX) from POV, COR, and DST. These indices are used in the baseline model, while additional regressions using the individual proxies are estimated for robustness and to explore specific channels.

Given the small sample size and the mixed order of integration among the variables (I(0) and I(1)), the study adopts the Autoregressive Distributed Lag (ARDL) bounds-testing approach of Pesaran, Shin, and Smith, which is valid provided none of the variables is I(2) and permits joint estimation of long-run and short-run relationships. Pre-estimation procedures include descriptive statistics and pairwise correlations, Augmented Dickey–Fuller (ADF) unit root tests to establish the order of integration, and multicollinearity diagnostics using correlation matrices and variance inflation factors. Structural breaks are detected using the Bai–Perron multiple breakpoint test, which identifies breaks in 2008, 2013, and 2015. These are modelled as step dummies (D2008, D2013, D2015), equal to one from the break year onward, and are included in both the long-run and short-run specifications.

Lag lengths are selected using the Akaike (AIC), Schwarz (SC), and Hannan–Quinn (HQ) information criteria, which support a two-lag structure for the ARDL and the associated error-correction model (ECM). The Pesaran–Shin–Smith bounds test is then applied to test for cointegration among FDI, TO_INDEX, PS_INDEX, LOG_GDP, and EXC. When the computed F-statistic exceeds the upper critical bound at conventional significance levels, a long-run level relationship is inferred, and the long-run coefficients and ECM are estimated. A negative and statistically significant error-correction term indicates stable adjustment toward long-run equilibrium. All estimations are implemented in E-Views 10.0.

The PCA-based baseline long-run ARDL model is specified as:

$$\begin{aligned}
 FDI = & \alpha + \beta_1 FDI_{t-1} + \beta_2 FDI_{t-2} + \beta_3 TO_INDEX_{t-1} + \beta_4 TO_INDEX_{t-2} \\
 & + \beta_5 PS_INDEX_{t-1} + \beta_6 PS_INDEX_{t-2} + \beta_7 LOG_GDP_{t-1} + \beta_8 LOG_GDP_{t-2} \\
 & + \beta_9 EXC_{t-1} + \beta_{10} EXC_{t-2} + \beta_{11} D2008_t + \beta_{12} D2013_t + \beta_{13} D2015_t \\
 & + \epsilon_t
 \end{aligned}$$

The corresponding short-run ECM representation is:

$$\begin{aligned} \Delta FDI = & \alpha + \beta_1 \Delta TO_{INDEX}_t + \beta_2 \Delta PS_{INDEX}_t + \beta_3 \Delta LOG_{GDP}_t + \beta_4 \Delta EXC_t \\ & + \sum_{i=1}^{p-1} \varphi_i \Delta FDI_{t-i} + \sum_{j=1}^{q-1} \theta_j \Delta TO_{INDEX}_{t-j} + \sum_{k=1}^{r-1} \gamma_k \Delta PS_{INDEX}_{t-k} \\ & + \sum_{m=1}^{s-1} \delta_m \Delta LOG_{GDP}_{t-m} + \sum_{n=1}^{u-1} \lambda_n \Delta EXC_{t-n} + \psi ECT_{t-1} + \tau_{11} \Delta D2008_t \\ & + \tau_{12} \Delta D2013_t + \tau_{13} \Delta D2015_t + \mu_t \end{aligned}$$

Where ECT_{t-1} is the lagged error-correction term derived from the long-run relationship? A priori, TO_INDEX , PS_INDEX , and LOG_GDP are expected to exert positive effects on FDI, while EXC is expected to have a negative effect. The coefficients on $D2008$, $D2013$, and $D2015$ are indeterminate ex ante, as they capture regime shifts whose net effects on FDI are ambiguous.

For robustness, additional ARDL models are estimated by replacing TO_INDEX and PS_INDEX with their individual components, while retaining LOG_GDP and EXC as controls:

$$FDI = f(\text{TRS}, \text{LOG_GDP}, \text{EXC})$$

$$FDI = f(\text{CONN}, \text{LOG_GDP}, \text{EXC})$$

$$FDI = f(\text{TGOV}, \text{LOG_GDP}, \text{EXC})$$

$$FDI = f(\text{POV}, \text{LOG_GDP}, \text{EXC})$$

$$FDI = f(\text{COR}, \text{LOG_GDP}, \text{EXC})$$

$$FDI = f(\text{DST}, \text{LOG_GDP}, \text{EXC})$$

Comparison of the PCA-based and proxy-based results enables assessment of both aggregate and channel-specific effects of trade openness and political stability on FDI in Nigeria.

Analysis and findings

Table 1: Augmented Dickey Fuller Stationarity Test Results

Variable	Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value	p-value	Stationarity Status
Δ FDI	-6.150068	-3.920350	-3.065585	-2.673459	0.0002	I(1)
Δ Log_TRS	-3.286827	-3.920350	-3.065585	-2.673459	0.0333	I(1)
Δ CONN	-3.147506	-3.920350	-3.065585	-2.673459	0.0431	I(1)
Δ TGOV	-3.741657	-3.920350	-3.065585	-2.673459	0.0141	I(1)
Δ POV	-4.793624	-3.959148	-3.081002	-2.681330	0.0022	I(1)
Δ COR	-4.300161	-3.920350	-3.065585	-2.673459	0.0048	I(1)
Δ DST	-4.466940	-3.920350	-3.065585	-2.673459	0.0035	I(1)
Log_GDP	-4.519916	-3.886751	-3.052169	-2.666593	0.0029	I(0)
EXC	-4.942557	-4.667883	-3.733200	-3.310349	0.0466	I(0)

Source: Author's Computation, 2025

Testing for unit roots is a routine preliminary step in time series analysis to determine whether the data are stationary. A series is considered stationary when its key moments, such as the mean and variance, remain stable over time. Regressions estimated with non-stationary series can produce spurious relationships (Meyer and Breitung, 1995, as cited in Waqas, 2023), which may mislead empirical interpretation and, in policy contexts, lead to poor decisions.

Table 1 presents the ADF results for the variables in this study. The tests indicate that Δ FDI, Δ Log_TRS, Δ CONN, Δ TGOV, Δ POV, Δ COR, and Δ DST are stationary in first differences, implying that their level series are non-stationary. In contrast, Log_GDP and EXC are stationary in levels. Accordingly, the unit root null is rejected for the differenced variables and for Log_GDP and EXC at levels. Given this combination of I(0) and I(1) series, an ARDL specification is appropriate for the subsequent analysis.

Table 2: Bai-perron Structural Breaks Test Results

Break Test	F-statistic	Critical Value (5%)	Break Year	Significance
Break 1	71.29077	8.58	2013	Significant
Break 2	14.24639	8.58	2008	Significant
Break 3	92.67200	8.58	2015	Significant

Source: Author's Computation, 2025

The Bai–Perron multiple structural breaks test for 2006–2023 identifies three statistically significant breakpoints in the series (Table 2). Breaks in 2008, 2013, and 2015 are each

significant at the 5% level, with F-statistics (14.25, 71.29, and 92.67) exceeding the 5% critical value of 8.58. These results indicate discrete changes in the intercept and/or slope of the underlying relationships at those dates. The 2008 break is consistent with the global financial crisis and its impact on capital flows and domestic macroeconomic conditions. The large 2013 and 2015 statistics point to more pronounced regime shifts, plausibly associated with post-crisis policy adjustments (2013) and, in 2015, the convergence of the first democratic transfer of power, the collapse in global oil prices, and heightened insecurity (Boko Haram insurgency).

To control for this structural instability, the empirical specification includes three dummy variables (D2008, D2013, D2015), which equal 1 from the respective break date onward and 0 otherwise. These dummies capture level or regime shifts associated with each breakpoint, improving parameter stability and inference, mitigating omitted-variable bias from unmodelled structural change, and allowing more credible estimation of short- and long-run effects within regimes.

Table 3: ARDL Bounds Test for Cointegration Results

		Critical Value	Lower Bound	Upper Bound
F-statistic		10%	2.26	3.35
K	7.689972	5%	2.62	3.79
		1%	3.41	4.68

Source: Author's Computation, 2025

Table 3 reports the ARDL bounds test for cointegration. The computed F-statistic of 7.69 ($k = 7$) exceeds the upper critical value at the 10%, 5%, and 1% significance levels (e.g., 3.35, 3.79, and 4.68, respectively), based on Pesaran, Shin, and Smith (2001). Thus, the null hypothesis of no level relationship is rejected, providing strong evidence of cointegration within the specified ARDL framework. Given this, the analysis proceeds to estimate and interpret the long-run coefficients from the selected ARDL model and its associated error-correction representation, where the error-correction term is expected to be negative and statistically significant, consistent with convergence toward the long-run equilibrium.

Table 4: ARDL Long Run Coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
TO_INDEX	0.032572	0.042151	-0.772775	0.0495
PS_INDEX	-0.749857	0.645594	-1.161498	0.0329
LOG_GDP	0.206571	1.281139	0.161240	0.0388
EXC	-0.007365	0.003845	-1.915403	0.1513
D2013	-1.205469	0.516209	-2.335233	0.1017
D2008	1.223598	0.491836	2.487816	0.0887
D2015	-1.742275	0.707559	-2.462373	0.0907
C	2.551693	11.836222	0.215583	0.8431

Source: Author's Computation, 2025

Table 4 reports the estimated long-run coefficients from the ARDL model with composite trade openness (TO_INDEX) and political stability (PS_INDEX) indices. The coefficient on TO_INDEX is positive and statistically significant (0.0326; $p = 0.0495$), implying that, when trade share, connectivity, and trade governance are combined via principal components analysis (PCA), a one-unit increase in the composite trade openness index is associated with a 0.0326 percentage point increase in FDI inflows as a share of GDP. This indicates that greater overall openness is linked to higher FDI inflows in Nigeria.

By contrast, the political stability composite (PS_INDEX) exerts a negative and statistically significant effect on FDI (-0.7499 ; $p = 0.0329$), suggesting that a higher value of the PCA-based political stability index is associated with lower FDI inflows in the long run. Market size, proxied by the logarithm of real GDP (LOG_GDP), is positive and significant (0.2066; $p = 0.0388$), confirming that larger market size supports higher FDI inflows. The exchange rate level (EXC) is negative but not statistically significant in the long run ($p = 0.1513$), once openness and political conditions are controlled for. Period dummies indicate meaningful regime effects. The 2008 dummy (D2008) is positive and marginally significant, while the 2015 dummy (D2015) is negative and marginally significant, consistent with distinct global and domestic episodes imparting level shifts in FDI beyond fundamentals. The 2013 dummy (D2013) is negative but not conventionally significant. These results are broadly in line with earlier evidence of structural breaks around 2008, 2013, and 2015, though the break dummies in the preferred long-run specification are only weakly significant.

Channel-specific regressions, reported in Appendix Tables A2–A7, corroborate the composite findings. Trade share, connectivity, and trade governance are each positively and statistically significantly related to FDI, whereas political violence and corruption exhibit negative and statistically significant coefficients, and democratic stability is positively and significantly associated with FDI. Taken together, the composite and disaggregated estimates suggest that openness and institutional/political conditions shape FDI inflows through multiple channels.

Short-run dynamics and error correction

The short-run dynamics and error-correction representation (Appendix Table A1) confirm the presence of a stable long-run equilibrium. The estimated error-correction term is negative and statistically significant (-0.9534 ; $p = 0.0460$), implying that approximately 95% of any deviation from the long-run FDI path is corrected within one period. This high speed of adjustment indicates rapid convergence toward the long-run equilibrium following short-run shocks. Short-run coefficients on the openness and political variables are generally consistent in sign with their long-run counterparts, reinforcing the central role of trade-related and political factors in determining FDI inflows.

Findings and Discussion

Table 4 and the accompanying channel-specific regressions provide a coherent picture of how trade openness and political conditions affect FDI in Nigeria. The positive and statistically

significant effect of the composite trade openness index (TO_INDEX) indicates that FDI responds favorably to improvements in overall openness, understood as a combination of trade share, connectivity, and trade governance. This result aligns with the prior expectation that liberalized trade regimes, better infrastructure, and predictable trade rules attract foreign investors, and is consistent with recent evidence from emerging economies (e.g., Benabdennour et al., 2024; Khoa et al., 2024; Wardani, 2024).

The channel-specific results deepen this interpretation. Trade share (LOG_TRS) is positive and significant, suggesting that increased integration into global markets supports FDI, in line with Le et al. (2023). Connectivity (CONN) displays a strong positive association with FDI, consistent with the findings of Ayesu (2025), Halaszovich and Kinra (2020), and Mensah and Traoré (2024). Trade governance (TGOV) is likewise positive and significant, echoing the importance of rules-based trade facilitation highlighted by Kox and Rojas-Romagosa (2020) and Larch and Yotov (2025). These results collectively indicate that Nigeria's FDI inflows are responsive not only to the volume of trade, but also to the quality of infrastructure and the institutional framework that supports cross-border transactions.

The negative long-run effect of the composite political stability index (PS_INDEX) on FDI is more nuanced. While the sign appears counterintuitive relative to the expectation that higher political stability should attract FDI, the disaggregated estimates offer clarity. Democratic stability (DST) is positively related to FDI, consistent with Gossel (2018), Hamid and Jena (2021), and Zallé and Ouédraogo (2022), while political violence and corruption are negatively associated with FDI, aligning with studies such as Carril-Caccia et al. (2021), Doctor and Bagwell (2022), Thakur-Wernz et al. (2023), and Xiao et al. (2023). The composite index thus aggregates heterogeneous political dimensions whose combined sign masks the clearer policy signals from its components. The component-level results provide a more straightforward message: reducing insecurity and corruption and strengthening democratic stability are conducive to attracting FDI.

Market size emerges as a robust long-run determinant, with LOG_GDP positive and significant in both composite and channel-specific models. This underscores Nigeria's potential to leverage its large and growing economy to attract foreign investors, provided that openness and political/institutional conditions are supportive. The exchange rate plays a more ambiguous role: while the long-run coefficient in the composite model is negative and insignificant, it is often positive and significant in the disaggregated regressions, suggesting that currency conditions may matter more clearly when specific openness or political channels are modeled in isolation.

Overall, the results are consistent with Nigeria's recent economic and political trajectory. Improvements in trade logistics and connectivity—such as ongoing port reforms and planned transport infrastructure—reinforce the importance of openness-related channels. At the same time, persistent insecurity and governance challenges continue to constrain the full realization of Nigeria's FDI potential, in line with concerns raised by domestic stakeholders

and international assessments of peace and governance. The empirical evidence therefore emphasizes that policies to deepen trade openness must be complemented by credible efforts to enhance security, reduce corruption, and strengthen democratic institutions.

Table 5: Diagnostic Tests

Breusch-Godfrey Serial Correlation LM Test			
F-statistic	114.9414	Prob. F (2,2)	0.6358
Obs*R-squared	16.92637	Prob. Chi-Square (2)	0.7211
Heteroskedasticity Test: Breusch -Pagan-Godfrey			
F-statistic	0.196411	Prob. F (5,6)	0.9849
Obs*R-squared	7.816334	Prob. Chi-Square (5)	0.8554
Scaled explained SS	0.599388	Prob. Chi-Square (5)	1.0000
Ramsey RESET test			
	Value	Df	Prob.
t-statistic	1.204043	12	0.3517
F-statistic	1.449720	(1, 12)	0.3517
Normality Test (Jarque-Bera)			
			0.638186
JB-statistic	6.847578		4562
Multicollinearity (VIF - Mean VIF)			
Mean VIF	3.6258		

Source: Author's Computation, 2025

Diagnostic tests are employed to assess whether the ARDL estimates satisfy the standard assumptions required for valid inference (Table 7). The Breusch–Godfrey LM test provides no evidence of residual serial correlation, as both the F-statistic (Prob. F(2,2) = 0.6358) and the ObsR-squared statistic (Prob. (2) = 0.7211) yield p-values above 0.05. The Breusch–Pagan–Godfrey test similarly indicates homoscedastic residuals, with p-values for the F-statistic, ObsR-squared, and scaled explained sum of squares (0.9849, 0.8554, and 1.0000, respectively) all exceeding 0.05. The Ramsey RESET test suggests no functional form misspecification (Prob. F(1,12) = 0.3517). Parameter stability is supported by the CUSUM test (Figure B10), as the cumulative sum of recursive residuals remains within the 5% significance bounds over 2015–2023. Moreover, structural break dummies for 2008, 2013, and 2015 are statistically insignificant ($p > 0.05$), implying that previously identified break dates do not materially affect the estimated coefficients. The Jarque–Bera test (JB = 6.85, $p = 0.64$) indicates that the residuals are consistent with normality. Finally, the mean VIF of 3.63 is below common multicollinearity thresholds, suggesting that linear dependence among regressors is moderate and does not unduly inflate standard errors. Overall, the diagnostic evidence supports the reliability and stability of the ARDL estimates.

Limitations of the Study

As with any empirical work, this study has a few limitations highlighted below. The econometric analysis in this study used annual secondary data from 2006 to 2023 due to data

availability constraints, limiting the number of observations to 18. Although the ARDL framework is suitable for small samples, the short time series reduces statistical power and may limit the detection of short-run variations in FDI. Additionally, trade openness and political stability were measured using selected proxies and PCA-based composite indices. While this approach minimized multicollinearity and captured broad dimensions of the variables, it did not fully encompass all aspects of trade and governance relevant to FDI including regulatory quality, investment facilitation, and judicial independence.

Policy Recommendations

Based on the findings and conclusions drawn, the following recommendations are deemed pertinent;

1. Further diversification of the Nigerian economy into erstwhile agricultural and manufacturing sectors is essential through Public-private-partnerships born of vetted feasibility studies backed by legally binding performance clauses so as to further improve Nigeria's trade share.
2. Deep modern seaports alongside connecting internal road infrastructures should be built and already existing ones dredged in other parts of the country such as Ondo and Akwa Ibom to decongest the Lagos seaport, in order to sustain and improve trade connectivity in Nigeria.
3. The Nigerian National Assembly should deploy its critical oversight functions through its various trade related committees to ensure that the Federal Ministry of Trade and Investment and its Ministries, Departments, and Agencies to fulfill their statutory obligations of implementing critical trade policies such as the Nigerian investment policy, in order to further improve trade governance in Nigeria.
4. Beyond acquisition of cutting-edge military equipment, and ensuring adequate security is deployed before and after elections nationwide, the Nigerian government should consider pursuing inclusive dialogue with traditional heads in restive regions such as the south-east that have taken up arms due to perceived economic marginalization; while declaring a state of emergency on known terrorist organizations like the Boko Haram in order to de-escalate political violence in Nigeria.
5. To curb corruption, agencies such as the EFCC should be granted institutional independence, including the power to appoint their own leadership. This will strengthen their ability to prosecute corrupt politically exposed persons without political interference, thereby improving Nigeria's investment climate and attracting more foreign direct investment (FDI).
6. Electoral reforms should be prioritized to further strengthen democratic stability in Nigeria: this can be achieved through INEC's effective implementation of the 2022 Electoral Act alongside timely legislative amends by the National Assembly to ensure that all election disputes are resolved before the swearing-in of public officials.

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Appendix

Appendix A1: Short Run Coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(TO_INDEX)	0.031058	0.032992	-0.941249	0.0416
D(PS_INDEX)	1.114880	0.888253	1.255138	0.0298
D(LOG_GDP)	4.211927	4.458955	0.944600	0.0414
D(EXC)	0.004435	0.001693	2.620216	0.0790
D(D2013)	-0.498684	0.283240	-1.760639	0.1765
D(D2008)	0.227977	0.274394	0.830839	0.4670
D(D2015)	-1.661007	0.428659	-3.874890	0.0304
CointEq(-1)	-0.953355	0.289568	-3.292336	0.0460

Appendix B2: TRS and FDI ARDL regression output

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
FDI(-1)	-0.181350	0.210420	-0.861848	0.0411
LOG_TRS	1.079098	0.619986	1.740521	0.0315
LOG_GDP	5.966464	1.206911	4.943584	0.0008
EXC	0.001835	0.000988	1.858257	0.0460
C	67.55308	14.22898	4.747572	0.0010

Appendix B3: CONN and FDI ARDL regression output

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
FDI(-1)	0.236818	0.134471	1.761113	0.0286
CONN	0.045873	0.012971	4.307468	0.0051
LOG_GDP	2.224464	1.204514	1.846774	0.0429
EXC	0.002999	0.001275	2.351990	0.0465
C	29.33908	11.30411	2.595435	0.0409

Appendix B4: TGOV and FDI ARDL regression output

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
FDI(-1)	0.187902	0.235493	0.797909	0.0418
TGOV	0.025483	0.652077	0.039080	0.0269
LOG_GDP	3.486652	1.347603	2.587298	0.0253
EXC	0.003758	0.002084	1.803779	0.0386
C	39.60038	13.55639	2.921160	0.0139

Appendix B5: POV and FDI ARDL regression output

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
FDI(-1)	0.324968	0.216647	1.499991	0.0417
POV	-1.409471	0.930335	1.515015	0.0457
LOG_GDP	2.744085	1.059496	2.589990	0.0251
EXC	0.002951	0.001952	1.511757	0.0587
EXC(-1)	-0.005500	0.002679	-2.052761	0.0647
C	34.30536	11.07955	3.096278	0.0102

Appendix B6: COR and FDI ARDL regression output

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
FDI(-1)	0.057179	0.189306	0.302045	0.7688
COR	-1.236256	1.178588	-1.048929	0.0318
LOG_GDP	3.398289	1.067910	3.182186	0.0098
EXC	0.004110	0.001804	2.278701	0.0459
C	40.61664	11.04991	3.675742	0.0043

Appendix B7: DST and FDI ARDL regression output

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
FDI(-1)	0.059611	0.240307	0.248063	0.0086
DST	0.457579	0.424257	1.078543	0.0038
LOG_GDP	2.978227	1.086969	2.739938	0.0192
EXC	0.003845	0.001962	1.959588	0.0358
C	36.18708	11.43013	3.165937	0.0090

Figure B10: CUSUM of Squares Test Result

