

Relationship Assessment of Political Risk and Foreign Direct Investment (FDI)

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Abstract

Most economic studies tend to agree that foreign direct investment (FDI) is supply-determined, although the association between FDI and political risk has become a key concern due to changes in the global investment climate and the growth in political hazards. Given that the host countries' demand is expected to be infinitely elastic, it is evident that no actual market is intended for FDI. This implied that the association between FDI and political risk would be envisioned from a corporate standpoint, namely, from the perspective of multinational corporations. The vector error correction model (VECM) technique was used to determine the impact and evaluate the association between political risk and FDI in Nigeria in order to fulfill the main goal of this study. The VECM analysis found that political risk measures, including political stability, country risk, corruption, and regulatory quality, have a non-significant positive effect on FDI in Nigeria in the short run. However, contrary to theoretical expectations, these measures will be positive and significant in the long run. Political stability and regulatory quality will significantly positively affect FDI, while country risk and corruption will lead to a broader decline.

Keywords: *Political risk, investment, foreign direct investment, multinational corporation, VECM*

Introduction

Connecting with large emerging markets now requires trade financing, risk management, and corporate protection. Even though these nations are expanding two to three times faster than developed nations, most emerging economies are experiencing turbulent political and economic upheavals. According to Gobinda (2014), political risk is the likelihood that unfavourable political developments will impact the investment climate and, in turn, the returns on investment in a given nation.

Investments made by a corporation or individual in one country into businesses located in another are referred to as foreign direct investment, or FDI, usually through establishing commercial activities or purchasing corporate assets (Busse & Hefeker, 2007). Multinational corporations must make tough choices about their approach to FDI in emerging economies, where additional political interests of FDI—political stability, country risk, corruption, and regulatory quality—loom large.

This situation altered the environment in which the country's interests are pursued, resulting in a new environment characterized by business globalization, the political and economic vulnerability of several investment partners, and increasing tension between the host countries'

economic and political objectives and the widely held values of foreign investors. The international investment community was alarmed by the unfavourable FDI trends and wondered about the main reason for the 12% (\$1.3 trillion) drop in FDI in 2022. UNCTAD, 2023. Contributions from the developing economies came to \$671 billion (down 0.07%) and the transition economies to \$47 billion (down 27.07 percent). The \$712 billion supplied by developed economies is a 37.14% drop, according to UNCTAD's report from 2016, it said that foreign direct investment dropped from \$1.87 trillion in 2016 to \$1.43 trillion in 2017 (UNCTAD, 2018).

Policymakers worldwide have long been concerned about the deteriorating trend, focusing on developing nations where FDI is crucial for long-term industrial and economic growth. FDI inflows affect developing nations, particularly regarding supplying the capital and foreign exchange needed for investments and transferring management expertise and human capital growth. According to Bayar and Alakbarov (2016), it boosts competitiveness in local markets, generates employment possibilities, and makes it easier for export commodities to reach the global market. These shifts in the global investment climate and the increase in political risks have made the link between FDI and political risk a major concern.

However, most economic studies on this topic agree that FDI is supply-determined. Given that the demand in the host nations is tacitly supposed to be indefinitely elastic, it is evident that no actual market is anticipated for FDI. This implied that the corporate perspective, or the perspective of multinational corporations, should be used to envision the relationship between political risk and FDI. Stated differently, foreign investments are vulnerable to the political climate of the State in which they operate since they may be shielded by a strong constitution or left vulnerable by a government that poses a threat. Political risks are high in most nations with a variety of rebel groups, child labour, and political instability. These groups can frequently topple an existing government and impose their own, potentially harming specific investments.

Oil workers were kidnapped, protests were held, oil theft occurred, and oil pipes and other refinery infrastructure were sabotaged as forms of resistance in Nigeria's Niger Delta. These measures forced multinational corporations to assess the area's political risks and develop tactics to lessen their effects. In light of the aforementioned, the purpose of this study is to examine the relationship between FDI and political risk.

Literature Review

Since political stability is a crucial component of a healthy macroeconomic and investment climate, it increases the likelihood of drawing more FDI inflows into emerging nations. A nation's degree of political risk is primarily determined by its level of political stability and the effectiveness of its government (Husain, 2009). A politically unstable economy undoubtedly lowers operating costs, so international investors prefer to invest in an environment with less political volatility.

Because they would rather be in a more tranquil setting, investors will be put off by the degree of timidity that is evident in these nations in the form of murder, hostage-taking, and kidnapping. While there is general agreement regarding the importance of a politically stable nation and the amount of foreign direct investment inflow into the nation, the evidence supporting the ranking of political stability across nations is still not entirely obvious. Research has shown that foreign investors may not need additional incentives in nations with abundant natural resources. Angola is a prime example of this, as political instability has been a widespread problem there.

The central premise is that foreign companies will continue to invest in these nations as long as they are sure they can operate economically without taking on undue risk to their capital and workforce. Some studies found that certain proxy variables related to the problem of political instability were highly significant for FDI inflow; however, the proxy variables used only cover a portion of the country's political risk measurement. For instance, the number of strikes, riots, lost workdays, etc., are examples of variables used (Jaspersen et al., 2000). Risk in exporting nations either raises or lowers the credit risk associated with payment postponement. Bondholders, financing banks, and exporters are all subject to credit and nonpayment risks. Alternatively, a direct investor may record losses due to local authorities' breach of contract, property rights violations, asset damage, and activity halts. Completely stopping all activity is not required.

Power outages, restrictions on local supply, or tariffs can often cause a decline in the company's local operations, which hurts the profit and loss statement. Through the Multilateral Investment Guarantee Agency (MIGA), the World Bank defined political risk in 2013 as risks associated with government acts that restrict an owner's or investor's capacity to use or profit from their assets and diminish the value of the company. One would think that a lower country risk would attract greater foreign direct investment.

However, there is a lot of discussion about country risk, and there is a fair amount of agreement about its occurrences. The concept of "country risk" is complex and includes both political and financial risk. Political risk, on the one hand, is the possibility that low-quality institutions and unstable political environments will have a detrimental effect on investment returns. Businesses are deterred from investing by the high sunk costs of foreign direct investment (FDI) (Helpman et al., 2004).

However, there would be significant uncertainty in economic transactions without strong institutions. In a severely poor institutional framework, multinational businesses may fear that the government of the host country may grab a portion of the profits from foreign direct investment or even carry out coercive nationalisation, putting them at a very high political risk.

High political risk and ineffective institutions can also hurt operating costs. Foreign companies' manufacturing costs might be significantly raised by excessive "red tape" or protracted permit application delays. Standard forms of corruption, like requests for particular payments and bribes connected to import and export permits, currency controls, tax evaluations, or security measures, can hinder the effective operation of multinational firms (Hayakawa et al., 2012).

Macroeconomic factors and institutional qualities, including the rule of law and corruption control, influence countries' FDI inflows.

One of the institutional traits that can affect foreign direct investment inflows into a country is corruption. Strong regulatory frameworks attract more FDI inflows, according to studies. However, investments cannot be protected by those with poor legal frameworks (Peres et al., 2018), which makes international investors wary of doing business there. Bribery and any other actions by those with obligations in the public or commercial sectors that interfere with their duties for personal benefit are considered forms of corruption (Gasanova et al., 2017). The threat of corruption, particularly among the younger generation, inspired the OECD Anti-Bribery Convention. It mandated that OECD member countries guarantee efficient oversight during its implementation phase and prosecute any foreign public officials found to have engaged in bribery in international business transactions (Blundell-Wignall & Roulet, 2017).

Public discussions have concerned the connection between corruption and FDI inflows. The "helping hand" theory of corruption has been supported by some academics, who contend that corruption increases foreign direct investment (FDI) inflows into nations with weak governance structures. In contrast, others contend corruption lowers investment returns and raises transaction costs. However, research has

shown that corruption harms FDI (Tristan, 2017). Although corruption did not affect FDI in several earlier studies (Helmy, 2013; Bayar & Alakbarov, 2016), the results of Gutierrez (2015) demonstrated that corruption had a favourable and noteworthy effect on FDI.

FDI can benefit from corruption, claim Bellos and Subasat (2011). In poor and rising countries, where FDI inflows are essential for economic growth, it removes any regulatory worries. To meet the demands of international investors, these nations have altered their economic environments and relaxed the majority of their rules. Corruption may encourage resource allocation and boost output in nations with poor governance (Bayar & Alakbarov, 2016). Notwithstanding the advantages of corruption in the modern era brought about by globalization, corruption is a global issue that hinders countries' progress in politics, society, and the economy and deprives young children of opportunity (Blundell-Wignall & Roulet, 2017; Gribincea, 2017).

Transparency International (TI) uses the corruption perception index to rank countries according to the degree of power abuse by governmental organizations for personal gain and the moral character of those in positions of authority (Raluca, 2015).

Government bureaucracy facilitates corruption in most corrupt countries, including Nigeria, permitting the legislative branches of the government to engage in high-level corruption (Erhieyovwe & Onokero, 2013). Since corruption permeates practically every aspect of the Nigerian economy, it has a detrimental impact on domestic and foreign investments. Nowadays, it is commonplace in daily business transactions (Omodero & Dandago, 2018). A country's legal and regulatory framework is essential to investors because it recognizes their property rights and ensures that those rights are consistently and successfully upheld. Economic theory states that when investors face fixed and irreversible setup costs, their responsiveness to new investment opportunities will be slowed down by uncertainty about local conditions, especially regulatory uncertainty.

Baker et al. (2016) created a news-based index of economic policy uncertainty in the United States among research that examines industrialized nations. They found that references to perceived policy uncertainty are most frequently associated with macroeconomic and regulatory policies. According to their empirical study, when uncertainty in the US increases, overall output and investment decrease. According to Alfaro et al. (2014), one of the research studies focusing on developing nations, particularly low regulatory quality, a source of uncertainty, is a significant barrier to foreign capital flows into low-income nations. Components of institutional quality, such as government transparency,

property rights protection, predictability of laws, regulations, and policies (Daude & Stein, 2007), and corruption (Wei, 2000) have all been shown to have a similar impact.

For several reasons, all governments must strengthen the regulatory structure to lower risk and aid in regaining investor confidence, even though the trend toward more protectionist measures has been centered in large economies. First, from a business perspective, managing country risk is challenging. According to a global study of chief financial officers, only 15% of participants say they employ political risk insurance, and almost half say they never invest in a dangerous nation (Giambona et al., 2017). Second, because multinational enterprises (MNEs) differ systematically in their susceptibility to and capacity to handle various risks, each nation's risk profile will impact the kinds of businesses that enter its markets.

According to a 2013 poll conducted jointly by the Multilateral Insurance Guarantee Agency and the Economist Intelligence Unit (MIGA), companies that fared better than their rivals gave political risk assessment and management much more thought. Compared to other businesses, better-performing enterprises that could better evaluate political risk also had fewer instances of expropriation, government payment default, license revocation for import/export, or currency transfer limitations. A considerable portion of the variance in political risk seems to occur at the firm level, and it is strongly linked to hiring and investment decisions, according to Hassan et al. (2019), who use a new measure of firm-level political risk. Furthermore, they discover that the degree of aggregate risk frequently rises with the dispersion of firm-level risk. This finding implies that lowering the distortion of resource allocation among enterprises as they react to different levels of risk is another way that lowering country-level risk can enhance macroeconomic outcomes. Finally, a poor record of government behavior can eventually hurt a nation's appeal to foreign direct investment. From the standpoint of signaling, lowering perceived and actual risk is critical.

Bitar et al. (2020) investigated the effects of the 12th ICRG empirically. Cohesion, institutional quality, and governance were the three categories into which the variables were regrouped to represent political risk in Lebanon from 2008 to 2018. The regression analysis showed that these three group categories influenced foreign direct investment inflows into Lebanon. They also came to the conclusion that one of the main elements affecting FDI is political stability. However, Rafat and Farahani (2019) used the 2-LS approach to investigate the association between FDI and national risk in Iran from 1985 to 2016. The study's findings showed that

socioeconomic status, military and religious tensions, ethnic tensions, and external conflicts significantly impacted FDI.

Salehnia et al. (2019) investigated the effects of financial, political, and economic risks on FDI in ten selected MENA nations from 2000 to 2017 employing the panel data approach. The outcomes of the study demonstrated that foreign direct investment is severely and adversely impacted by political, financial and economic nature of risk. Peres et al. (2018) assessed how institutional quality affected FDI flows into both advanced and emerging nations. The study engaged anti-corruption and rule of law principles to evaluate the quality of institutions in the nations it studied. The findings demonstrated that whereas the legal framework in poor countries had the opposite effect, the institutional quality in wealthy countries had a large and positive impact on foreign direct investment flows.

To assess the impact of corruption on FDI inflows, Gasanova et al. (2017) divided countries into four (4) groups. From the outcomes, FDI is drawn to nations with robust economies and low levels of corruption, but not to those with high levels of corruption and weak economies. According to the report, Brazil, China, India, and Russia were classified as having outrageous corruption levels and attracting a lot of FDI because of their abundant natural resources, vast domestic markets, and inexpensive labour.

Tristan (2017) assessed the impact of corruption on FDI flows in Asia and the Pacific region using panel approach from 46 nations between 2006 and 2013 and the Arellano-Bond difference GMM approach. The results showed that FDI inflows were negatively impacted by corruption. Additionally, in low- and middle-income nations, the study revealed no appreciable correlation between FDI inflows and corruption. Hasan et al. (2017) examined the connection between corruption and FDI inflows using China and India as case studies. Despite the belief held by some that corruption promotes FDI in an economy, the results for China and India were different; the former saw a positive effect, while the latter experienced a negative one.

Aziz (2017) looks into the association between FDI flows into the Arab world and institutional quality. Between 1984 and 2012, panel data from 16 Arab nations are analyzed using the system GMM estimate. The paper found that the institutional quality elements of international country risk (ICRG), ease of doing business, and economic freedom have a favorable and substantial influence on foreign direct investment (FDI) flows into Arab economies. Bayar and Alakbarov (2016) investigated the influence of corruption on FDI inflows into 23 emerging countries between 2002 and

2014 using the Westerlund-Durbin-Hausman cointegration test. According to the results of the entire panel data, neither corruption nor the operation of the law had a extensive consequence on FDI influxes.

In their study, which includes data from 91 countries and spans 2002–2012, Erkekoglu and Kilicarslan (2016) used panel data scrutiny to show how political risk affects FDI. Variables of political risk and control have been employed. Foreign direct investment has decreased as political stability, the lack of violence, and managerial performance have increased. In particular, Elleuch et al. (2015) tried to distil the essence of the connection between political risk and FDI. Due to the implementation of macroeconomic policies to enhance the country's stability, the inquiry was permitted to highlight the positive association between Tunisia's political risk and country risk regarding foreign investors' intentions.

Methodology

The study is designed to empirically explore the effect of political risk on FDI in Nigeria. In order to confirm the kind, extent, and potential direction of the link between the target variables, the study uses exploratory, descriptive, and ex-post facto research designs, which are essentially parametric estimations. The study relied on annual time series data on foreign direct investment (FDI) as a proxy for the dependent variable. At the same time, political stability (PLS), country risk (CTR), corruption (CRP), and regulatory quality (RGQ) were independent variables. The proxies used to model the link between the independent and dependent variables are listed below:

$$\begin{aligned} \text{FDI} &= f(\text{PLS}, \text{CTR}, \text{CRP}, \text{RGQ}) & 1 \\ \text{FDI} &= a_0 + a_1\text{PLS} + a_2\text{CTR} + a_3\text{CRP} + a_4\text{RGQ} + u_t & 2 \end{aligned}$$

The *apriori* expectations are thus: $a_0, a_1, a_2, a_3, a_4 < 0$. However, specifying a single equation as in equation 2 is inappropriate given the simultaneous relationship observed among the variables. In analyzing the effect of political risk on FDI in Nigeria, this work specified a five-variable vector autoregressive (VAR) model. Every variable in the system is treated as endogenous in the conventional VAR approach. In addition, the vector error correction model (VECM) approach can address issues with data limitation and accommodate unobserved individual heterogeneity (Kandil et al., 2015). The following is a standard form of the standard VAR model:

$$y_t = \alpha_0 + \sum_{k=1}^j \alpha_k y_{t-k} + u_t \quad 3$$

The error term, u_t , with its usual assumption, is independent and identically distributed with a zero mean and constant variance. Shocks to the endogenous variables in the conventional VAR model are included in the error term of the VAR model that is given. The VAR model has the advantage of estimating the impact and long-term consequences of shocks to each variable on itself and other variables, while also allowing for interactions among all endogenous variables, thereby reflecting the intricate dynamics of the economy, the VAR version of the VECM as thus;

$$\Delta Y_t = \alpha_0 + \alpha_1 \Delta Y_{t-1} + \dots + \alpha_p \Delta Y_{t-p} + \beta_0 \Delta X_t + \beta_1 \Delta X_{t-1} + \dots + \beta_p \Delta X_{t-p} + \theta e_{t-1} + U_t \quad 4$$

where p is the number of lags and e_{t-1} is the lagged value of the error correction term (ECT) from the regression $Y_t = a + bX_t + e_t$. A VECM comprises the lagged first differences of the endogenous variables, X_t and Y_t , and the one-period lagged cointegrating equation, e_{t-1} . The VECM can be considered an adjustment mechanism that causes Y_t to change in response to departures from the equilibrium relationship in the preceding period, as shown by e_{t-1} . This specification permits a variety of short-term dynamics while guaranteeing that the endogenous variable's long-term behaviour converges to the cointegrating relationship. Given the scenario, the VEC model is as follows;

$$\begin{aligned} \Delta \log FDI_t = & \alpha_{i0} + \sum_{i=1}^j \alpha_{i1} \Delta \log FDI_{t-i} + \alpha_{i2} \Delta PLS_t + \sum_{i=1}^j \alpha_{i3} \Delta PLS_{t-i} + \\ & \alpha_{i4} \Delta CTR_t + \sum_{i=1}^j \alpha_{i5} \Delta CTR_{t-i} + \alpha_{i6} \Delta CRP_t + \sum_{i=1}^j \alpha_{i7} \Delta CRP_{t-i} + \alpha_{i8} \Delta RGQ_t + \\ & \sum_{i=1}^j \alpha_{i9} \Delta RGQ_{t-i} + \phi ECM_{t-1} + U_1 \end{aligned} \quad 5$$

Where foreign direct investment is FDI, political stability is PLS, country risk is CTR, corruption is CRP, and regulatory quality is RGQ.

Results and Discussion

A unit root test establishes whether the data matches the model, if a time series variable has a unit root, and if it is non-stationary. Some stochastic processes have a property called a unit root that can lead to issues when using a data model for statistical inference. To discover if the pertinent variables are stationary in data regression, the unit root test must be run first. In regression analysis, non-stationary variables can result in co-

integration and erroneous regressions. When the persistent parameters are the same across cross sections, this process is a typical unit root test. Levin, Lin, and Chu (LLC) (2002) used this presumption to construct a standard unit root technique. Otherwise, this unit root process known as an individual unit root procedure when the persistent parameters freely travel throughout the cross-section.

This form is the foundation for the Im, Pesaran, and Shin W-statistic, ADF-Fisher Chi-square, and PP-Fisher Chi-square tests. The measurement of the group unit root in the data showed that not all of the variables in the group were jointly integrated in all of the methods, i.e., not all of the variables were found to be jointly stationery at the 1 percent, 5 percent, and 10 percent significance levels, as shown by the summarised group unit root test results in Table 1. The study can accept the null hypothesis that the variables (FDI, PLS, CTR, CRP, and RGQ) have unit roots at the 1%, 5%, and 10% levels of significance based on the information of the summarised group unit root tests when performed at their levels. As indicated in Table 1, the variables (FDI, PLS, CTR, CRP, and RGQ) were found to be stationary in all methods and to have no unit root at the 1%, 5% and 10% levels of significance when the series were subjected to additional tests at first difference. The null hypothesis was thus disproved. The variables selected for this study are appropriate for use in subsequent analyses since the study has verified the stationarity of the variables.

Table 1: Summarized unit root test results

Series: FDI, PLS, CTR, CRP, RGQ

Sample: 1998 2024

AT LEVELS

Method	Statistic	Prob.**	Cross-sections	Obs
Null:Unit.root.(assumes.common.unit.root.process)				
Levin,Lin&Chu.t*	-1.30014	0.0968	5	126
Null:Unit.root.(assumes.individual.unit.root.process)				
Im,Pesaran ndShin.W-stat	-1.88484	0.0297*	5	126
ADF-Fisher.Chi-square	19.0544	0.0396*	5	126
PP-Fisher.Chi-square	15.8140	0.1051	5	130

AT 1ST DIFF.

Null:Unit.root.(assumes.common.unit.root.process)				
Levin,Lin&Chu.t*	-9.30647	0.0000*	5	116
Null:Unit.root.(assumes.individual.unit.root.process)				
Im,PesaranandShin.W-stat	-9.79327	0.0000*	5	116
ADF-Fisher.Chi-square	90.9801	0.0000*	5	116
PP-Fisher.Chi-square	95.3931	0.0000*	5	125

The time lapse for endogenous data must be established before the VAR model can be estimated. The VAR lag length criteria was chosen for this study out of several options for figuring out the endogenous data lag period. The results in Table 2 showed that the model's optimal lag order, according to the value of the Akaike information criterion (AIC), is two (2), indicating that it has a strong enough explanatory capacity. In light of this, The root reciprocal mod of AR features was used to analyse the model's stability. Since all of the mods are in the circle, as shown in Figure 1, the model's lag order is suitable and considered stable.

Table 2: VECM lags selection criteria

Lag	LogL	LR	FPE	AIC	SC	HQ
0	46.69044	NA	2.45e-08	-3.335235	-3.091460	-3.267623
1	100.8075	82.25786*	2.50e-09	-5.664596	-4.201945*	-5.258919
2	130.8626	33.66175	2.20e-09*	-6.069007*	-3.387481	-5.325266*

* indicates lag order selected by the criterion

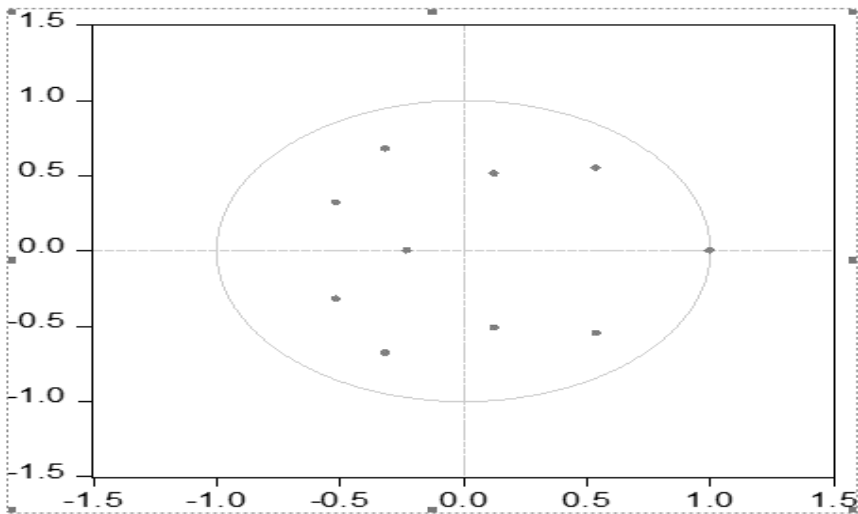


Fig. 1: Model of AR characteristics root reciprocal

The lag order uses only the intercept and linear trend terms to test for the association between the parameters in the VAR equation, and the appropriate version of the cointegration test is the Johansen cointegration test. The Johansen cointegration test on FDI, political stability, country risk, corruption and regulatory quality revealed two (2) positive association at the 5% significance level in the trace and maximum eigenvalue test outputs, which are presented in Table 3 and Table 4. This suggests that there is a stable equilibrium relationship between the variables over the long term. The VECM approach can therefore be used further.

Table 3: Unrestricted Cointegration Rank Test (Trace)

Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None*	0.815056	87.72526	69.81889	0.0000
Note(s): Trace test indicates 1 cointegration equ(s) at the 0.05 level				

Table 4: Unrestricted Cointegration Rank Test (Maximum-eigenvalue)

Hypothesized		Max-Eigen	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None*	0.815056	42.19250	33.87687	0.0041
Note(s): Max-eigenvalue test indicates 1 cointegration eqn(s) at the 0.05 level				

VECM analysis: The analysis of the cointegration outputs showed that the parameters (FDI, political stability, country risk, corruption, and regulatory quality) exhibit the theoretically anticipated long-term equilibrium and short-term disequilibrium for VECM to be carried out. Given that the VAR lag order is two (2), the following equation represents the VEC model:

$$FDI_{t-1} = 6.57PLS_{t-1} - 5.84CTR_{t-1} - 15.64CRP_{t-1} + 2.85RGQ_{t-1} + 22.27$$

If everything else is equal, the equation's values indicate that a percentage rise in political stability will eventually lead to a 6.57 percent gain in FDI in Nigeria. In contrast, FDI in Nigeria will eventually decline by 5.84 percent for every percentage increase in nation risk. Similarly, FDI in Nigeria will eventually decline by 15.64 percent for every percentage increase in corruption. Finally, FDI in Nigeria will finally increase by 2.85 percent for every percentage increase in regulatory quality.

Given that each cointegration equation's R-squared value is greater than 0.5 ($R^2 > 0.5$) and that the AIC and SC criteria have relatively small values, the VECM output demonstrated that the equations of the VEC system had a good fit, as depicted in Matrix 1, thus, reasonable and appropriate. Although there was a significant variance within the parameters of this investigation, an analysis of Figure 2's VECM cointegration relation graph exposed that the zero average line denotes the presence of a constant equilibrium link in the model over the long term. This suggests a notable deviation from the long-term equilibrium connection in the short-term

period signals. The preferences for the adoption of which political risk measures were/were appropriate may be the cause of the short-term volatility.

Matrix 1: Vector error correction model result

$$\begin{bmatrix} FDI_t \\ PLS_t \\ CRT_t \\ CRP_t \\ RGQ_t \end{bmatrix} = \begin{bmatrix} 0.0831 \\ -0.0073 \\ 0.0216 \\ -0.0044 \\ -0.0058 \end{bmatrix} + \begin{bmatrix} -0.0180 & 0.0745 & -0.0530 & -0.0686 & -0.0271 \\ -1.3281 & -0.6759 & -0.1293 & -0.0664 & 0.1013 \\ 0.0397 & 0.4510 & -0.1442 & -0.0207 & 0.4245 \\ 0.8508 & -0.4902 & 0.5842 & 0.4726 & -0.1729 \\ -1.0143 & -0.1939 & 0.7040 & 0.4436 & -0.2861 \end{bmatrix} \begin{bmatrix} FDI_{t-1} \\ PLS_{t-1} \\ CRT_{t-1} \\ CRP_{t-1} \\ RGQ_{t-1} \end{bmatrix} + \begin{bmatrix} -0.0952 & 0.0328 & -0.0996 & -0.0161 & 0.0004 \\ 0.3717 & -0.6759 & -0.1293 & -0.0664 & 0.1013 \\ 0.9587 & 0.0327 & -0.1697 & 0.3286 & -0.1082 \\ -2.2646 & -0.3573 & 0.4605 & 0.4761 & 0.6337 \\ 0.2458 & -0.4258 & 0.2358 & 0.0566 & -0.3764 \end{bmatrix} \begin{bmatrix} FDI_{t-2} \\ PLS_{t-2} \\ CRT_{t-2} \\ CRP_{t-2} \\ RGQ_{t-2} \end{bmatrix}$$

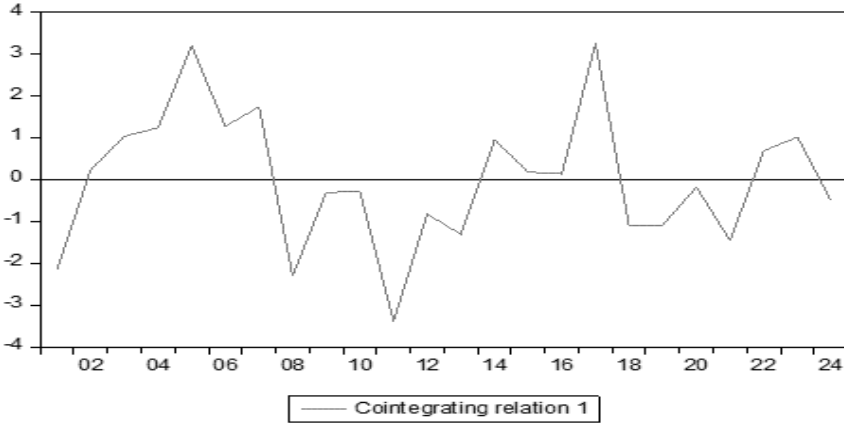


Fig. 2: VECM cointegration relation graph

The inverse roots of the AR Characteristic Polynomial stability test were used to perform a stability test following the completion of the VEC result above. By presuming that every AR root would lie inside the unit circle, the stability of the VEC result was ascertained. Since all of the modulus values in Figure 3 are less than one, it is reasonable to assume that all of the AR roots will be found inside the unit circle, and the VECM meets the stability requirements. The VECM autocorrelation graphs in figures 4a [cor(FDI, FDI(-1)), 4b [cor(PLS, PLS(-1)), 4c [cor(CTR, CTR(-1)), 4d [cor(CRP, CRP(-1)), and 4e [cor(RGQ, RGQ(-1))] simultaneously showed

that none of the variables of interest had autocorrelation, indicating that the VECM model had favourable effects.

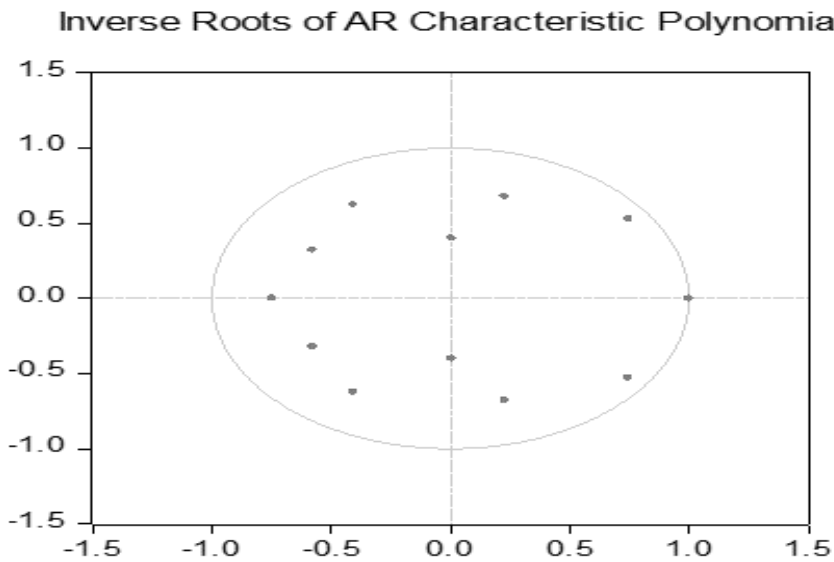


Fig. 3: inverse roots of AR Characteristic Polynomial stability test

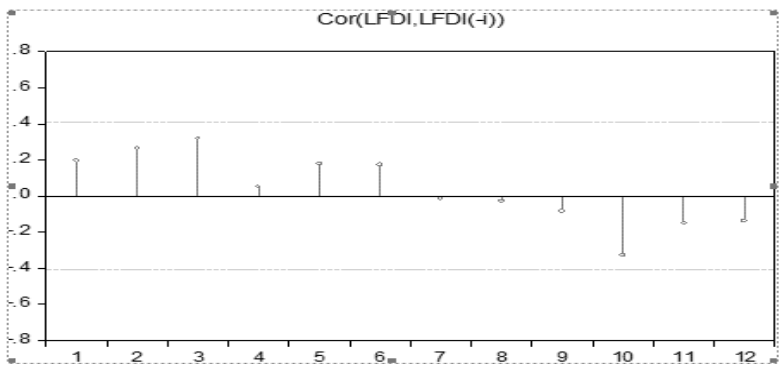


Fig. 4a: VECM autocorrelation graph (FDI)

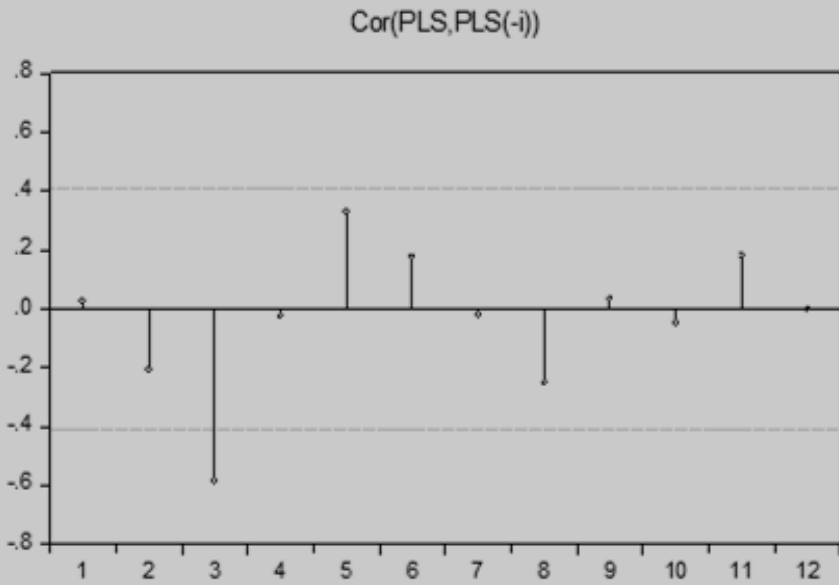


Fig. 4 b: VECM autocorrelation graph (PLS)

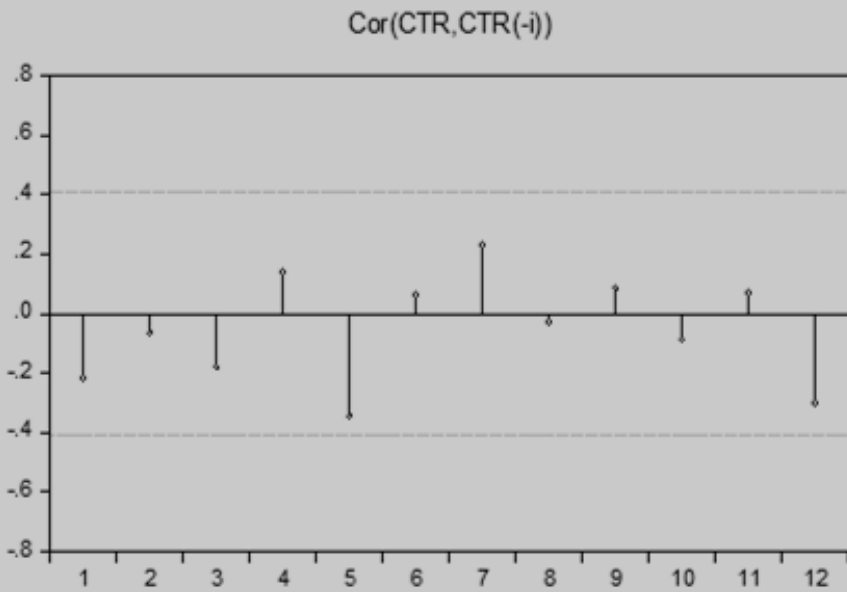


Fig. 4c: VECM autocorrelation graph (CTR)

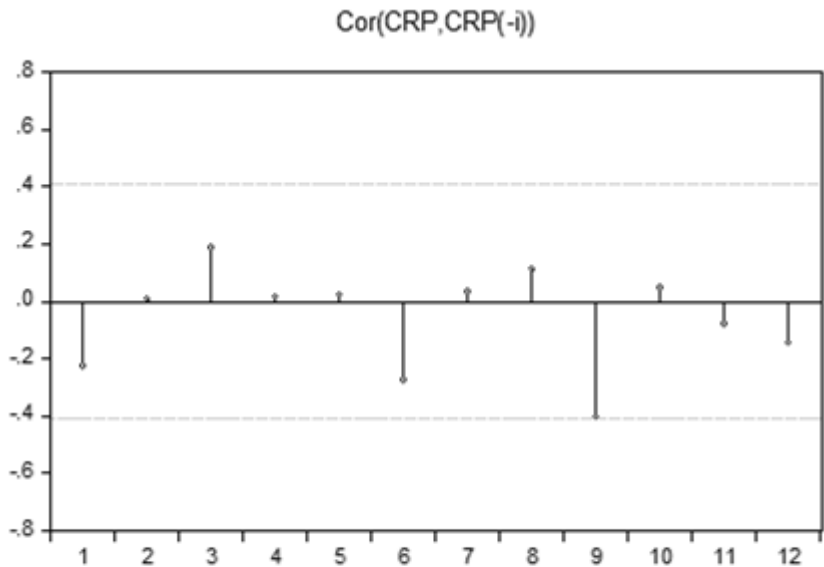


Fig. 4d: VECM autocorrelation graph (CRP)

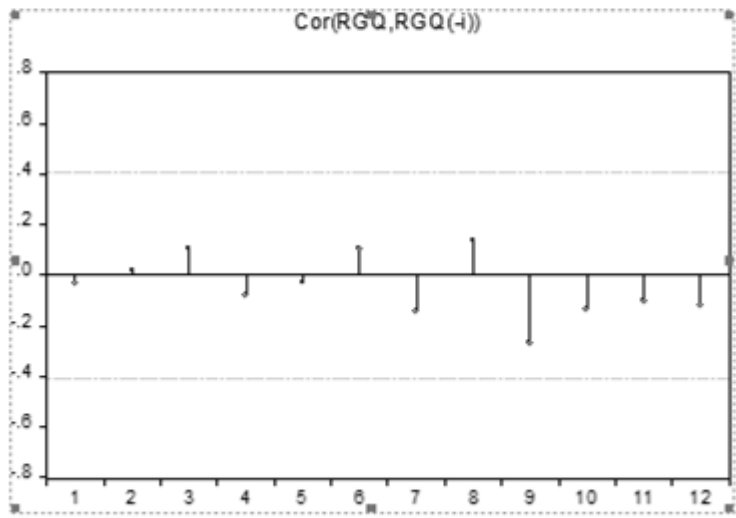


Fig. 4e: VECM autocorrelation graph (RGQ)

The VECM for ten periods is used to calculate the dynamic impacts of foreign direct investment, in reaction to some disturbances from the explanatory parameters (political stability, nation risk, corruption, and regulatory quality). According to Figure 6, FDI maintained all positive values from the initial year to the remaining years selected in the future, even when subjected to a positive or negative shock of one standard

deviation of FDI to FDI. Between the peak value of 0.608 in the 1st year and the lowest figure of 0.398 in the 3rd, the reaction recovered. The results of the FDI response to PLS showed that only the first and third years had positive responses, while the other years (2nd, 4th, 5th, 6th, 7th, 8th, 9th and 10th) selected for future FDI had negative responses. The response recovered between its lowest figure, -0.108 in the 2nd year, and its uppermost value, 0.038 in the fourth year. A closer look at FDI's relationship to CTR showed that it only had a negative response in the second and fifth years, but had a positive response in the other years. The response fluctuated between its lowest values in the 2nd year (-0.085) and its maximum in the fourth year (0.067).

FDI responded favourably from the first year to the subsequent years selected, according to an additional study of FDI to CRP. The reaction fluctuated between its lowest value of 0.000 in the 1st year and its uppermost value of 0.107 in the fifth. Finally, FDI only reacted negatively in the second year, according to the analysis of FDI to RGQ; in the other years selected for the future, FDI reacted favourably. The response recovered between the second year's lowest value of -0.038 and the 5th year's maximum worth of 0.037.

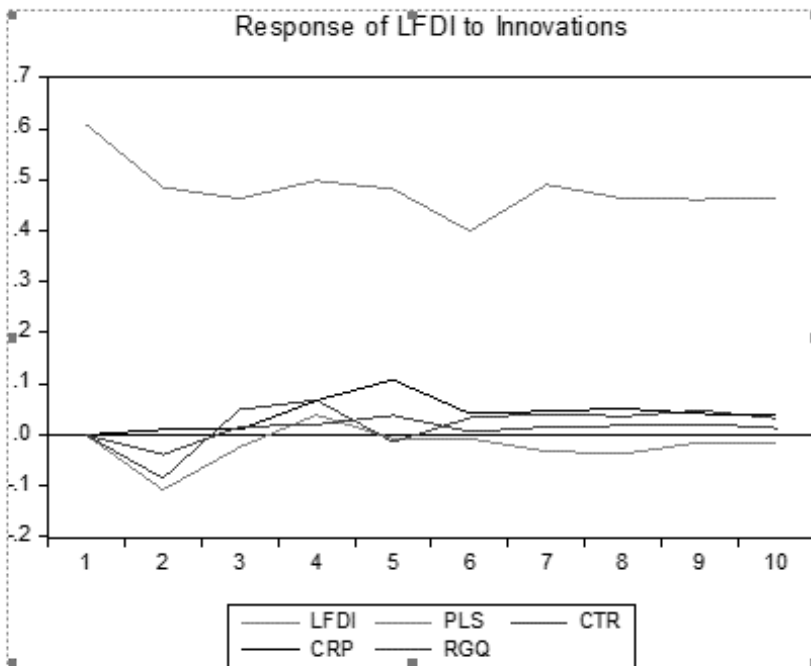


Fig.5: Impulse response function combined graph

In the short run, particularly in the first period, 100 percent of the forecast variance error in FDI is explained by the variable itself, implying that no other variable in the model has a strong influence on FDI in the first period, as such, PLS, CTR, CRP and RGQ has substantial exogenous impact on FDI. However, FDI exhibited a weak influence on itself (that is, weakly endogenous), specifically, in the long run, FDI maintained a powerful influence of 97.12 percent of forecast variance error by itself right from the short-run periods into the future.

Regarding the influences of PLS, CTR, CRP, and RGQ on FDI, they all exhibited very weak influence (strongly exogenous) up to 1.88 percent, 1.19 percent, 1.18 percent, and 0.26 percent, respectively, of forecast variance error on FDI from the short run periods into the future, ceteris paribus.

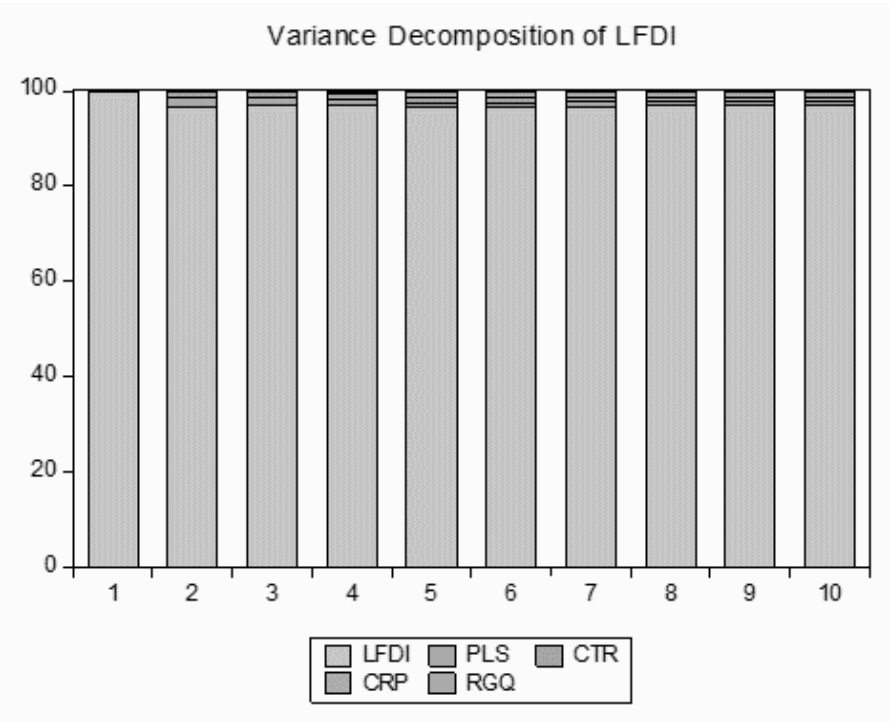


Fig. 6: Variance decomposition of forecast errors stacked graph

Conclusions

This study's main goal was to determine how political risk affected foreign direct investment in Nigeria. According to the results of the VECM

analysis, in the near term, political risk measures (political stability, country risk, corruption, and regulatory quality) had a non-significant positive effect on foreign direct investment. In contrast, it was positive and significant against theoretical expectations in the long-run period. Specifically, given Nigeria's current political risk dynamics, only political stability and regulatory quality would significantly positively affect foreign direct investment in the long run, all things being equal. On the other hand, country risk and the level of corruption in the country would lead to a widening decline in FDI, *ceteris paribus*.

The results of the examination of the IRF function indicate that it was expected that FDI in Nigeria would respond positively to itself; however, in a twist of expectation, it responded positively to corruption. Regarding the forecast variance errors, foreign direct investment could influence itself in the first period, and the remaining periods showed it to be strongly endogenous. On the other hand, with regards to the influences of political risk measures (PLS, CTR, CRP, and RGQ) on FDI, they all exhibited very weak influence (strongly exogenous) respectively of forecast variance error on FDI from the short run periods into the future, *ceteris paribus*.

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