TRADE OPENNESS AND FOREIGN DIRECT INVESTMENT: AN EMPIRICAL ANALYSIS FROM NIGERIA

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Keywords

Trade openness, Foreign Direct Investment, Gross Domestic Product, Nigeria

Abstract

The influence of trade openness is a significant subject of investigation regarding the factors that stimulate foreign direct investment inflows into a country. Following this, this study examines the effects of trade openness and foreign direct investment in Nigeria. The study employed ARDL techniques in analyzing the data from 1986 to 2023 using data obtained from World Development Indicator (WDI, 2023). The results demonstrate that foreign direct investment adversely affects gross domestic product per capita. The unproductive character of foreign direct investment accounts for this effect; hence, it has adversely impacted growth. This data corroborates the prevalent notion that alterations in the composition of FDI generally exert a negative impact on GDP. These findings, along with previous research, indicate that trade openness significantly influences the attractiveness of FDI inflows. This perspective asserts that governments should enact various rules and regulations to foster trade openness. Governments endeavor to liberalize their trade sectors by enacting various open-door policies, fostering integration, and reducing barriers and bureaucratic obstacles to attain enhanced economic development.

Introduction

Foreign direct investment (FDI) has significantly contributed to the economic progress of several nations and areas during the past few decades. Global foreign direct investment inflows have surged significantly since 1980 (Wang et al. 2022). Various factors influence the inflow of foreign direct investment (FDI). International commerce is one of the elements most significantly impacted in literature. To liberalize their economies and enhance FDI, numerous countries have implemented a series of progressive regulations concerning international trade.

In numerous nations, foreign direct investment is swiftly ascending to the forefront of factors impacting economic development. These inflows significantly impact the economic development and advancement of nations and constitute a principal driver of globalisation. The emerging market is considered one of the most advantageous investment locations. To facilitate international trade, attract increased foreign direct investment, and liberalise their economies, numerous governments have implemented a series of progressive policies and established a favourable political and economic climate. Numerous economies have sought to enhance foreign direct investment by

liberalising their markets and enacting progressive policies and infrastructure improvements. By facilitating access to modern technology and critical production inputs, fostering healthy rivalry among enterprises, and other reasons, FDI inflows significantly enhance domestic investment in recipient economies. Foreign Direct Investment (FDI) has demonstrated its significance in enhancing local productivity, fostering innovation, and sustaining economic growth, as indicated by Bergougui et al. (2023), Tahir et al. (2019) and Gbadebo et al. (2024)

Numerous studies conclude that trade openness serves as an indicator of a nation's trade policy and influences foreign direct investment (FDI). Certain research indicate that the characteristics of FDI flow may react differently to trade openness in each nation. Moreover, certain research suggests that foreign direct investment significantly influences its own dynamics. The concept of "trade openness" encompasses several definitions throughout the literature. Trade openness is defined as the aggregate of imports and exports (X+M), normalised by GDP. Lee et al. (2023), Liargovas et al. (2012), Ho et al. (2013), Dewi et al. (2023), Tahmad et al. (2018), Zaman et al. (2018), Mudiyanselage et al. (2021), Kayani et al. (2024), Ahmad et al. (2024), and Fraihat et al. (2023) assert that GDP is the most prevalent and valuable indicator. Trade openness is vital in monitoring the nation's export-import equilibrium and plays a crucial role in foreign direct investment (FDI) inflow.

The influence of trade openness is a significant subject of investigation regarding the factors that effect foreign direct investment inflows into a country. The primary objective of several studies was to assess the influence of trade openness on foreign direct investment. Sabir et al. (2019) emphasised the significance of trade openness for foreign direct investment inflows to both developed and developing countries. Their findings demonstrate that foreign direct investment inflows rise by over 3.7% in low-income nations and by more than 2.1% in lower-middle-income countries for each 1% enhancement in trade openness.

Moreover, Moraghen et al. (2023) demonstrate that foreign direct investment (FDI) increases almost proportionately, with Mauritius exhibiting a greater degree of openness. Furceri and Borelli (2008) emphasised the relationship between exchange rate and openness, demonstrating that a nation's level of openness fundamentally determines the impact of exchange rate volatility on foreign direct investment. Empirical research (Liargovas et al., 2012) indicates that the introduction of free-trade agreements substantially augmented foreign direct investment inflows into Latin American nations. Additional research illustrating the beneficial impact of trade openness on foreign direct investment encompasses studies in sub-Saharan Africa (Asiedu 2002), developing economies (Liargovas and Skandalis 2012), Arab economies (Aziz and Mishra 2016), Turkey (Güri¸s and Gözgör 2015), as well as India, Iran, and Pakistan (Donghui et al. 2018).

Foreign direct investment is theoretically influenced by trade openness in various manners. The impact of trade openness on foreign direct investment (FDI) is contingent upon the trade policies of the host nation. Liargovas et al. (2012). Research by Janick et al. (2004), Zaman et al. (2018), and Makoni (2018) indicates that most empirical studies demonstrate a positive correlation between trade openness and FDI inflows. Research indicates that a nation is more inclined to attract foreign direct investment (FDI) when it imposes fewer restrictions on imports and exports. Certain research have identified a negative association between trade openness and foreign direct investment (Tahmad et al., 2018; Cantah et al., 2018). Ultimately,

additional research indicated no significant effect of trade liberalisation on foreign direct investment (Ho et al., 2013; Wickramarachchi, 2019). The objective of this study is to determine the long-term impact of trade openness on foreign direct investment in Nigeria, a developing nation. This study employs the ARDL model to examine the short- and long-term relationships between trade openness and foreign direct investment (FDI) from 1986 to 2022, utilizing both empirical and theoretical data.

Literature Review

The literature clearly demonstrates that FDI inflows have improved the economic performance of various countries and regions over the past few decades. In theory, trade openness may influence FDI inflows positively or negatively. Numerous academics have examined the benefits of foreign direct investment (FDI) to identify the factors influencing FDI inflow. Recent research indicate that regional, national, and business factors predominantly influence the decision to invest internationally (Sarker et al., 2023). Anyanwu (2011) presented extensive evidence concerning the factors influencing FDI inflows, asserting that trade and market size exert a favourable impact on FDI inflows.

The literature encompasses extensive study and data regarding the benefits of trade openness for economic growth. The earlier analysis completely overlooked the significant significance of trade openness in luring FDI inflows. Aziz et al. (2016) empirically established that economic size, as measured by GDP, significantly influences FDI inflows, utilising data from Arab states spanning 1984 to 2012. Moreover, Ho et al. (2011) shown that trade openness enhances foreign direct investment inflows. Conversely, other research suggests that trade openness adversely affects foreign direct investment inflows.

Kimino et al. (2007) shown that trade openness adversely affected Japan's foreign direct investment inflows. Dua et al. (2015) found that trade liberalisation has adversely impacted foreign direct investment inflows in the Indian economy. These data suggest that trade openness and foreign direct investment serve as alternatives rather than complements. Vijayakumar et al. (2010) empirically established that trade openness does not influence the elucidation of foreign direct investment inflows inside the BRICS economies. It remains ambiguous whether trade openness facilitates or hinders FDI inflows. The evident discrepancies in the literature concerning the influence of trade openness on FDI inflows are the principal catalysts for the present inquiry.

Ullah et al. (2017) analysed the determinants of foreign direct investment in BRICS and MINT from 2001 to 2011 employing a cross-sectional pooled time series analysis and a random effects model. The dependent variable was net FDI inflows, whereas the independent variables considered included GDP, the proportion of natural resources in GDP, infrastructure, inflation, trade openness, and institutional indices. The findings indicated that market size, infrastructure, commercial accessibility, and openness are the primary attractions for foreign direct investment (FDI) in BRICS and MINT. Nonetheless, the calibre of institutions and the accessibility of natural resources has minimal influence on long-term foreign direct investment.

Mudiyanselage et al. (2021) examined the causal relationship between trade openness and Romania's foreign direct investment inflows from 1997 to 2019. In this study, trade openness serves as the principal independent variable, whereas the real effective exchange rate, GDP, inflation, and education are employed as control factors to examine the correlation between trade openness and

foreign direct investment inflows into Romania. The Auto Regressive Distributed Lag (ARDL) bounds test methodology was utilised to accomplish the purpose. The study reveals detrimental consequences and statistically significant short- and long-term correlations between trade openness and FDI inflows to Romania. Trade openness adversely impacts FDI inflow, indicating that a market's enduring capacity to attract FDI is inversely related to its degree of openness. The Granger causality test results demonstrate a unilateral association between Romania's trade openness and foreign direct investment. Moreover, he demonstrated that trade openness and foreign direct investment were causally linked.

Methodology

This section delineates the model specifications. The seminal research conducted by Benabdennour et al. (2024), which assessed the influence of trade openness on FDI inflows, constituted the basis for our proposed modelling framework. Trade openness is one of the determinants that may influence foreign direct investment inflows to Nigeria. For instance, foreign direct investment inflows are substantially affected by the magnitude of the domestic market, as shown by GDP. Aziz and Mishra (2016) illustrated that institutional quality is a crucial determinant in attracting foreign direct investment (FDI) inflows, utilising data from Arab economies. According to prior studies, the independent variables encompass the exchange rate, inflation rate, and natural resources (Anyanwu 2011; Dua and Garg 2015; Dewi and Septriani, 2023). The model's needed functional form is denoted by expression (1).

$$FDI = f(TRO, INF, EXR, GDP) \quad 1$$

Expression (1) indicates that trade openness, market size, natural resources, exchange rate, inflation rate, and institutional quality collectively elucidate FDI inflows. Considering the potential non-linearities, we transform

Expression (1) as shown below

$$FDI = \emptyset_0 + \emptyset_1 TRO + \emptyset_2 INF + \emptyset_3 EXR + \emptyset_4 GDP + \mu \quad 2$$

$$\Delta FDI = \emptyset_0 + \sum_{s=1}^{J} . \emptyset_{1s} \Delta FDI_{.t-n} + \sum_{s=1}^{J} . \emptyset_{2s} \Delta TRO_{.t-n} + \sum_{s=0}^{J} . \emptyset_{3s} \Delta EXR_{.t-n} + \sum_{s=0}^{J} . \emptyset_{4s} \Delta GDP_{.t-n} + \sum_{s=0}^{J} . \emptyset_{5s} \Delta InF_{.t-n} + \partial_1 FDI_{t-1} + \partial_2 TRO_{t-1} + \partial_3 EXR_{t-1} + \partial_4 GDP_{t-1} + \partial_5 InF_{t-1} + \mu \quad 3$$

$$\Delta FDI = \emptyset_0 + \sum_{s=1}^{J} . \emptyset_{1s} \Delta FDI_{.t-n} + \sum_{s=1}^{J} . \emptyset_{2s} \Delta TRO_{.t-n} + \sum_{s=0}^{J} . \emptyset_{3s} \Delta EXR_{.t-n} + \sum_{m=0}^{J} . \emptyset_{4m} \Delta GDP_{.t-n} + \sum_{m=0}^{J} . \emptyset_{5m} \Delta \mathrm{InF}_{.t-n} + \partial_1 FDI_{t-1} + \partial_2 TRO_{t-1} + \partial_3 EXR_{t-1} + \partial_4 GDP_{t-1} + \partial_5 InF_{t-1} + \in ECT_{t-1} + \in_t \quad 4$$

Result and Discussion

Unit Root Testing

Before employing the ARDL approach, it is essential to confirm the order of integration. To confirm that all variables were integrated at

I(0) and I(1), as seen in Tables 1 and 2 below, we employed the ADF and PP tests. The established integration sequence and the AIC criterion indicating an ideal lag structure of 3 render the ARDL technique suitable for this analysis.

Table 1. ADF

Variable	Level		First Difference	
	Prob. (with trend)	intercept	Prob. (with trend)	intercept
FDI	0.061	0.456	0.000	0.000
GDP	0.021	0.004	0.000	0.000
TrO	0.021	0.000	0.000	0.000
InF	0.004	0.010	0.001	0.002
ExR	0.010	0.020	0.000	0.000

Note: (0.000), and (0.050), indicate significance at the 1%, 5%, and 10% levels, respectively.
Source: Author's Compilation, 2025

Table 2. PPT Test Output

Variable	Level		First Difference	
	Prob. (with trend)	intercept	Prob. (with trend)	intercept
FDI	0.679	0.403	0.000	0.000
GDP	0.021	0.000	0.000	0.000
TrO	0.000	0.000	0.000	0.000
INF	0.070	0.050	0.000	0.000
ExR	0.011	0.001	0.000	0.000

Note:
(0.00), and (0.050) indicate significance at the 1%, 5%, and 10% levels, respectively.
Source: Author's Compilation, 2025

Cointegration Evaluation Using Bound Testing Approach

Table 3. Cointegration Evaluation Using Bound Testing Approach in 1986-2022

Test Statistic	Value	K
F-statistic	1.011712	4
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	2.45	3.52
5%	2.86	4.01
2.5%	3.25	4.49
1%	3.74	5.06

Source: Author's Compilation, 2025

The estimation outcomes for the ARDL models are presented in Table 4. We employed the Akaike information criteria to select the optimal ARDL model. The results demonstrate

that foreign direct investment significantly adversely affects gross domestic product per capita. The unproductive character of foreign direct investment accounts for this effect; hence, it has adversely impacted growth. This data corroborates the prevalent notion that alterations in the composition of FDI generally exert a negative impact on GDP.

The results indicate that governance, infrastructure quality, and investment have significantly contributed to the stimulation of FDI inflows. The paramount characteristic of governance is its magnitude of impact. These findings indicate that investors prioritise institutional quality when selecting a nation for investment (Sabir and Qureshi, 2020; Paul and Jadhav, 2019; Asamoah et al., 2016; Bevan et al., 2004; Dunning, 1998).

We see that affluent countries are more significantly affected by the magnitude of investment effects than emerging nations. Indeed, the investment contributions of affluent nations to foreign direct investment attractiveness exceed those of emerging nations by more than 3.5 times. This result can be elucidated by the complementarity effect between foreign and domestic productive investments; local investments, predominantly concentrated in the industrial and service sectors, would have facilitated FDI inflows.

The findings indicate that inflation significantly adversely affects foreign direct investment (FDI) inflows across the entire sample; thus, increasing economic instability discourages FDI inflows (Kunofiwa et al., 2018). It is essential to emphasise that inflation adversely affects developing nations while benefiting developed nations; this observation corroborates the notion of a non-linear relationship between inflation and economic activity, where high inflation yields negative effects and moderate inflation produces positive outcomes (Fisher, 1993; Boujelbene, 2021; Sall, 2020; and Baglan and Yoldas, 2014). Descriptive statistics reveal inflation.

Findings demonstrate that trade openness exerts a significantly positive long-term effect on foreign direct investment (FDI), irrespective of the sample (total, developed, and developing nations). For instance, trade openness exhibits no significant short-term impact on foreign direct investment. The enduring advantages of trade liberalisation corroborate the conclusions of Zaman et al. (2018) and Makoni (2018). Studies indicate that a nation is more inclined to attract foreign direct investment (FDI) when it imposes fewer import and export restrictions.

Trade openness exerts a more significant influence on FDI inflows to impoverished nations than infrastructure quality, with an impact ratio of 6.6 to 10 times. The enduring effect of openness on FDI is uniformly positive and significant across all three samples, maintaining a typically stable magnitude despite fluctuations in the governance measure. Descriptive data indicate that developed countries exhibit greater trade openness; however, the long-term impact of trade openness on foreign direct investment (FDI) is far more pronounced in developing countries, ranging from 8 to 13 times greater than in developed nations. This outcome can be elucidated by the decreasing marginal impacts of trade openness on FDI inflows. The principal findings corroborate the results of Liargovas and Skandalis (2012) and Djulius (2017) for a panel of 36 emerging economies from 1990 to 2008. Musabeh and Zouaoui (2020) examined the determinants of FDI inflows in Algeria, Egypt, Libya, Morocco, and Tunisia from 1996 to 2013, finding that trade openness positively and significantly influenced FDI inflows, whereas market size and natural resources had minimal effects.

Table 4. Long-run output

Variable	Coeff	Std. Error	t-Statistic	Prob.*
FDI(-1)	0.724389	0.179966	4.025137	0.0007
FDI(-2)	0.358316	0.213469	1.678538	0.1096
FDI(-3)	0.312276	0.210616	1.482681	0.1546
FDI(-4)	-0.748086	0.213844	-3.498274	0.0024
GDPC	-1.82E+08	87225122	-2.089904	0.0503
TRO	-0.003248	0.006176	-0.525844	0.6051
INF	-52382275	28046879	-1.867669	0.0773
INF(-1)	18478690	24154974	0.765006	0.4537
INF(-2)	-49190160	21645507	-2.272534	0.0349
EXR	7196040.	7277045.	0.988868	0.3352
EXR(-1)	-3508144.	7563136.	-0.463848	0.6480
EXR(-2)	-7837633	6454902.	-1.214214	0.2395
C	3.94E+09	1.42E+09	2.781535	0.0119

Source: Author's Compilation, 2025

CointEQ01 represents the coefficient in the cointegration equation, indicating the pace of adjustment. All estimations indicate that "CointEQ01" is significant at the 1% level; this finding corroborates the integration of the variables, demonstrating that the independent factors together affect FDI inflows in the long term. The coefficient's size (ranging from −1 to 2) signifies that equilibrium is attained with diminishing volatility.

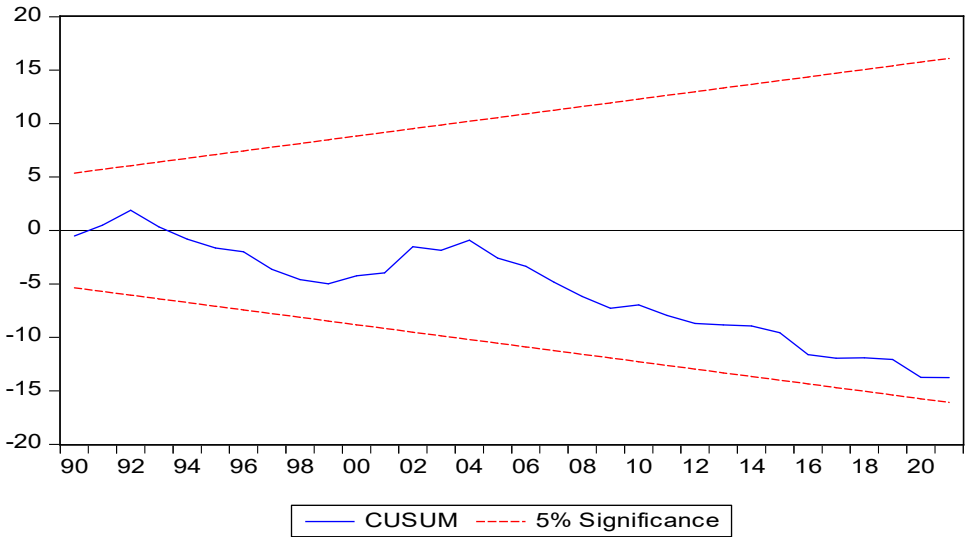
Table 5: Short run Output

Cointegrating Form				
Variable	Coeff	Std. Error	t-Statistic	Prob.
D(FDI(-1))	0.077494	0.190841	0.406067	0.6892
D(FDI(-2))	0.435810	0.203017	2.146664	0.0449
D(FDI(-3))	0.748086	0.213844	3.498274	0.0024
D(GDPC)	-1822921	187225121.7	0.000000	0.0000
D(TRO)	-0.003248	0.006176	-0.525844	0.6051
D(INF)	-5238227	28046878	0.000000	0.0000
D(INF)	49190159.	21645507	0.000000	0.0000
D(EXR)	7196039.5	7277045.1	0.000000	0.0000
D(EXR(-1))	7837632.8	6454901.6	0.000000	0.0000

CointEq(-1)	-0.353105	0.109767	-3.216864	0.0045

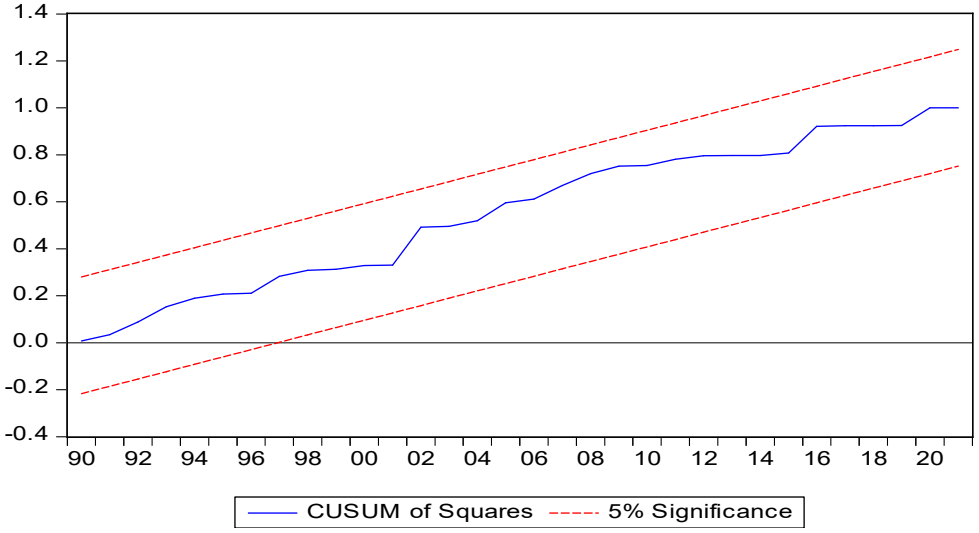
Source: Author's Compilation, 2025

Figure 2. CUSUM Stability Test



Source: Author's Compilation, (2025)

Figure 3. CUSUM of Squares Stability Test



Source: Author's Compilation, (2025)

Table 6: Serial Correlation Test for the Study in 1986-2021

F-statistic	6.371453	Prob. F(2,17)	0.0086
Obs*R-squared	13.70992	Prob. Chi-Square(2)	0.0011

Source: Author's Compilation, 2025

Heteroskedasticity Test: ARCH

F-statistic	1.343122	Prob. F(1,29)	0.2559
Obs*R-squared	1.372198	Prob. Chi-Square(1)	0.2414

Source: Author's Compilation, 2025

Conclusion

Foreign Direct Investment (FDI) exerts both direct and indirect effects on various economic activities, rendering it a crucial component of a transparent and effective international economic framework. Various research indicate that trade openness can influence FDI inflows positively, negatively, or insignificantly. Furthermore, previous studies have demonstrated that trade openness influences FDI inflows variably across different countries and regions. Employing the ARDL model in a panel framework, we investigate the long-term effects of trade openness on foreign direct investment (FDI) across 124 industrialised and developing countries from 1996 to 2021. The principal findings revealed that trade openness exerts a substantial and positive long-term effect on foreign direct investment inflows in both affluent and developing countries, with the long-term advantage being more pronounced in poorer nations. In developing countries, trade openness exerts a more significant long-term influence on foreign direct investment (FDI) than the quality of infrastructure, by a factor of 6.6 to 10 times. The short-term impacts are minimal for three samples. The results indicate a bidirectional causal association between trade openness and foreign direct investment for both the overall sample and developed countries. For all samples, trade openness exerts a significantly positive long-term effect on FDI. In all samples, trade openness has no significant short-term impact on foreign direct investment. The enduring effect of openness on foreign direct investment (FDI) is consistently positive and substantial across all samples, remaining robust against the influence of governance variables.

These findings, along with previous research, indicate that international openness significantly influences the attractiveness of FDI inflows. This perspective asserts that governments should enact various rules and regulations to foster trade openness. Governments endeavour to liberalise their trade sectors by enacting various open-door policies, fostering integration, and reducing barriers and bureaucratic obstacles to attain enhanced economic development.

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