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Impact of Security Expenditure on Foreign Direct Investment in Nigeria

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Abstract: This study investigates the relationship between Expenditure on Security and Foreign Direct Investment in Nigeria using secondary data spanned through 1985 to 2012. Preliminary unit root tests were conducted using the Philip-Perron approach. Co-integration and Error Correction Mechanism (ECM) was employed to examine the nexus between Expenditure on Security and Foreign Direct Investment. The study found that internal security expenditure and Inflation maintained negative long run relationship with index of Foreign Direct Investment while defense expenditure exhibited long run positive relationship with the dependent variable. Consequently, it is recommended that an investment friendly environment capable of attracting Foreign Direct Investment should be of priority to the federal government. Likewise, serious and tight border strategic management is direly needed now as Nigeria borders have been porous and weak to the extent that ammunitions and other weapons freely fly across our borders unchecked. If these are allowed, a higher inflow of direct investment into Nigeria is imminent.

Keywords: Defence, Internal Security, Insurgence, Foreign Direct Investment

1. Introduction

Several unpalatable and barbaric incidences seem to be traceable to political cum economic system of Nigeria; these are ranging from kidnappings, protracted ailment of corruption and even obnoxious killing of innocent citizens. The state of insecurity in Nigeria has become very high to the extent that bombings especially in the Northern part of Nigeria pose great challenges and threat to the stability and peace of Nigeria's aggregate economic environment. This country has experienced serious losses ranging from infrastructural, human lives and properties; to cap it all, the sour happenings had repelled the inflow of foreign direct investment which contributes in no small measure to the Gross Domestic Product of Nigeria. Needless to say that foreign direct investment has significant contribution to the economic growth in terms of the introduction of modern science, technology and organization and many other countless benefits. FDI encourages entrepreneurs to invest and gives room for cordial relationship among the countries involves. It is important to emphasize that no economic or nation can witness growth or thrive and survive without peace and cooperate will to succeed, Nigeria is never an exception. Business progress and momentum had dwindled especially in the Northern part of Nigeria all because of insecurity and the obnoxious monster of "Boko Haram Sect". This has a lot of implications on economic growth in relation to foreign direct investment. Countless havoc had been carried out by this deadly sect called 'Boko Haram'; the recent one executed on Nigeria Independence Day in 2011 left much to be desired and made one to doubt the existence of this country in the nearest future as bombs went off right in the assembly of Christians while they were performing thanksgiving service for Independence Day (Suleiman, 2012). Several lives were lost. In the same year, not less than 60 people were killed in Yobe State bomb blast; UN building and the Nigeria police Headquarters were attached; Jos, Plateau, Kaduna, Adamawa, Nassarawa, Bornu and even Kano and other states in the north are now labeled as no-go-area especially for domestic and foreign investors. Over 8000 Nigerian have reportedly lost their precious lives in religious, political and post election violence cum ethnicity conflicts just between 2000 and 2014. Civil war, terrorism and social unrest will not only result in uncertainty in the investment and financial environment but also increase security expenses, lead to poor output and retard productive capacity, reduces foreign direct investment benefits, damage properties and infrastructures and displacement of both direct and indirect foreign investment which has serious impact on the economic growth and development of emerging economies.

Nevertheless, the security challenges Nigeria seem not to have severed effects on the foreign direct investment inflow into the country. This can be traced to data released in the first three quarters in 2012 by the Central Bank of Nigeria (CBN) which show that portfolio investment accounted for US$ 4.6 billion while foreign direct investment stood at US$ 1.44 billion. With this figure, it means foreign investors controlled an average of 60 per cent of all trading being carried out on the Nigeria Stock Exchange in 2012 regardless of rising insecurity in the country.

This work assesses and delves the nexus between security expenditure and foreign direct investment; with special interest to explore the impact of security expenditure on foreign direct investment in the country. Has the funds injected into security forces cum defence had effects on the perfect protection of people's lives and properties in Nigeria? Does the budget allocation to security forces guarantee peace and serenity which the good citizens of Nigeria crave for and do foreigners feel secured in the country? In essence, this paper examines the nexus between security expenditure and foreign direct investment in Nigeria.

The arrangement of this paper goes thus: the study first treats the examination of fundamental concepts of foreign direct investment, followed by National security issues in section two. Also, the nexus between national security challenges and FDI is explored in section three. Meanwhile, section four will specify the model and empirical outcomes. Finally, section five deals with summary, conclusion and recommendations.

1.1. Literature Review

There are several forms through which Foreign Direct investment could flow into a country. It could come in firm of subsidiary of a multinational company or in form of merger and acquisition with a local firm in the host country. It could come in form of creation of non-current assets in the other country by the national of the investing country (Obadan, 2004). In this kind of investment, the Multinational firm exercises de facto or de jure authority over the assets they have formed. One major reason an investor acquires asset in a foreign country is to establish its physical presence in that country and thus exercises lasting control in the management of the enterprise wherein the direct investment evolves. It is not compulsory that they gain major shareholding; however, having a reasonable stake in the management denotes that the foreign investor has the inherent strength to influence or participate in the enterprise's management. Therefore, it is the element of control and influence that differentiates portfolio investment from direct foreign investment (Global Price Index, 2012). It is interesting to understand that foreign direct investment has less exposure compared to external debt for the borrowing country, although the latter may have higher reward. Honestly, foreign Direct Investment has the merits that it does not contribute to country's causes of debt portfolio.

1.2. Causes of Insecurity in Nigeria

High rate of unemployment is the prime factor of incessant increase in insecurity in Nigeria. Officially, the rate of unemployment stood at 23.9 per cent while some economist argued that the figure could be up to 50% of the workforce. The alarming rate of unemployment is the major cause of poverty level which is uo to 60% in some states in the North according to the data released by the National Bureau of Statistics (NBS, 2012)

Another cause of rapid rising in the level of insecurity could be traced to an unhealthy form of training of security personnel and paucity of fund to acquire modern weapons (machines) to fight insurgency. Data released by the Business Day finding shows that Nigeria police incurs an average of 94% of its total allocation on payment of salaries to its personnel. The Navy and Army, on the other hand, incur a proportion of 76% of their total annual allocation (budget) on personnel cost. With this kind of situation, the security agencies find it extremely stressful to cope with the demands of modern equipments to combat insurgencies and to arrange for contemporary training of staff overseas on how to put paid to insecurity in the country; most especially when such insurgencies are engineered by foreign interest with huge remunerations or being financed by crude oil theft.

Misappropriation of funds is a cause of security challenges in Nigeria. Where the budget allotted for the purchase of ammunitions and weapons are not utilized as appropriate, there is bound to be underperformance on the part of military forces in their ability to combat insurgency squarely. Almost 65 per cent of funds budgeted for security cum defence is not managed properly and part of the funds is being transferred to personal accounts (Hazen and Horner, 2012).

Unethical habit of security agencies also causes insecurity problem in the country. From the last point above, unethical practices of security officers is responsible for the security challenges we witness in the country today. Insurgency thrives in the country because those saddled with responsibility of protecting lives and properties engage in unethical practices.

Customs and immigration also allow insurgency to thrive in that most of the ammunitions and weapons found in the country today passed through boarder unchecked by custom officers. Meanwhile, immigration officers had allowed inflow of unauthorized citizens to the country which are the brains behind security challenges experience in Nigeria presently.

Politics side of security problems cannot be undermined. Politics cannot be divorced from the troubles and unpalatable experiences Nigerians face day- in day-out especially in the North –East of Nigeria. Politicians play game with the lives of their citizens which all result in displacement of thousands of Nigerians within their fathers' land.

Corruption is not alien among Nigerians right from the topgovernment officials to the average Nigerianwhich has led to serious backwardness in the last few decades. It retards growth and development and hinders sound planning and impoverished the citizens. Aggrieved by the prevalent of corruption, jobless youths decided to take up free offer to join Boko Haram sect and militant to take part in insurgency within the country.

1.3. FDI and National Security

Terrorism and insecurity are twin inseparable phenomena. Where thereare lapses in the security structure, it will be conducive for social vices and domestic terrorism to thrive. Although the two terms are used interchangeably, yet differs in term of analytical method. In this paper, efforts are put in place to examine the effect of expenditure on security as it affects the Foreign Direct Investment. Regardless of the huge amount of budget expended on security, cases of domestic terrorism and insecurity are still very pronounced in the country (Nwagbosa, 2012). Domestic terrorism has its bedrock in the home soil, that is, its perpetrators, victims, supports, financiers or funders and targets emanate from the home country. For example, the cases of kidnapping of innocent citizens for political reasons or economic gain, suicide bombing of the holy worship places or government properties are domestic terrorist incidences. There are very few literatures on the relationship between FDI and security expenditure. While this paper tries to delve and explore the impact of security expenditure and Foreign Direct investment: empirical evidence from Nigeria, using defense and security vote of government expenditure (annual budget) as a proxy for National Security, it further seeks to enrich knowledge by reducing the gaps in literature. Yearly, developing countries expend huge

Insecurity and terrorism are two inseparable phenomena. Domestic terror and other social vices are perpetrated in the absence of strong security structure (Igbuzor, 2011). Thus, the two terms can be used interchangeably although they differ in terms of analytical approach. In this section, the emphasis is on insecurity and domestic terrorism. Domestic terrorism is where the perpetrators, victims, supporters, and targets are all from the home country and the incidents normally occur on home soil (Adagba et al, 2012). For instance, the kidnapping of a citizen for political purposes or economic reasons, the suicide bombing of a church or government buildings are domestic terrorist incident. The literature on the relationship between FDI and National security are very scanty. While this paper tends to investigate the impact of National security using defense and security vote of government expenditure (annual) as a proxy for National security, it also helps to reduce the gaps in literature. Every year, developing countries spend large portion of their budget on defense and security (Adedeji and Eziyi, 2010). For instance, in 2010, over 448 billion naira was voted for security spending in Nigeria. In that same year, the Nigeria Economic Fact Sheet (2011), reported that U.S. which is the largest contributors of FDI in Nigeria dropped by 29% from $8.65 billion in 2009 to $6.1 billion in 2010. The decline in U.S FDI in 2010 was due to ongoing uncertainty related to the proposed Petroleum Industry Bill (PIB) as well as political unrest in the Niger Delta (Anyanwu, 2011).

The important question is "does the huge fund allocated to defense and security sector actually reflects the social well-being of the Nation?" A critical look at the 2012 budget of Nigeria reveals that security vote received over N900 billion, the highest ever since independence in 1960. Proponents of the budget may attribute this to the insurgence of the Islamic fundamentalist Group and the inability of the security agents to keep pace with the recent trend of events (Azazi, 2011). Opponents are of the views that the despicable state of security structure has remained the same year-in-year-out, with little or no improvement. Chunk of the budget are plaque by corruption and gratification. The answer to the above question however lies in the balance.

Along this line, Enders and Sandler (2008) argued that developing countries are particularly prone to the economic ramifications of terrorism. This will not only lead to loss in GDP but also significant losses in FDI and GDP growth (Abadie and Gardeazabal, 2003). Through disruptions, damage, and insecurity, terrorism is anticipated to reduce FDI (Enders et al., 2006).

Using a terrorism risk index for 2003-2004 in a cross-country analysis, Abadie and Gardeazabal (2008) conclude that a higher risk of terrorism depresses net FDI to a country. High risk and uncertainty are clearly associated with insecurity and political instability. Such incidents cannot only disrupt infrastructure thereby affecting GDP growth rate but also discourage the flow of FDI.

Bandyopadhyay, Sandler and Younas (2011) investigating the impact of terrorism on FDI/GDP in 78 developing countries for 1984-2008 and applying a system-GMM estimator to a dynamic panel, consisting of eight three-year averages of all variables. They conclude that domestic terrorism has a negative and significant impact on FDI as a share of GDP. This implies that the much needed resources for development can be eroded and displaced given the incessant state of insecurity and terrorism.

2. Methodology

The study aims at providing empirical evidence on the effect of capital market reforms on the economic growth of Nigeria. The data were sourced from the Central Bank of Nigeria statistical bulletin. The study hypothesized that capital market reforms does not have a significant effect on the economic growth of Nigeria. The study employed annual time-series data from 1985 to 2012. The study employed Philip-Perron unit root test, Johansen Co-integration test, and Error Correction Mechanism (ECM).

2.1. Specification of the Empirical Model

The model is used in this research work is based on Demirgue-kunt and Levine (1996). They investigated the linkage between Security Expenditure and Foreign Direct Investment. Their model specified that Security Expenditure (proxy by Expenditure on Internal Security and Expenditure on Defence) is significantly influenced by Foreign Direct Investment.

But in this study, the model with be;

$$FDJ = F\ (EINS, EDEF, INFR) \quad (1)$$

$$FDI = \lambda_0 + \lambda_1\ EINS + \lambda_2\ EDEF + \lambda_3\ INFR + \mu \quad (2)$$

By log linearization the equation becomes:

$$LogFDI = \lambda_0 + \lambda_1\ logEINS + \lambda_2\ logEDEF + \lambda_3\ INFR \quad (3)$$

Where:
FDI = Foreign Direct Investment
EINS = Expenditure on Internal Security
EDEF = Expenditure on Defence
INFR = Inflation Rate

2.2. A Prior Expectation

As earlier stated the variables include Foreign Direct Investment (FDI), which is taken as the dependent variable, EINS, EDEF, and INFR which are the independent variables. It is expected that all explanatory variables will have a direct relationship with the dependent variable. That is a unit increase in any of these variable will lead to an increase in the dependable variable. This can be expressed mathematical as:

$$\lambda_1, \lambda_2 \text{ and } \lambda_3 > 0$$

3. Data Analysis and Interpretation of Results

This section provides in detail the analysis of data used in the study and interpretation of the empirical results. The unit root test was performed to confirm the stationarity of data; the co-integration test was used to establish the existence of a long-run equilibrium relationship among the variables while the error correction mechanism shows the speed of adjustment of the dependent variable to changes in the independent variables.

3.1. Unit Root Test

Non-stationary data produces spurious regression; hence the result may be misleading. Therefore, it is cognizant to establish the stationarity of data. This is carried out using the Philip -Perron (PP) unit root test. The decision rule is that the PP test statistic value must be greater than the Mackinnon critical value at 5% and at absolute value.

The table below shows the summary of unit root test conducted on the parameter at level.

Table 1. *Unit root test at level.*

Variables	PP Test Statistic Value	Mackinnon critical Value at 5%	Prob.	Remark
FDI	0.39132	-2.97626	0.9788	Non-stationary
EINS	17.17079	-2.97626	1.0000	Non-stationary
EDEF	3.12136	-2.97626	1.0000	Non-stationary
INFR	-2.50123	-2.97626	0.1263	Non-stationary

From the table above, it can be deduced that all the variables are non-stationary because they have their Philip-Perron (PP) statistics less than Mackinnon critical value at 5%. This led to the testing for stationarity at first difference and second difference for EDEF only.

Table 2. *Unit root test at first/second difference.*

Variables	PP Test Statistic Value	Mackinnon critical Value at 5%	Prob.	Remark
FDI	-8.55054	-2.98104	0.0000	I(1)
EINS	-9.69916	-2.98104	0.0000	I(2)
EDEF	-4.43727	-2.98104	0.0018	I(1)
INFR	-5.18805	-2.98104	0.0003	I(1)

All the variables are stationary at first difference except EDEF because they have their respective PP statistics greater than Mackinnon critical value at 5%. The fact that one is stationary at second difference shows that the variables are not co-integrated in the same order.

3.2. Co-integration

The essence of co-integration test is to ascertain if a long-run equilibrium relationship exist among variables of the model.

Decision rule

The traced statistics (likelihood ratio) must be greater than 5% critical ratio at None Hypothesized

(None**)

The table below shows the summary of result from analysis conducted on the specified model.

Table 3. *Presentation of Johansen Co-integration result.*

Date: 07/05/14Time: 03:24				
Sample (adjusted): 1987 2012				
Included observations: 26 after adjustments				
Trend assumption: Linear deterministic trend				
Series: LOGFDI LOGEINS LOGEDEF INFR				
Lags interval (in first differences): 1 to 1				
Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.646839	59.21072	47.85613	0.0030
At most 1 *	0.453783	32.14912	29.79707	0.0263
At most 2 *	0.351838	16.42592	15.49471	0.0361
At most 3 *	0.179754	5.151932	3.841466	0.0232
Trace test indicates 4 co-integrating equation(s) at the 0.05 level				
* denotes rejection of the hypothesis at the 0.05 level				
**MacKinnon-Haug-Michelis (1999) p-values				

From the table above, it could be deduced that the log likelihood ratio of 59.21 is greater than 5% critical value of 47.86. This shows the existence of a long-run equilibrium relationship among the variables. Also, in the result of the Johansen co-integration test, the lowest log likelihood ratio is -116.44and its respective co-integration equation is specified below:

$$FPI = -1.388977_{EINS} + 0.527879_{EDEF} - 0.012089_{INFR}$$

$$(0.19933)(0.23555)(0.00414)$$

Note: The standard error statistics attached to each variable are in parenthesis.

It can be deduced from the result that FDI has decreased overtime by 1.389 units due to poor expenditure on Internal Security in Nigeria. However, the result indicates that coefficient of EDEF is positive (0.528). This implies that there exists a positive relationship between FDI and EDEF in the Long-run. A unit increase in EDEF leads to an increase in FDI by 0.528 unit. The coefficient of INFR is -0.012. This implies that this variable share a negative relationship with FDI in the long-run. Any attempt to increase this variable in the long-run will enhance a decrease in FDI.

3.3. Error Correction Mechanism

The error correction mechanism involves developing two models; the over-parameterized model (ECM1) and the parsimonious model (ECM2). ECM1 involves leading and lagging of the variables while ECM2 introduces short-run dynamism into the long-run equilibrium.

Table 4. *Result of overparamatisedecm.*

Dependent Variable: DLOG(FDI)				
Method: Least Squares				
Date: 07/05/14Time: 03:34				
Sample (adjusted): 1988 2012				
Included observations: 25 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.037938	0.288451	-0.131524	0.8975
DLOG(EINS)	0.221069	0.399138	0.553867	0.5898
DLOG(EINS(-1))	0.129534	0.413750	0.313072	0.7596
DLOG(EINS(-2))	0.314743	0.347764	0.905046	0.3833
DLOG(EDEF)	0.118698	0.275991	0.430081	0.6748
DLOG(EDEF(-1))	0.175250	0.268665	0.652300	0.5265
DLOG(EDEF(-2))	-0.065131	0.253330	-0.257098	0.8015
D(INFR)	-0.000878	0.005250	-0.167247	0.8700
D(INFR(-1))	0.010006	0.008588	1.165056	0.2666
D(INFR(-2))	-0.012653	0.008222	-1.539044	0.1497
DLOG(FDI(-1))	0.061122	0.352754	0.173270	0.8653
DLOG(FDI(-2))	0.352209	0.216870	1.624056	0.1303
ECM(-1)	-0.877233	0.423973	-2.069077	0.0608
R-squared	0.797651	Mean dependent var		0.244722
Adjusted R-squared	0.595302	S.D. dependent var		0.613898
S.E. of regression	0.390537	Akaike info criterion		1.263440
Sum squared resid	1.830225	Schwarz criterion		1.897256
Log likelihood	-2.793003	Hannan-Quinn criter.		1.439234
F-statistic	3.941951	Durbin-Watson stat		2.309914
Prob(F-statistic)	0.012352			

Table 5. *Result of parsimonousecm.*

Dependent Variable: DLOG(FDI)				
Method: Least Squares				
Date: 07/05/14Time: 14:11				
Sample (adjusted): 1988 2012				
Included observations: 25 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.225556	0.077549	2.908543	0.0087
D(INFR(-1))	0.009543	0.004485	2.127883	0.0460
D(INFR(-2))	-0.010830	0.003776	-2.867837	0.0095
DLOG(FDI(-2))	0.280872	0.117883	2.382634	0.0272
ECM(-1)	-0.806421	0.161720	-4.986516	0.0001
R-squared	0.765906	Mean dependent var		0.244722
Adjusted R-squared	0.719087	S.D. dependent var		0.613898
S. E. of regression	0.325373	Akaike info criterion		0.769168
Sum squared resid	2.117352	Schwarz criterion		1.012943
Log likelihood	-4.614595	Hannan-Quinn criter.		0.836780
F-statistic	16.35895	Durbin-Watson stat		2.057207
Prob(F-statistic)	0.000004			

3.4. Interpretation of the ECM

The ECM otherwise known as speed of adjustment is significant with the appropriate sign i.e. negative sign. This can be seen on the over-parameterized ECM that shows ECM value of -0.8772. This implies that the present value of FDI adjust rapidly to changes in EINS, EDEF and INFR.. The lagged value of ECM given as 87.72% indicates a feedback of or an adjustment of 87.72% from the previous period disequilibrium of the present level of FDI in the determination of causality between the past level of FDI and the present and past level of the explanatory variables.

3.5. Implication of Findings

The implication of some of the explanatory variables is to tell their real effect on inflow of Foreign Direct Investments in Nigeria. For instance, EINS bears the highest negative influence on FDI inflow implying that the current level of insurgence emanating from the sect known as 'Boko Haram' is basically an impediment to the inflow of FDI within the timeframe examined. On the other hand, only increase in expenditure on defence aids Foreign Direct Investment. A unit increase in EDEF enhanced 0.53 unit increase in FDI. The explanation for this is that external aggression is not the issue in Nigeria that currently scares off foreign investors, thus the fund allocated for defence is commensurate to the peace enjoyed relative to external invasion. This result is line with the view of Levine and Zervos (1996) about long-run implication of National security on Foreign Direct Investment.

Lastly, inflation is negatively related to FDI. A unit increase in INFR enhanced 0.004 unit decrease in FDI. The implication of this is that the decreasing rate of inflation does not theoretically support investment. For instance, between 2008 and 2012, a consistent decrease in inflation was witnessed. Investors are generally motivated by consistent rise in price but then INFR bore the weakest effect on the dependent variable.

4. Summary, Conclusion and Recommendations

This study reveals that there is a linkage between Foreign Direct Investment and Government Expenditure on security vis-à-vis Expenditure on Internal security, Expenditure on defence and inflation. As it can be observed that two of these variables EINS and INFR are inimical to the inflow of Foreign Direct Investment in Nigeria. In order for Nigeria to substantially attract foreign investments with a pivotal force towards a better socio-economic growth and development, the following suggestions are put forward.

First, improvement in government's allocation towards internal security should be an earnest priority of the Federal Government. This will help to curb the rising trend of socio-economic insurgence in the economy and a consequential increase in the inflow of Foreign Direct Investment will be imminent.

It is also recommended that an investment friendly environment capable of attracting Foreign Direct Investment should be of priority to the federal government. Likewise, serious and tight border strategic management is direly needed now, as Nigeria borders have been porous and weak to the extent that ammunitions and other weapons freely fly across our borders unchecked. If these are allowed, a higher inflow of direct investment into Nigeria is obvious.

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