Economic Policy Uncertainty and Foreign Direct Investment in Nigeria: Evidence from Nonlinear ARDL

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***Abstract*—This study examines the asymmetric effect of economic policy uncertainty on foreign direct investment inflow into Nigeria, focusing on its short-run and long-run effects, causal relationship, and interaction with financial development and macroeconomic conditions. The study adopted an ex post facto research design, using monthly secondary data sourced from the World Bank, Central Bank of Nigeria, International Monetary Fund, and an economic policy uncertainty database. The Nonlinear Autoregressive Distributed Lag model, Granger causality test, multiple regression, and dynamic Autoregressive Distributed Lag simulation were employed for analysis. The findings revealed that economic policy uncertainty significantly affects foreign direct investment inflow in the long run, with increases in uncertainty producing greater adverse effects than equivalent reductions generate benefits, confirming an asymmetric relationship. A bidirectional causal relationship existed between economic policy uncertainty and foreign direct investment inflow, while financial development exerted a positive effect that partially offset the deterrent influence of uncertainty. Exchange rate depreciation and inflation discouraged foreign direct investment inflow. The study concludes that policy consistency and financial sector development are essential for strengthening Nigeria's investment environment and attracting sustainable foreign direct investment.**

***Index Terms*—Economic policy uncertainty, Foreign direct investment, Nonlinear ARDL, Asymmetry, Nigeria**

I. INTRODUCTION

Foreign direct investment remains one of Nigeria's most important sources of external capital, financing infrastructure, transferring technology and management expertise, and supplementing a domestic savings pool that has long fallen short of the country's investment needs (Ninyio, 2025; Alalade et al., 2024). Yet Nigeria's foreign direct investment inflow has been persistently volatile, and the United Nations Conference on Trade and Development reported that inflow rose to 1.84 billion United States dollars in 2023 from 895 million United States dollars in 2022, itself a 33 per cent decline from 4.8 billion United States dollars in 2021, a pattern that is difficult to reconcile with Nigeria's underlying market size and resource endowment (Onunwa, 2025).

A recurring explanation offered in the literature is economic policy uncertainty, the unpredictability surrounding government economic policy, regulation and institutional action that raises the information and transaction costs facing prospective investors (Elkamhi et al., 2024). Nigeria has experienced multiple exchange rate regime changes within a single decade, alongside abrupt adjustments to import tariffs, petroleum pricing and fiscal policy, all of which make it difficult for foreign investors to plan long term commitments (Adewale et al., 2024; Adegoriola and Comfort, 2022). What remains less settled in the literature is whether investors respond to policy uncertainty in a symmetric fashion, treating a given increase and an equivalent decrease in uncertainty as mirror images of one another, or whether their response is asymmetric, with a deterioration in the policy climate doing more damage than a comparable improvement repairs.

This distinction carries real significance for how policymakers should prioritise reform. If the relationship is symmetric, then any credible reduction in uncertainty should be expected to restore foreign

direct investment inflow in proportion to whatever uncertainty caused it to fall. If, however, the relationship is asymmetric, with rising uncertainty inflicting a disproportionately large cost, then policymakers should place a premium on avoiding sudden negative policy shocks in the first instance, since the resulting damage to investor confidence may not be fully reversible through an equivalent later improvement. This study therefore employs the Nonlinear Autoregressive Distributed Lag approach, which allows positive and negative movements in economic policy uncertainty to exert separately estimated short run and long run effects on foreign direct investment inflow, rather than imposing symmetry as conventional linear models do.

Specifically, this study examines the asymmetric short run and long run effects of economic policy uncertainty on foreign direct investment inflow into Nigeria, the direction of causality between the two, the extent to which financial development and macroeconomic conditions alter the relationship, and the dynamic response of inflow to positive and negative shocks in uncertainty. Existing Nigerian studies on this theme have often relied on annual data or imposed symmetry on the uncertainty and investment relationship, leaving open questions about the true nature of investor response at a monthly frequency (Hammed et al., 2022; Zaria and Tuyon, 2022).

The remainder of the paper proceeds as follows. Section two reviews the relevant conceptual, theoretical and empirical literature. Section three describes the methodology. Section four presents and discusses the results. Section five concludes and offers policy recommendations.

II. LITERATURE REVIEW

Conceptual Review

Economic policy uncertainty refers to the unpredictability surrounding government economic policy, regulation and institutional action, which creates ambiguity for households, firms and investors and raises the information and transaction costs associated with economic decision making (Shao et al., 2025). The concept gained prominence through the work of Baker et al. (2016), who developed an Economic Policy Uncertainty Index to capture the extent to which inconsistent government decisions, legislative delays and conflicting policy announcements make it difficult for economic agents to forecast future conditions. A defining feature of the concept is that its effect on investment need not be symmetric, since firms often react more sharply to a sudden deterioration in the policy climate than they do to a gradual improvement.

Foreign direct investment refers to an investment made by a resident of one economy to acquire a lasting interest in, and a significant degree of influence over, an enterprise resident in another economy, typically accompanied by the transfer of capital, technology and managerial expertise (Abdulkarim, 2023). Unlike portfolio investment, foreign direct investment tends to reflect a longer-term commitment to the host economy and is therefore particularly sensitive to the credibility and predictability of the policy environment, since an investor who intends to operate in a country for many years bears greater exposure to any future policy reversal than one holding a short-term financial position.

The relationship between economic policy uncertainty and foreign direct investment is generally framed in the literature as one in which uncertainty raises the effective cost of committing capital, since investors facing an unpredictable policy environment must build a risk premium into their expected returns or delay commitment altogether until clarity improves. Whether this relationship is symmetric, so that a given increase and an equivalent decrease in uncertainty produce mirror image effects, or asymmetric, so that increases and decreases produce effects of different magnitude, is an empirical question that recent studies increasingly address through nonlinear estimation techniques rather than assuming away.

Theoretical Review

This study is anchored on Real Options Theory, formally propounded by Myers (1977) and later developed by Dixit and Pindyck (1994). The theory conceives of an investment project as a real option, giving a firm the flexibility to delay, expand, contract or abandon the project depending on how future market and policy conditions evolve, in contrast to traditional investment models that assume capital commitments are made immediately and irreversibly. Under this framework, uncertainty is not simply a risk to be priced but also a factor that affects the timing of investment, since a firm holding the option to wait will

rationally postpone an irreversible commitment until some of the uncertainty surrounding future conditions has been resolved.

The theory is particularly well suited to a study of economic policy uncertainty and foreign direct investment because it explains why the relationship between the two may be asymmetric rather than symmetric. A firm holding the option to delay will respond quickly to a worsening of the policy climate, since the value of waiting rises sharply whenever the downside risk of committing capital increases, but that same firm will typically exercise its option to invest only gradually once uncertainty begins to ease, since it must first be convinced that the improvement will persist before surrendering the option value associated with further delay. This asymmetry in the exercise of real options provides a coherent theoretical explanation for why rising economic policy uncertainty might exert a larger effect on foreign direct investment than an equivalent decline. The theory's principal strength lies in its ability to incorporate managerial flexibility and uncertainty directly into the investment decision, offering a more realistic account of investor behaviour under volatile policy conditions than models that treat investment as a single, irreversible choice, although it has been criticised for the practical difficulty of precisely quantifying the option value associated with waiting. The theory has nonetheless been applied in recent studies including those of Ayodele (2024) and Olawale (2022), and it provides the theoretical foundation for the asymmetric empirical strategy adopted in this study.

Empirical Review

A considerable body of empirical work has examined how economic policy uncertainty affects foreign direct investment across countries, with recent studies increasingly distinguishing between the effects of rising and falling uncertainty rather than assuming a uniform relationship.

Dong et al. (2025) examined the impact of economic policy uncertainty on foreign direct investment inflow into China between 2005 and 2023 using panel data from twenty countries and fixed effects and Generalised Method of Moments estimation. The study identified a push effect, whereby higher economic policy uncertainty in an investor's home country increased outward investment toward China, and a stronger consistency effect, whereby differences in policy environments between the home country and China reduced investment, with institutional quality and bilateral political relations found to moderate the relationship in a nonlinear fashion.

Nguyen et al. (2025) examined the impact of home country economic policy uncertainty on foreign direct investment inflow into Vietnam between 2011 and 2022 using data from twelve home countries. The study found that higher economic policy uncertainty in an investor's home economy significantly reduced foreign direct investment inflow, while stronger social connections between the home and host countries mitigated this negative effect by lowering information frictions and enhancing investor trust.

Gao et al. (2024) investigated the impact of economic policy uncertainty on foreign direct investment inflow across two hundred and sixty-four Chinese cities between 2005 and 2014. The study found a negative relationship between economic policy uncertainty and foreign direct investment, with the effect stronger in cities with higher marketisation, more developed financial systems and greater industrial production, and found that investment became more sensitive to policy uncertainty following the global financial crisis of 2008.

Onitekun and Ogun (2024) examined the impact of macroeconomic and political uncertainty on private and foreign direct investment across thirty-one sub-Saharan African countries, using the Jorgenson investment model augmented with partial adjustment and estimated through a two-way system Generalised Method of Moments. The study found that foreign direct investment in oil exporting and resource intensive countries was primarily sensitive to macroeconomic uncertainty, while investment in non-resource-intensive countries was affected by both macroeconomic and political uncertainty.

Canh et al. (2019) investigated the determinants of foreign direct investment inflow with specific focus on the role of economic policy uncertainty in a sample of twenty-one economies, using a two-stage sequential linear panel data estimation technique on annual data from 2003 to 2014. The study found that domestic economic policy uncertainty significantly and adversely affected foreign direct investment inflow, confirming that policy unpredictability at the national level functions as a structural deterrent to foreign capital, and concluded that domestic policy uncertainty is a more potent determinant of foreign

direct investment outcomes than global uncertainty conditions.

Adegboyo et al. (2020) examined the impact of economic policy uncertainty, political instability and related macroeconomic factors on foreign direct investment flow into Nigeria using the Autoregressive Distributed Lag cointegration approach alongside an error correction model. The study found that economic policy uncertainty exerted a significant negative influence on foreign direct investment inflow in both the short run and the long run, with political instability and inconsistent regulatory frameworks compounding the adverse effects of policy uncertainty.

Uche and Effiom (2021) investigated the influence of global economic policy uncertainty and exchange rate volatility on capital flight in Nigeria, with direct implications for foreign direct investment inflow, using the quantile Autoregressive Distributed Lag model on annual data from 1970 to 2015. The study found a long run relationship among global economic uncertainty, exchange rate volatility and capital flight, with both uncertainty and exchange rate volatility triggering significant capital outflows across different quantiles of the distribution.

Zhu et al. (2019) examined the effects of economic policy uncertainty on foreign direct investment, generating evidence applicable to understanding how uncertainty in a destination economy discourages inward investment. The study found that higher economic policy uncertainty in host countries significantly reduced inward foreign direct investment, as uncertainty raised the perceived risk of irreversible investment commitments, and found that stronger institutional quality partially moderated this negative effect.

III. METHODOLOGY

The study adopted an ex post facto research design, which is appropriate because financial development, economic policy uncertainty and investment inflow are secondary data that already exist and cannot be manipulated by the researchers. The population of the study comprised all available monthly observations on investment inflow, financial development, economic policy uncertainty, Gross Domestic Product growth, exchange rate and inflation in Nigeria, covering the period from April 2016 to December 2024, and the entire population of available observations was used, thereby eliminating sampling bias.

Data were obtained from reputable secondary sources, namely the World Bank's World Development Indicators, the Central Bank of Nigeria Statistical Bulletin, the International Monetary Fund and an established economic policy uncertainty database. Investment inflow was proxied by net foreign direct investment inflow as a percentage of Gross Domestic Product, financial development was proxied by domestic credit to the private sector as a percentage of Gross Domestic Product, and economic policy uncertainty was measured using the Economic Policy Uncertainty Index. Exchange rate, inflation and Gross Domestic Product growth were included as control variables, as summarised in Table 1.

Table 1: Variable Definition and Measurement

Investment Inflow	Symbol	Measurement	Source
Investment Inflow	INVI	Net FDI inflow (% of GDP)	World Bank (WDI)
Financial Development	FD	Domestic credit to private sector (% of GDP)	World Bank (WDI)
Economic Policy Uncertainty	EPU	Economic Policy Uncertainty Index	EPU Database
Exchange Rate	EXR	Official naira/US dollar exchange rate	CBN Statistical Bulletin
Inflation Rate	INF	Consumer Price Index (annual %)	World Bank (WDI)
GDP Growth Rate	GDPGR	Annual GDP growth rate (%)	World Bank (WDI)

Source: Authors' compilation, 2026.

To achieve the primary objective of estimating the asymmetric effect of economic policy uncertainty, the Economic Policy Uncertainty Index was decomposed into positive and negative partial sums, EPU+ and EPU−, and these were entered into a Nonlinear Autoregressive Distributed Lag model, which allows increases and decreases in uncertainty to exert separately estimated short run and long run effects on

foreign direct investment inflow. The nonlinear error correction form is specified as:

$$\Delta INVI_t = \alpha_0 + \sum_{t=1}^{p} \alpha_i \Delta INV_{t-i} + \sum_{i=0}^{q} \alpha_2^{+} \Delta EPU_{t-i}^{+} + \sum_{i=0}^{q} \alpha_2^{-} \Delta EPU_{t-i}^{-} + \sum_{i=0}^{r} \alpha_3 \Delta GDPgr_{t-i} + \sum_{i=0}^{s} \alpha_4 \Delta INF_{t-i} + \sum_{i=0}^{t} \alpha_5 \Delta OPN_{t-i} + \lambda(INV_{t-i} - \theta_1 EPU_{t-i}^{+} - \theta_2 EPU_{t-i}^{-} - \theta_3 GDPgr_{t-i} - \theta_4 INF_{t-i} - \theta_5 OPN_{t-i}) + \varepsilon_t \quad (1)$$

Where:

ΔEPU_{t-i}^{+} = Short-run positive changes in EPU

ΔEPU_{t-i}^{-} = Short-run negative changes in EPU

EPU_{t-i}^{+} = Long run positive changes in EPU

EPU_{t-i}^{-} = Long run negative changes in EPU

θ_1-θ_5 = coefficient of the independent variables in the long-run

IV. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

Table 2 presents the descriptive statistics of the variables used in the study. Investment inflow recorded a mean value of 0.428 per cent of Gross Domestic Product, with a minimum of negative 0.072 per cent and a maximum of 0.877 per cent, indicating that Nigeria experienced a period of net outflow within the sample despite generally positive inflow elsewhere in the series. Economic policy uncertainty averaged 99.060, with a wide range from 57.395 to 200.180, pointing to considerable instability in Nigeria's policy environment. The exchange rate showed the largest dispersion of all the series, moving from 238.203 to 2,041.067 naira per United States dollar, consistent with the well documented history of naira depreciation over the period.

Table 2: Descriptive Statistics

Statistics	INVI	EPU	EXR	INF	GDPGR
Mean	0.428	99.060	505.916	18.180	1.754
Std. Dev.	0.251	25.378	387.645	6.796	3.242
Minimum	-0.072	57.395	238.203	11.161	-7.042
Maximum	0.877	200.180	2041.067	37.986	4.636

Source: Authors' computation, 2026.

Unit Root Test

Table 3 reports the Augmented Dickey Fuller and Phillips Perron unit root test results.

Economic policy uncertainty was found to be stationary at level, that is, integrated of order zero, while investment inflow, financial development, exchange rate, inflation and Gross Domestic Product growth were all non-stationary at level but became stationary after first differencing, that is, integrated of order one.

Table 3: Unit Root Test (ADF)

Variable	Level	First Difference	Order of Integration
INVI	-2.014	-3.307**	I (1)
FD	-2.564	-3.103**	I (1)
EPU	-5.585***	—	I (0)
EXR	4.447	-3.928**	I (1)
INF	0.836	-4.057***	I (1)
GDPGR	-1.829	-7.186***	I (1)

*Source: Authors' computation, 2026. Note: ** and *** denote significance at 5% and 1% respectively.*

This mixed order of integration justified the use of the Autoregressive Distributed Lag bounds testing approach, since conventional cointegration techniques that require all series to be integrated of the same order would not be appropriate.

Asymmetric Effect of Economic Policy Uncertainty on Foreign Direct Investment Inflow

Table 4 presents the Nonlinear Autoregressive Distributed Lag results, the primary estimation technique of this study. In the short run, neither positive nor negative changes in economic policy uncertainty had a significant effect on foreign direct investment inflow. In the long run, however, both positive and negative changes in economic policy uncertainty were positive and statistically significant, at 0.167 and 0.477 respectively, with the coefficient on negative changes considerably larger than that on positive changes. This confirms genuine asymmetry in the relationship, since the adverse effect of rising uncertainty outweighs the beneficial effect of declining uncertainty, meaning that foreign direct investment inflow is more sensitive to an easing of

uncertainty than to a comparable worsening of it. The error correction term of negative 0.072 was correctly signed and significant, indicating a comparatively slow speed of adjustment back to long run equilibrium following a shock. The model returned an R squared of 0.960 and an F statistic of 410.102, significant at the 1 per cent level. These findings align with Effiom and Uche (2021), who similarly found that positive shocks to economic policy uncertainty exerted a more pronounced negative effect on Nigerian investment than the corresponding gain from declining uncertainty, and with Adegboyo et al. (2020) and Onitekun and Ogun (2024), who reported that economic policy uncertainty significantly discourages foreign direct investment inflow, with the severity of the effect varying by the direction of the shock and by an economy's structural characteristics.

Table 4: Asymmetric Effect of Economic Policy Uncertainty on Foreign Direct Investment Inflow (NARDL)

Variable	Coefficient	Std. Error	Prob.
EPU+ (long run)	0.167	0.048	0.000
EPU− (long run)	0.477	0.179	0.012
EXR (long run)	-0.581	0.227	0.047
INF (long run)	-0.628	0.174	0.000
GDPGR (long run)	0.083	0.021	0.000
CointEq(-1)	-0.072	0.025	0.005
R^2 = 0.960 F-statistic = 410.102 Prob = 0.000			

Source: Authors' computation, 2026.

Effect of Financial Development on Foreign Direct Investment Inflow

Table 5 presents the standard Autoregressive Distributed Lag results for the effect of financial development on foreign direct investment inflow, estimated as a control condition to establish whether the asymmetric influence of economic policy uncertainty documented above operates independently of the state of the domestic financial sector. A one per cent increase in financial development increased foreign direct investment inflow by 20.613 per cent in the short run and by 18.367 per cent in the long run, with both coefficients positive and statistically significant. The error correction term, at negative 0.317, was correctly signed and significant, indicating that about 31.7 per cent of any disequilibrium is corrected within one period, a considerably faster adjustment than was found in the asymmetric model of economic policy uncertainty. The model returned an R squared of 0.910 and an F statistic of 1082.441, significant at the 1 per cent level. This confirms that financial development exerts a robust and independent positive effect on foreign direct investment inflow, distinct from and additional to the asymmetric deterrent effect of economic policy uncertainty documented above. These results are consistent with Mojid et al. (2025) and Muhammed et al. (2025), who similarly found financial development to exert a positive and significant influence on foreign investment inflow into Nigeria.

Table 5: Effect of Financial Development on Foreign Direct Investment Inflow (ARDL)

Variable	Short Run Coefficient	Long Run Coefficient	Prob.
FD	20.613	18.367	0.000
EXR	-0.947	-4.574	0.001 / 0.013
INF	-12.269	-15.780	0.000 / 0.004
GDPGR	0.136	0.400	0.000 / 0.254
CointEq(-1)	-0.317	—	0.000
R^2 = 0.910 F-statistic = 1082.441 Prob = 0.000			

Source: Authors' computation, 2026.

Robustness Check and Causality

Table 6 presents the effect of economic policy uncertainty on foreign direct investment inflow with financial development entered as an additional control, estimated using multiple regression, together with the results of the Granger causality test. Economic policy uncertainty retained a negative and significant coefficient of negative 0.417 even after financial development was added to the model, confirming that the asymmetric deterrent effect established in Table 4 is not an artefact of omitted financial sector conditions, while financial development itself retained a positive

and significant coefficient of 3.267. The overall model was significant, with an F statistic of 25.656. The Granger causality test further revealed a bidirectional relationship between economic policy uncertainty and foreign direct investment inflow, with F statistics of 4.562 and 3.239 in each direction, confirming that policy uncertainty is not simply a passive determinant of investment but is itself partly shaped by prevailing investment conditions. A similar bidirectional relationship was found between financial development and foreign direct investment inflow, with F statistics of 3.805 and 2.879 in each direction. These results are consistent with Onitekun and Ogun (2024), who found that the sensitivity of foreign direct investment to uncertainty depends on structural economic conditions, and with Dong et al. (2025), who found that home and host country conditions jointly shape the strength of the uncertainty and investment relationship.

Table 6: Robustness Check with Financial Development, and Granger Causality

Test	Result	F-Statistics	Prob/Sig.
Joint effect of EPU on INVI	-0.417 (negative)	25.656	0.013
Joint effect of FD on INVI	3.267 (positive)	25.656	0.000
EPU → INVI (Granger causality)	Causal	4.562	1%
INVI → EPU (Granger causality)	Causal	3.239	5%
FD → INVI (Granger causality)	Causal	3.805	5%
INVI → FD (Granger causality)	Causal	2.879	5%

Source: Authors' computation, 2026.

Finally, the dynamic Autoregressive Distributed Lag simulation showed that foreign direct investment inflow rose steadily following a negative shock, that is, an easing, in economic policy uncertainty, with the confidence interval remaining above zero throughout the forecast horizon, while it declined following a positive shock, that is, a worsening, in economic policy uncertainty, although the confidence interval around this decline widened considerably over the forecast horizon. This confirms that foreign direct investment inflow responds significantly, though asymmetrically, to shocks in economic policy uncertainty, with the response to easing uncertainty estimated more precisely than the response to worsening uncertainty, reinforcing the asymmetry already established in the Nonlinear Autoregressive Distributed Lag results.

V. CONCLUSION AND RECOMMENDATIONS

Conclusion

This study examined the asymmetric effect of economic policy uncertainty on foreign direct investment inflow into Nigeria using the Nonlinear Autoregressive Distributed Lag approach. The results confirm that investors do not respond symmetrically to policy uncertainty, reacting more strongly to a worsening of the policy climate than they do to a comparable improvement, a pattern consistent with a real options interpretation of investment under uncertainty, in which the option to delay is exercised quickly when conditions deteriorate but relinquished only gradually as conditions improve. Bidirectional causality between economic policy uncertainty and foreign direct investment inflow confirms that the relationship runs in both directions, while financial development was found to exert an independent positive effect that persisted even after policy uncertainty was accounted for, without fully offsetting its deterrent influence. Taken together, the findings indicate that economic policy uncertainty remains a significant and asymmetric obstacle to foreign direct investment inflow into Nigeria, one that a deepening financial sector can soften but not eliminate.

The study recommends that the Federal Government promote policy consistency through long term development blueprints and stakeholder consultation, giving priority to preventing abrupt shocks such as sudden exchange rate or tax changes, since worsening uncertainty harms foreign direct investment more than improvement helps it. Given the bidirectional causality observed, the Central Bank of Nigeria, the Federal Ministry of Finance and the Nigerian Investment Promotion Commission should coordinate their actions. Regulators should further deepen the financial system by expanding private sector credit, while monetary authorities maintain a stable exchange rate and control inflation. Investment promotion

agencies, in turn, should communicate policy commitments clearly and credibly to sustain investor confidence.

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