



THE KEYS DRIVERS OF FDI ATTRACTIVENESS IN ECOWAS COUNTRIES: EVIDENCE OF GOVERNANCE INDICATORS ON FRANCE FDI

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Abstract

The purpose of this study is to investigate the determinants of France foreign direct investment (FDI) in Economic Community of West African States (ECOWAS) region main focus on governance indicators. The study used data of France annual amount invested in those countries selected countries from Organization for Economic Co-operation and Development (OECD) stat.export, and the governance indicators data from World governance index (WGI)

and World Bank for the control variables. The study used panel data on 15 countries members of ECOWAS over the period from 2008 to 2018. Ordinary least square (OLS) and Fluorescence Minus One Control Statistics (FMOLS) were used, and on both estimation method, the study revealed that governance indicators namely governance effectiveness and Voice and Accountability have a positive and significant influence on France FDI in ECOWAS, therefore Corruption control, and Regulatory quality have a negative and significant effect on France FDI inflow. Political stability has not any impact on France FDI. For the control variables, Natural resources has a negative and significant effect on France FDI in ECOWAS ,while Market size has a positive and significant effect on France FDI inflow in ECOWAS . The findings suggested that the increasing of governance performance and infrastructure through improvement of a good institutional framework may help to increase competitiveness and will attract more FDI flow in ECOWAS.

Keywords: France; ECOWAS; Governance indicators; FDI

INTRODUCTION

The contribution of foreign direct investment has been well recognized in the literatures in the last decade. Foreign direct investment (FDI) is acknowledged as a key source of financial inflowing and technology transferring specially for developing countries towards economic growth (Loannis A Tampakoudis, Demetres 2017). Meanwhile apart from macroeconomics factors knew as FDI drivers in developing countries, governance performance for improving investment climate is getting deep attention for police maker and researchers. Malraj B Kireella (2017), argued that

FDI challenged government to improve regulation for facilitating foreign investments. Countries capabilities to set favorable environment for investors have been found to impact foreign investors. Therefore, most of developing countries face uncertainty and challenges in the competitive business environment, and unfavorable raised the challenges to attract FDI inflows (World development report 2015). To solve this issues, developing countries governments constantly revised their institutional conditions through regulations and policies to stimulate the entry of FDI. To remain competitive in business arena, developing countries should create facilities for foreign firms to operate and invest in the country's leading to reducing risk and cost. There no any doubt that as developing countries, ECOWAS are facing to institutional challenges and recognize consequences that it may cause to their countries members. Though, some ECOWAS members have down some reforms to improve investment climate, include tax exemption, policies implementation, FDI inflows still not increasing. Foreign

direct investment (FDI) has been identified to play an important role in economic growth and sustainable development of every nation Mengistu and Adhikary (2011). They form the key source of finance inflowing and technology transferring in developing countries. Despite the increasing awareness that Foreign Direct Investment (FDI) are integral to economic development, strategies aimed at supporting them have tended more often than not, to fail. In developing countries in ECOWAS sub region; are currently facing government challenges political stability, high corruption rate, voice and accountability, government effectiveness, regulatory quality and rule of law however ,the chances of making investment in this countries are greatly reduced within the last two decades (UNCTAD 2017). Success stories in term of investment attractiveness exist but are rare in the sub region. This causes pause for concerns for effort on how governance indicators can influence France Foreign Direct Investment in ECOWAS sub region.

In the last two decades, the role of Governance indicators on FDI has received much attention in research Tran, N.H and Dat Le, C. (2019); (Acs et al., 2008; Stenholm et al.; 2013); Herrera Echeverri et al., (2014); Fuentelsaz et al. (2015). Despite the widely held view that Governance indicators can play an important role on the international relationship (Kurul and Yalta 2017) ,and enhance development sustainability for countries (Younsi, Moheddine and Bechtini, Marwa 2019) little are known on the effect that, governance indicators can play a role on FDI attractiveness in developing countries such as ECOWAS countries. This study therefore is positioned to fill the gap in the literature on lack of governance indicators study focusing on France FDI attractiveness.

THEORETICAL AND LITERATURE REVIEW

Theoretical review

This section presents review on the important theories that this study is built on. The theories include theory based on FDI and institutional analysis.

Theoretical framework on FDI

There are many researches on learning what factors lead Foreign Direct Investment (FDI) to entry in foreign market. Bilali Basesa Jumanne, Choong Chee Keong (2018). This chapter focuses on the specific theoretical aspects of governance and public infrastructure as the significant determinants influencing inward FDI into ECOWAS countries. It widely believe that more Outward Foreign Direct Investment is going to occur in countries with good governance indicators. The theories related to Foreign Direct Investment attempted to explain the main factors that attract FDI, to explain why the Multinational Enterprises (MNEs) prefer to

invest abroad and how they make entry in host countries, and also to show the impact of FDI for home and host countries. From a macroeconomic point of view, FDI is a particular form of capital flows from countries of origin to host countries, which are found in the balance of payments. The variables of interest is: capital flows and stocks, revenues obtained from investment. The microeconomic point of view, tries to explain the motivations for investment across national boundaries from the point of view of the investors. It also examines the consequences to investor, to the country of origin and to the host country, of the operations of the multinationals rather than investment flows and stock (Lipsey, 2009).

Theory based on institutional analysis

The concept explained the importance of institutional framework on FDI attraction. The theory mentioned that political stability is the key factor of healthy institutional framework. According to this theory, FDI is determined less by intransigent fundamentals than by institutional variables more amenable to change, namely policies, law, and their implementation. The institutional contributing to FDI are: government indicators, market, education, and culture. (Saskia Wilhelms, 1998) developed the concept of Institutional FDI fitness. The ability of Government to attract, maintains and absorbs FDI is led by the (Saskia theory) mentioned above and can be drawn as follows (Figure 1):

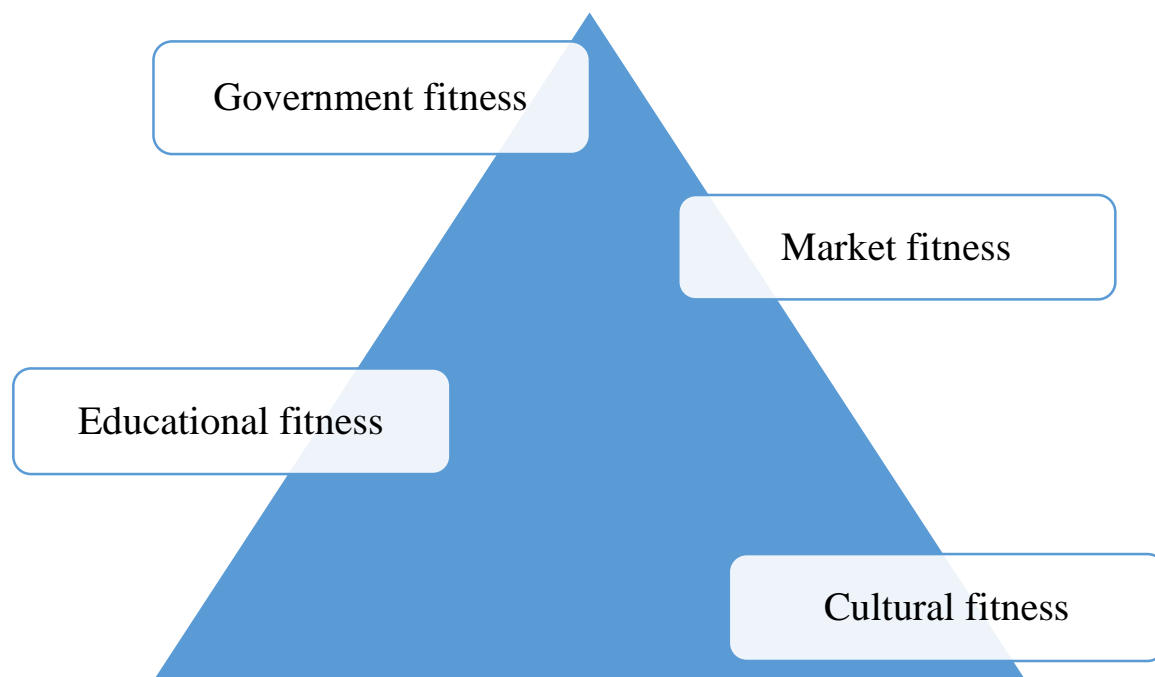


Figure 1: Pyramid of FDI Fitness Institutions

In the Institutional Pyramid, all the institutions Fitness are provided from the oldest one namely Socio Cultural Fitness. The Socio cultural Fitness is the level which the population of one country are able to accept others sociocultural and business relationship, it relevant to the global economy. Socio Cultural Fitness provides FDI, due to the fact that when the receptiveness degree of the Citizen's increase, they are more able to attract FDI.

Educational Fitness: The second FDI Fitness is Educational Fitness, main focused on the way of thinking and acting of the Citizen's and led by the human capital. Educational Fitness is set a conducive environment to attract FDI. Since, Educational Fitness help to improve the information's access, and also increase the research fields. However, the labor intensity and skill requirements are the main conditions under Educational Fitness on FDI attractiveness.

The next FDI Fitness Institution is the Market, based on economic and financial determinants of FDI Fitness. Market Fitness, it can be revealed that competitiveness market attracts more FDI than markets experienced with barriers to entry.

At the end, according to the Institution Fitness Pyramid the governmental Fitness is on the top place in the Pyramid. This denotes the great importance and involvement of government on FDI attractiveness issues.

Literature review

The study focuses on specific theoretical aspects of governance indicators as a significant factors attracting FDI. It is widely believed that more FDI is going to occur in countries with physical good governance performance

Relationship between Governance indicators and FDI location

Governance is a process of governability, that's how the power is executed in country and outside country. Governance depends actually to the relationship of the power relating to the collective decision. Generally good governance has a positive impact on development since it increases investment climate and provides investors security. The Governance performance ability to promote FDI is attributed to the fact that it is one the essential factors which create a favorable investment climate for foreigners to entrust their funds in the host country. The set of good governance such as transparency, and policies regulation are major factors that influence enormous OFDI inflows location to the host country. The low transparency on the public affairs, lack of transparencies, the corruption habits, impact negatively Foreign Direct Investment inflows to the host countries. (Jan-Yan Lin et al., 2016). Furthermore, in their studies, Using Scully (2017) made the evidence between political and civil right indicators, and the result

showed that the institutional framework has a significant impact on the Foreign Direct Investment leading to the host country. Seeing the institutions and the policies as the endogenous factors, Hall and Jones argued that the country ability to attract Foreign Direct Investment inflows is related to the quality of its institutions and governance policies. Country with a better governance receives more FDI inflows.

In the same sense, (Asiedu, 2006), using the dataset from several surveys of investors argue that large corruption rate, restriction on investment, macroeconomic instability impact negatively FDI inflows location in Africa.

Mumtaz Hussain Shah (2017), using the dataset of bilateral FDI stock from OECD countries find that the corruption and bad institutions have a negative effect on private investment, and therefore a negative impact on FDI location.

Fung et al. (2018) classify the institutional factors as follows: political stability, rule of law, governance performance, corruption control in the form of more transparent institution and deeper reforms, leads to more FDI. Their analysis controls for other determinants of Foreign Direct Investment (FDI) such as regional market size, human capital and tax policies. Their data is on FDI from the United States, Japan, Korea, Hong Kong and Taiwan to regions of China. They find that lower tax, political stability and good governance are important determinants to bring FDI into the host countries. The study describes that lower tax in the host countries invites higher inward FDI in emerging economies.

For the government, the institutional determinants such as the rule of law, and good governance have a major impact on Foreign Direct Investment attractiveness (FDI). According to Halbleib, Kristina Peseek (2017), the rule of law can impact significantly the investment decision into the host countries. Countries have experienced to constrain the foreign enterprises to be conformed to home environment receives less FDI inflows. Therefore, Multinational enterprises can escape those countries going towards other countries more attractive (Jing Li, Jun Xia 2018).

According, Eva Niesten, Albert Jolink (2017) in their study argued that political instability, corruption, modification of sovereign dept., non-transparent affect negatively the FDI inflows in the host countries and consequently reduces the FDI inflows in the host country.

Therefore Morisset (2000), in his study showed that the bad governance has negative impact on FDI inflows in the host country by increasing administrative procedure costs, therefore decrease the flows of FDI in the host countries. Therefore in the work of Zulaihatu Zubair, NorAzrin and Muhammad Azam (2017), they showed that political and institutional factors play an important role in term of FDI attractiveness and economic growth in global context. Vlado Vivoda (2017), also make an evidence relationship between political risk and FDI

inflow in mining industry, the results showed that those factors have a negative impact on FDI inflows in the host country.

Conceptual framework

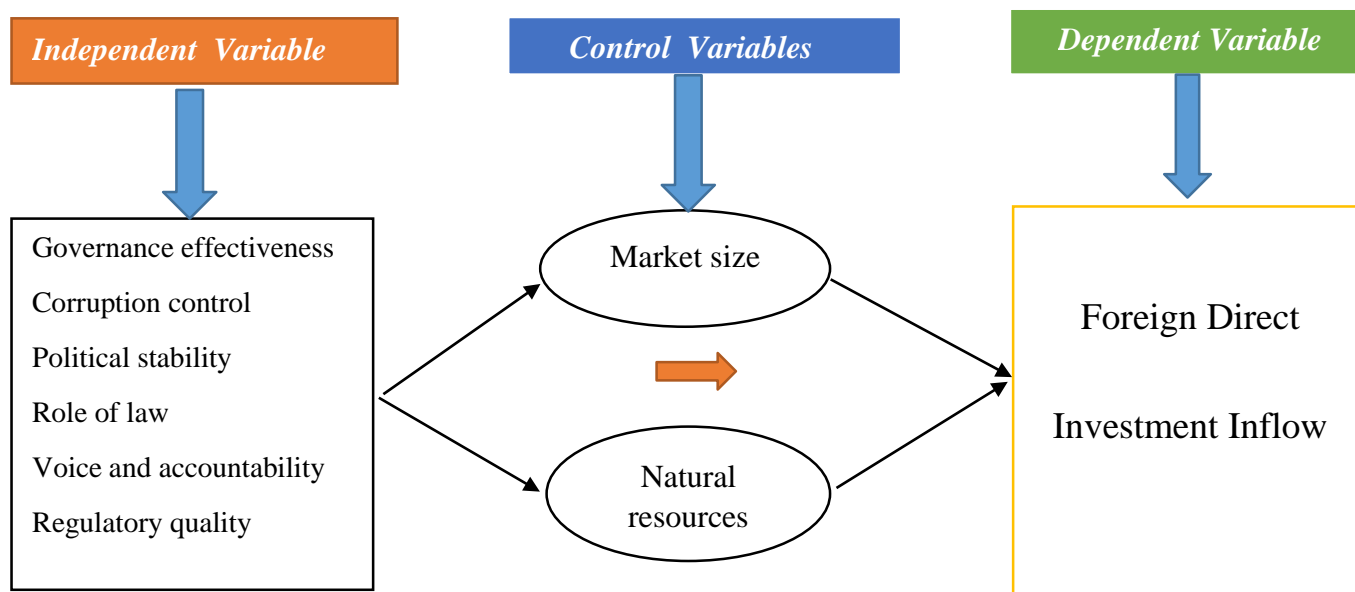


Figure 2: Conceptual framework

METHODOLOGY

The determinants of FDI inflows into countries are analyzed over time. The period of analysis for FDI determinants is significant to determine the country's capability to attract FDI. However, most studies (Jaiblai & Shenai, 2019; Sane, 2016) focused on long term period (at least 30 years). To the best of our knowledge there is no literature on short period (10 years) to find out how FDI is attracted into a country. As a result, the aim of this study was to investigate the determinants that attract FDI into a country over 10 years period. The data used was obtained from OECD statistics collected up to 2018 with no update till date.

The econometric method used for the study is the ordinary least square (OLS) as the main regression method and fully modified ordinary least square (FMOLS) as the robust check method. Conversely, fully modified ordinary least square (FMOLS) estimation technique provides the optimal estimates of the cointegration equation (Phillips and Hansen, 1990; An & Jeon, 2006) and modifies the OLS to control the problems of serial correlation and endogeneity in the regressors (Hansen, 1995; Phillips & Hansen, 1990). Upon review of relevant literatures,

the study derived the function below to ascertain the impact of international trade on human development;

$$FDI = f(GE, CC, RL, RQ, VA, PS, MZ, NR)$$

In the equation, foreign direct investment is a function of GDP thus market size (MZ), natural resources (NR), political stability (PS), rule of law (RL), regulatory quality (RQ), corruption control (CC) and government effectiveness (GE) aggregate effects are considered in the models.

However, the econometric models for the methods (OLS and FMOLS) can be written as;

$$FDI_{it} = \beta_0 + \beta_1 GE_{it} + \beta_2 CC_{it} + \beta_3 RL_{it} + \beta_4 RQ_{it} + \beta_5 VA_{it} + \beta_6 PS_{it} + \beta_7 MZ_{it} + \beta_8 NR_{it} + \varepsilon_{it} \quad (1)$$

In the equation (1), FDI represents foreign direct investment inflows into West African countries from France, Market size (MZ) represents real gross domestic product in value of US\$ annually, Government effectiveness (GE) represents the independence of state institutions from incumbency of ruling government to formulate and implement sound policies measured on scores of +2.5 to -2.5 where +2.5 means strong, -2.5 means weak, Corruption control (CC) represents the extent at which a country is perceived to be corrupt in the public and private sector measured on scores of +2.5 to -2.5 where +2.5 means strong, -2.5 means weak, rule of law (RL) represents the independence and consistency of democratic institutions like the police, the court or Judiciary, the legislature to formulate and implement, also enforce enacted laws to ensure safe property acquisition, favourable legal redress without interference measured on scores of +2.5 to -2.5 where +2.5 means strong, -2.5 means weak, regulatory quality (RQ) represents sound policies and regulations to police the private sector for sustainable growth measured on scores of +2.5 to -2.5 where +2.5 means strong, -2.5 means weak, Voice and accountability (VA) represents the freedom of speech, freedom of association and freedom to participate in decision making and also the ability of elect political leaders through voting measured on scores of +2.5 to -2.5 where +2.5 means strong, -2.5 means weak. Political stability (PS) represents the extent at which a country is exposed to civil unrest, terrorism, violence and criminal activities measured on scores of +2.5 to -2.5 where +2.5 means strong, -2.5 means weak. Natural resource represents the export of ore and oil in value of US\$ annually. Moreover, β_0 represents the intercept of the model, ε represents the error term or stochastic disturbances that could occur in the model or equation and t represents the time period from 1990 to 2018 as the sample years for the study and i represent the cross section of the countries or panel.

In order to achieve the study's objective of assessing the contribution of international trade to human development in Ghana; the study has collected data from Worldwide

Governance Indicators from World Bank Data Repository and OECD database from 2008 to 2018 hence time series study. However, the data needs to be transformed and properly checked whether it is statistically fit for the study. In this regard, unit root tests are performed to check for stationarity of the data series. At 5% significance level or below, the null hypothesis (H_0) of unit root test is expected to be rejected and H_1 thus the alternate hypothesis is supposed to be accepted to declare the data as unit root free. Subsequently, the check for multicollinearity becomes of essence hence correlation matrix is computed to unravel that. The rule of thumb of multicollinearity stipulates that no two or more independent variables should be highly correlated with the dependent variable with coefficient of $-/+0.80$. Perhaps, the problem of multicollinearity would cause heteroskedasticity in the regression analysis. Furthermore, after the check of collinearity or multicollinearity have been significant then the next approach is to check for cointegration relationship between the dependent and the independent variables. The check for cointegration reveals the long run relationship or equilibrium of the variables. Apparently, evidence of cointegration is eminent when the results show p-value of 5% or less significance level.

The final approach is to perform the regression analysis and the main regression method is the ordinary least square and it is robust checked with fully modified ordinary least square to better check for the problem of serial autocorrelation, heteroskedasticity and endogeneity problems that may arise in the course of the regression analysis. Lastly, granger causality test is performed to ascertain the causal relationship between the dependent and the independent variables perhaps two causal relationships are expected thus unidirectional and bidirectional causality.

FINDINGS

Descriptive statistics

Table 1 exhibits the descriptive statistics of the study's variables. From the table, the mean, median, standard deviation, minimum and maximum values, Kurtosis, Skewness and JarqueBera statistics of the variables are reported. Taking into account the mean of the variables, foreign direct investment inflows from France to West African countries for the sample period had an average growth rate of 1.172% annually, real gross domestic product for the sample years had an average growth rate of 22.8% annually, governance indicators thus political stability, corruption control, regulatory quality, rule of law, voice and accountability, and government effectiveness had an annual average score between -0.290 to -0.804 within the sample period (see table 1 for further details).

Moreover, the minimum and maximum values of government effectiveness, political stability, rule of law, voice and accountability, regulatory quality and corruption control substantiate the differential patterns of these variables perhaps this huge disparity supports the heterogeneous nature of the variables during the sample period. To test for normality of the distribution, the Jarque-Bera statistics confirm that six of the variables are in normal distribution as they exhibited pvalue more than 5% and the other three variables reject the hypothesis of normality. In effect, the study could confirm that the data is in normal distribution hence the use of parametric method of analysis would be appropriate. Therefore, the study employs ordinary least square (OLS) and fully modified ordinary least square (FMOLS) methods for its regression analysis.

Table 1: Descriptive statistics of the variables

	FDI	GE	MZ	NR	PS	RQ	RL	VA	CC
Mean	1.172	-0.804	22.809	10.935	-0.558	-0.588	-0.654	-0.290	-0.602
Median	0.000	-0.834	22.761	1.169	-0.394	-0.586	-0.668	-0.283	-0.663
Maximum	7.032	0.319	26.875	86.420	0.886	0.128	0.635	0.998	0.950
Minimum	0.000	-1.767	20.481	0.000	-2.211	-1.341	-1.586	-1.460	-1.563
Std. Dev.	2.037	0.446	1.500	20.553	0.757	0.367	0.501	0.588	0.525
Skewness	1.375	0.439	0.935	2.167	-0.423	0.029	0.555	0.301	1.220
Kurtosis	3.349	2.546	3.844	6.467	2.566	2.049	3.121	2.554	4.847
Jarque-Bera	52.857	6.720	28.925	211.763	6.225	6.243	8.563	3.858	64.355
Probability	0.200	0.135	0.000	0.000	0.144	0.144	0.114	0.145	0.000
Observations	165	165	165	165	165	165	165	165	165

Unit root test

Testing for unit root requires that the null hypothesis of unit root should be rejected when the tests show p-value of 5% or less but when the p-value is greater than 5% then the alternate hypothesis is accepted. However, H (I) thus alternate hypothesis posits that there is no evidence of unit root in the data series and H (O) thus null hypothesis posits that there is an evidence of unit root in the data series; therefore the data series is not stationary. In that regard, the study performed unit root tests by employing the tests of Levin, Lin & Chu, Im, Pesaran, & Shim and ADF and PP-Fisher chi-square to unravel the stationary status of the variables. Table 2 below depicts the results of the unit root tests and from the table, it is

documented that at level form Levin, Lin & Chu test confirmed unit root in the data series but the other three confirmed stationary of the variables. Furthermore, the tests were performed at first difference and evidently all the tests confirmed that there is no evidence of unit root hence all the variables are stationary. Therefore, the null hypothesis of unit root is rejected at 1% significance level.

Table 2: Unit root tests

Group unit root test: Summary				
Method	Statistic	rob.**	Cross-sections	Obs
Levin, Lin & Chu t*	1.883	0.970	9	90
Im, Pesaran and Shin W-stat	-2.769**	0.003	9	90
ADF - Fisher Chi-square	61.539***	0.000	9	90
PP - Fisher Chi-square	106.601***	0.000	9	90
Levin, Lin & Chu t*	-6.936***	0.000	9	75
Im, Pesaran and Shin W-stat	-11.764***	0.000	9	75
ADF - Fisher Chi-square	178.063***	0.000	9	75
PP - Fisher Chi-square	214.608***	0.000	9	81

Note: *** indicates 1% significance level, ** indicates 5% significance level

Table 3 depicts the results of the correlation matrix computed. The purpose of this analysis enables the study to check whether there is an evidence of collinearity or problem of multicollinearity among the variables. All indications confirm that the study did not encounter the problem of multicollinearity because none of the variables had coefficient of -/+0.80 with the dependent variable. Moreover, it can be reported that during the sample period, export of goods and service, import of goods and services, government effectiveness, market size, regulatory quality rule of law, voice and accountability and corruption control positively correlated foreign direct investment inflow significantly except rule of law, voice and accountability and corruption control. On the other, political stability and natural resources negatively correlated foreign direct investment but natural resources show insignificant correlation during the sample period

Table 3: Correlation matrix

Corr Prob	FDI	GE	MZ	NR	PS	RQ	RL	VA	CC
FDI	1								
GE	0.151**	1							
MZ	0.443***	0.117	1						
NR	-0.078	-0.139*	-0.040	1					
PS	-0.195**	0.529***	-0.508***	-0.222**	1				
RQ	0.212**	0.884***	0.220**	-0.222**	0.496***	1			
RL	0.064	0.892***	0.004	-0.262**	0.645***	0.873***	1		
VA	0.073	0.730***	0.077	-0.304***	0.554***	0.645***	0.809***	1	
CC	0.034	0.866***	-0.077	-0.206**	0.611***	0.771***	0.931***	0.806***	1

Note: *** indicates 1% significance level, ** indicates 5% significance level,

* indicates 10% significance level.

FDI = foreign direct investment, GE= Government effectiveness, MZ= Market size, NR= Natural resources, PS = Political stability, RQ= Regulatory quality, RL= Rule of law, VA= Voice and Accountability, CC= Corruption control

Kao Cointegration Test

To ascertain the long run relationship between the study's dependent and independent variables, the test for cointegration that stipulates that there is a cointegration relationship among the selected variables hence the coefficients that would be generated by the regression analysis affirms the long run impact of the variables. Apparently, the rule of thumb for cointegration test stipulates that at 5% significance level, the null hypothesis of cointegration should be rejected to accept the alternate hypothesis hence the variables are cointegrated. Table 4 exhibits the outcome of the cointegration test. From the table, it is evident that all the variables are cointegrated hence there is a cointegration relationship between the dependent and the independent variables. Therefore, at 1% significance level evidence of cointegration relationships were ascertained hence the null hypothesis is rejected.

Table 4: Outcome of the cointegration test (Kao Cointegration Test)

	t-Statistic	Prob.
ADF	-3.89131***	0.0000

Note: *** indicates 1% significance level

Table 5: Regression statistics

	OLS	FMOLS
GE	2.452 (4.632)*	2.529 (4.829)***
CC	-1.652 (-6.632)*	-2.072 (-6.380)***
PS	-1.475 (-5.789)	-1.744 (-6.433)***
RL	0.526 (1.254)	0.627 (1.574)
RQ	-3.562 (-11.125)*	-3.882 (-11.217)***
VA	3.125 (9.902)**	3.199 (9.915)***
NR	-0.062 (-15.689)**	-0.075 (-16.659)***
MZ	1.253 (6.234)*	1.989 (6.364)***
Constant	-3.670 (-0.483)	
R-squared	0.335	0.563
Adjusted R ²	0.325	0.452

Note: *** indicates 1% significance level, ** indicates 5% significance level, * indicates 10% significance level. FDI = foreign direct investment, GE= Government effectiveness, MZ= Market size, NR= Natural resources, PS = Political stability, RQ= Regulatory quality, RL= Rule of law, VA= Voice and Accountability, CC= Corruption control

Inferences of the results

The estimation by the model for OLS and FMOLS produces the above result in **Table 5**. The results by the OLS estimation show that governance indicators namely governance effectiveness and Voice and Accountability have a positive and significant influence on France FDI in ECOWAS at 5% significance level; Corruption control, and Regulatory quality have a negative and significant effect on France FDI inflows at 10% significance level. The control variables, Natural resources has a negative and significant effect on France FDI in ECOWAS at 5% level, while Market size has a positive and significant effect on France FDI inflow in ECOWAS at 10% significance level .

By the FMOLS estimation model, the results show that governance indicators; governance effectiveness and Voice perform play a positive and significant effect on France FDI inflow in ECOWAS at 1% significance level. Corruption control and Regulatory quality have a negative and significant relationship with France FDI inflow in ECOWAS at 1% significance level. The control variables in the second estimation shows that, natural resources has a negative and significant effect on France FDI inflows in ECOWAS at 1% significant level while Market size has a positive and significant relationship on France FDI in ECOWAS at 1% significant level.

CONCLUSION

The study focused on the impact of governance indicators on FDI inflows evidence from France FDI in 15 ECOWAS countries over the period of 2008 to 2018. The variables were categorized into three groups: (1) the dependent variable; FDI inflow, (2) governance indicators; the explanatory variables and (3) control variables; market size and natural resources. All the variables of the three groups were significant. Voice and Accountability exhibited positive significant effect on France FDI. Likewise, Market size had significant positive effect on France FDI. Government Effectiveness, Market size, Political stability and Regulatory quality strongly correlated with France FDI. However, among these variables Political stability showed negative correlation. Based on the results obtained, further studies are recommended in this filed. Also, policy makers or governments of the ECOWAS states could use this results to improve upon the FDI drivers in their countries to enhance it's attractiveness into the respective countries.

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