Migration Letters

Volume: 21, No: S5 (2024), pp. 2019-2027

ISSN: 1741-8984 (Print) ISSN: 1741-8992 (Online)

www.migrationletters.com

Governance Quality Indicators And Foreign Direct Investment In Sub-Saharan African Countries

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Abstract

This paper investigates the interaction between foreign direct investment (FDI) and governance quality indicators in Sub-Saharan African (SSA) from 1996-2022. A sample of 47 sub-Saharan countries were studied. Data was extracted from the World Development Indicators (WDI). The study employed panel data estimation techniques and the results suggest that a mixed relationship exists between governance indicators and FDI inflow to SSA countries. The study nuanced findings offer policymakers and stakeholders insights into the areas of governance that require attention to enhance the attractiveness of SSA for foreign direct investment. By and large, the findings have practical implications for policymakers aiming to promote economic development in SSA through the instrument of greater FDI attraction.

Keywords: *Good governance, governance quality indicators, Sub-Saharan Africa countries, foreign direct investment*

INTRODUCTION

Prior to the 2020 recession experience of SSA countries, the two main policy objectives of countries in the region in the 21st century were the stability of the political environment and inclusive economic and financial development. Despite the remarkable reduction in extreme poverty, income inequality, and unemployment rate in SSA countries from to 1990-[1]2015, insecurity, political instability, corruption, infrastructural gap, high illiteracy rate, mismatch with the labour market, economic and gender inequalities, political instability, and global economic factors are still on the rise, while human capital development is on the geometric decrease. This is evidence of widespread political and social instability, insecurity, government ineffectiveness, the lack of rule of law, and high corruption that resulted to incidences of military interventions from to 2020-2023 as witnessed in countries like Gabon in 2023, Niger in 2023, Burkina Faso in 2022, Sudan in 2021, Guinea in 2021, and Mali in 2020 and 2021.

Of particularly concern the findings of Bergstrom (2020) accredited the increase in poverty and inequality to the coronavirus disease (COVID-19) most especially to the SSA and South Asia regions. The abysmal growth rate in sub-Saharan Africa over the decades has rekindled the need to enhance governance quality to check the incessant crisis and terrorist activities of different arms groups such as Boko Haram, Al-Qaeda, Al-Shabaab, and Islamic Movement for the Azawad, among others, to stimulate inclusive and stable economic, political, and social development to foster and sustain shared prosperity in SSA countries through FDI. It is important to examine the relation between governance indicators and FDI in SSA countries because the region's Agenda 2063 aims to promote inclusive growth, attract greater FDI, enhance sound political governance, particularly, strong institutional governance that promotes a conflict free environment, ensures accelerated socio-economic change and unity of purpose (Ivanyna & Salerno, 2021; Doumbia 2020; Asongu & Nwachukwu 2016; Khan 2012).

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Available evidence suggests that attracting FDI is a necessary condition toward achieving growth and development in regions such as SSA. It is also shown that poor governance quality in countries may hinder ability to attract FDI.

Despite the theoretical relation between governance quality indicators and FDI, there is a dearth of empirical studies in the SSA countries. Studies assessing this nexus focused primarily on developed economies with well-established governance systems, ignoring SSA countries with the challenges of weak governance, political instability, corruption, infrastructural gap, high illiteracy rate, mismatch with the labour market, and economic and gender inequalities. This study adopted a panel pool regression model utilizing quantitative data to assess the relation between governance quality indicators and FDI in SSA countries. The significance of the study rest in the fact that it provides useful insights about SSA countries governance quality and how this affects the regions' ability to attract FDI for accelerated sustainable development as specified in the region's Agenda 2063.

Literature

Theoretical nexus governance indictors and FDI

The theoretical nexus between governance quality and FDI is a complex and multifaceted relationship involving various theoretical underpinnings. The theoretical underpinnings of this study stem from institutional theory, which emphasizes the contributions of the formal and informal sectors in shaping behaviour, including economic transactions such as FDI. Governance indicators, which include the rule of law, institutional quality, and the regulatory environment, are crucial in attracting FDI. Investors are disposed to commit their capital to countries with strong and transparent institutions that provide a stable and predictable environment for business operations. Proponents of political economists argued that political stability ensures a secure environment for investment, while low corruption levels reduce the risk associated with business transactions. The studies of Mengistu and Adhikary (2011), Gangi and Abdulrazak (2012) and Saidi, et al. (2013) assessing the extent to which political institutions and processes influence economic outcomes, support the arguments of political economists. Governance indicators related to political stability, violence-free environment, and anti-corruption are considerable determinants of FDI.

The proponents of globalization and liberalization school of thought emphasize the role of open markets and reduced trade barriers in attracting FDI. Governance indicators are essential for signaling a commitment to economic openness. Countries with transparent and accountable governance structures are more likely to benefit from globalization and attract FDI, as investors seek opportunities in markets with clear and reliable regulatory frameworks. OCED (2014), IMF (2016), UNDP (2011) including the World Bank (2013) are in consensus that appropriate political, social, and economic space founded on good governance are essential drivers of inclusive growth and FD/globalization. The nexus between governance indicators and FDI is rooted in a range of economic, political, and social theories.

This relationship is dynamic and context-dependent, with good governance acting as a crucial determinant of a country's attractiveness for foreign investors. Over the last decade, FDI inflow into SSA countries has greatly increased moving from US$18 billion to US$98 billion between 2004 and 2020 though it reduced to US$54 billion in 2015 (UNCTAD 2016). The leading countries in this FDI growth, in no particular order include South Africa, Nigeria, Senegal, Ethiopia, Rwanda, and Mozambique (UNCTAD 2020). Following the above theoretical connections, we test five main hypotheses with governance decomposed into: Rule of law, political stability, government effectiveness, control of corruption and regulatory quality as exogenous variables and FDI as the outcome variable.

Empirical Review

Mengistu and Adhikary (2011) 15 Asian countries from 1996 to 2007 examined the nexus between governance indicators and FDI, using fixed-effects regression, and Prais-Winstein panel estimation models. The findings reveal that governance indicators are

significant determinants of FDI inflows in the investigated countries except for voice, accountability, and regulatory quality which were found to be insignificant.

Gangi and Abdulrazak (2012) investigate the nexus between governance indicators and FDI in 50 African countries from 1996 to 2010. Panel regression analysis (fixed and random effects) was adopted. The findings revealed that voice and accountability, government effectiveness and the rule of law significantly influenced FDI inflows, while the other indicators had a non-significant effect. The findings of this study align with Saidi et al. (2013) who examined the governance indicators and FDI interface in 20 developed and developing countries from 1998 to 2011.

Chaib and Siham (2014) investigated institutional quality proxied by government effectiveness, voice, and accountability on FDI inflows from 1995 to 2011. Using the Johansen cointegration test, VEC, among other techniques. The results show a cointegrating relationship between institutional quality and FDI inflows in the country. Voice and accountability positively impact FDI, while government effectiveness negatively affects FDI inflows. This study covered only one country in North Africa and adopted only two governance indicators.

Nizam and Hassan (2018) assessed the interaction between governance and FDI inflows in eight South Asian countries, sampled from 2002 to 2015, using multiple regression analysis. It was found that voice, accountability, and government effectiveness significantly impacted FDI inflows, while other governance indicators were found to be negative influencers of FDI inflows in the selected countries within the study region. A similar study like Khan, et al. (2019) with India as the geography of interest covering the period 1996 to 2012, using multiple regressions for data analysis reveal that governance in India is significantly responsible for the huge FDI inflows that the country attracts.

Awadhi, et al. (2022) investigated institutional development and FDI inflows in 45 SSA countries using empirical evidence from 1986 to 2015 with the generalized method of moments (GMM) as estimation method. All the governance indicators were found to positively and significant affect FDI inflows in the SSA region except voice and accountability, regulatory quality, political stability and absence of violence, and corruption that showed no significant impact.

Ricciardulli (2019) examine the link between remittances and governance practices in 195 countries using the regression model. The results revealed that remittances significantly impact on government expenditure but do not increase corrupt practices.

In a cross-country study on the dependence on remittances on governance quality from 1996 to 2015, Cho (2020) observed that poor governance quality attracts higher remittance inflows. The results of the analysis as to whether the volume of remittances for altruistic and investment motives favours good governance quality. The study sampled 158 countries and employed Tobit estimation techniques, pooled OLS, random effects, and for the analysis. Although this study used WGIs, it did not specifically focus on SSA countries and estimated the relationship between governance quality and remittances only, neglecting FDI.

Ajide and Olayiwola (2021) investigated the relationship between remittances and corruption from 1986 to 2016. ARDL was used for data analysis. The study found that remittances significantly improves corruption control in Nigeria. The findings of this study supports the notion that remittances are useful instrument for improving governance quality in a country.

3. Data and Methodology

The datasets employed in this study span the period 1996 to 2020. The study employs

longitudinal “cross-sectional” data (secondary data) of published variables extracted from the World Development Indicators (WDI). The study population consists of 48 SSA countries recognized by the United Nations (UN). The sample size was 47 SSA countries (Table 1). South Sudan was excluded because of lack of data and because the country became an independent state only in 2011, specifically July 9, 2011. Foreign direct investment proxied by net foreign direct investment was adopted as the dependent variable, while governance indicators were proxied by government effectiveness, rule of law, control of corruption, regulatory quality and political stability.

Table 1: Sample Size

Country	**Date of Independence**	**Country**	**Date of Independence**
Angola	1975	Sao Tome and Principe	1975
Benin	1960	Senegal	1960
Botswana	1966	Seychelles	1976
Burkina Faso	1960	Sierra Leone	1961
Burundi	1962	Somalia	1960
Cape Verde	1975	South Africa	1931
Cameroon	1960	Sudan	1956
Central African Republic	1960	Tanzania	1964
Chad	1960	Togo	1960
Comoros	1975	Uganda	1962
Democratic Republic of Congo	1960	Zambia	1964
Congo Republic	1960	Zimbabwe	1980
Cote D'Ivoire	1960		
Equatorial Guinea	1968		
Eritrea	1993		
Eswatini	1993		
Ethiopia	Not colonized		
Gabon	1960		
Gambia	1965		
Ghana	1957		
Guinea	1958		
Guinea-Bissau	1973		
Kenya	1963		
Lesotho	1966		
Liberia	1847		
Madagascar	1960		
Malawi	1964		
Mali	1960		
Mauritania	1960		
Mauritius	1968		
Mozambique	1975		
Namibia	1990		
Niger	1960		
Nigeria	1960		
Rwanda	1962		

Model Specification

This study adopted the panel least squares models following the Random Effects or the Fixed Effect framework to analyse the effect of governance indicators on foreign direct investment in the selected SSA countries. The choice of the countries is influenced by availability of data. The functional relationship between governance indicators and foreign direct investment is as follows:

$Y_{it} = \beta_0 + \beta_1 X_{it} + \beta_2 Z_{it} + \mu_i$ ……………………………….(1)

$Y_{it} = \beta_0 + \beta_1 PSV_{it} + \beta_2 GOE_{it} + \beta_3 RUL_{it} + \beta_4 COC_{it} + \beta_5 REQ_{it} + \mu_{it}$.............................(2)

Hypotheses

1. Political stability does not significantly impact on foreign direct investment in SSA countries.

$FDI_{it} = \beta 0 + \beta 1 PSV_{it} + \beta 2 TOP_{it} + \beta 3 SZE_{it} + \beta 4 INF_{it} + \beta 5 EXR_{it} + \beta 6 POV_{it} + \beta 5 INR_{it}$ μ_{it}…………(3)

2. Government effectiveness does not significantly impact on FDI in SSA countries.

$FDI_{it} = \beta 0 + \beta 1 GOE_{it} + \beta 2 TOP_{it} + \beta 3 SZE_{it} + \beta 4 INF_{it} + \beta 5 EXR_{it} + \beta 6 POV_{it} + \beta 5 INR_{it}$ μ_{it}…………(4)

3. The rule of law does not significantly impact on FDI in SSA countries.

$FDI_{it} = \beta 0 + \beta 1 RUL_{it} + \beta 2 TOP_{it} + \beta 3 SZE_{it} + \beta 4 INF_{it} + \beta 5 EXR_{it} + \beta 6 POV_{it} + \beta 5 INR_{it}$ μ_{it}…………(5)

4. Control of corruption does not have a significant impact on foreign FDI in SSA countries.

$FDI_{it} = \beta 0 + \beta 1 COC_{it} + \beta 2 TOP_{it} + \beta 3 SZE_{it} + \beta 4 INF_{it} + \beta 5 EXR_{it} + \beta 6 POV_{it} + \beta 5 INR_{it}$ μ_{it}…………(6)

5. Regulatory quality does not significant impact on FDI in sub-Saharan African countries.

$FDI_{it} = \beta 0 + \beta 1 REQ_{it} + \beta 2 TOP_{it} + \beta 3 SZE_{it} + \beta 4 INF_{it} + \beta 5 EXR_{it} + \beta 6 POV_{it} + \beta 5 INR_{it}$ μ_{it}…………(7)

Where:

PSV = Political Stability and Absence of Violence

FDI = Foreign Direct Investment

GOE = Government Effectiveness

REQ = Regulatory Quality

RUL = Rule of Law

COC = Control of Corruption

POV = Poverty

INR = Interest Rate

EXR = Exchange Rate

INF = Inflation

ESZ = Size of the Economy

TOP = Trade Openness

Yit = Dependent Variable (Foreign Direct Investment)

β0 = Intercept of the Equation,

β1 = Coefficient of Xit Variables.

Xit = Independent Variable (political stability, government effectiveness, rule of law, control, of corruption and regulatory quality).

I = (Cross-Sectional Variables) sample countries 47

t = Time Period

μ= Error terms

Estimation Procedure: The estimation processes are as follows:

- Pre-estimation tests: Panel descriptive statistics, panel unit root test and panel correlation analyses were conducted to determine the goodness of the panel dataset.

- panel estimation: The panel regression model was adopted because of its ability to combine both spatial (units) and temporal (time) dimensions. In addition, it measures the effects that cannot be observed only cross-sectional or time-series data

Results and Empirical Analysis

Descriptive statistics provided showed the distributional characteristics of the study variables. From the results presented in Table 2 governance indicators, such as controlling corruption, improving government effectiveness, and ensuring political stability, are crucial for FDI inflow in SSA countries. As such, the mean value of 4.17 for FDI support this result, suggesting the need for attention to enhance investment attractiveness in SSA countries. A moderate level of corruption control (27.86) indicates room for improvement, as lower corruption tends to attract more FDI. The moderate government effectiveness score of (25.33) emphasizes the importance of improving governance structures to foster investment. A high mean (37392.4) indicates high political instability. In SSA countries. This is evidence of various military intervention from to 2020-2023 as witnessed in countries like Gabon in 2023, Niger in 2023, Burkina Faso in 2022, Sudan in 2021, Guinea in 2021, and Mali in 2020 and 2021.

The moderate regulatory quality mean score of (29.52) indicate the need for improvement to create a more favourable business environment. The moderate mean of (29.60) underscores the importance of strengthening the rule of law to enhance the investment climate of SSA countries. The average size of SSA economies indicates the need for upper-middle, lower- middle, and low- middle- income SSA economies to focus on creating conducive conditions for investment. The relatively open trade environment, with a mean value of (65.36) indicate a positive factor for attracting FDI.

There is a dare need for policymakers and investors to work collaboratively to address specific weaknesses and leverage strengths within each country, taking into consideration the unique economic, political, and regulatory landscapes.

Table 2: Description Statistics

Variables	Mean	Median	Std. Dev.	Skewness	Kurtosis	Jarque-Bera	Prob	CV
FDI	4.17	2.45	7.99	5.95	55.2	122348.	0.00	1.91
COC	27.86	25.48	20.41	0.53	2.23	64.97	0.00	0.73
GOE	25.33	20.91	19.92	0.82	2.84	106.9	0.00	0.78

PSV	37392.4	28.98	1163	31.0	967.	37676	0.00	31.10
REQ	29.52	25.96	22.84	2.94	32.5	36008	0.00	0.89
RUL	29.60	27.88	21.18	0.70	3.13	77.07	0.00	0.71

Sources: Author (2023)

Note: *PSV = Political Stability and Absence of Violence, FDI = Foreign Direct Investment, REQ = Regulatory Quality, RUL = Rule of Law, COC = Control of Corruption and CV = coefficient of variation.*

Test of Hypotheses

Dependent Variable = Foreign Direct Investment					
Hypotheses	**PSV**	**GOE**	**RUL**	**REQ**	**COC**
PSV	0.062 (2.055)				
GOE		0.1414(11.865)			
RUL			-0.032 (-3.686)		
REQ				-0.0047 (-0.514)	
COC					-0.062(-9.088)

Source: Author (2023)

Discussion of Results

Individual indicators of governance were used to estimate their respective effects on foreign direct investment in SSA countries and provide policy implications. The various governance indicators in SSA countries impact on FDI differently because of the dynamic nature, challenges, and interplay related to each governance indicator. Political stability had a negatively significant impact on FDI implying that a unit change of 0.06% caused a decrease in FDI in Sub-Saharan African countries, as political instability creates a risky business climate and deterrents to the inflow of FDI.

Government effectiveness positively and significantly impacts on foreign direct investment in sub-Saharan African countries. This implies that a unit change of 14% in government effectiveness increases FDI in Sub-Saharan African countries, as effective governance is a key driver for attracting FDI.

Investors are attracted to countries that have efficient and transparent government systems. The rule of law negatively and significantly impacts on foreign direct investment in sub-Saharan African countries.

This implies that a unit change of 0.03% caused a decrease in foreign direct investment in sub-Saharan African countries, as such weaknesses in the rule of law discourage foreign investors and create a breeding ground for injustices. An unreliable legal environment can lead to contract disputes, property rights issues, and challenges in enforcing agreements. Regulatory quality negatively and significantly impacts on foreign direct investment in sub-Saharan African countries.

This implies that a unit change of 0.04% caused a decrease in foreign direct investment in Sub-Saharan African countries due to cumbersome regulations, bureaucratic hurdles, and inconsistent enforcement deterring foreign investors and hindering the growth of the business environment. Control of corruption negatively and significantly impacts on foreign direct investment in sub-Saharan African countries. This implies that a unit change of 0.06% caused a decrease in FDI in Sub-Saharan African countries, such as a
lack of control over corruption eroding trust and discouraging long-term investments. In summary, the findings of this study are supported by those of Saidi, et al. (2013), Gangi

and Abdulrazak (2012), Mengistu and Adhikary (2011), Shah and Afridi (2015), Mengistu and Adhikary (2011) and Nizam and Hassan (2018).

Conclusion and Policy Implications

The study on the effect of governance indicators on FDI in Sub-Saharan African (SSA) countries provides valuable insights into the complex relationship between investment and governance in the region. The analysis of various governance factors has revealed both positive and negative impacts on FDI. This study underscores the crucial role of political stability in attracting foreign investments. Political uncertainties and conflicts negatively influence FDI, emphasizing the need for SSA countries to prioritize measures that enhance political stability and reduce risks. Effective governance has emerged as a significant driver of FDI. Countries with efficient and transparent governance structures are likely to attract foreign investors.

Policymakers must focus on improving administrative efficiency, reducing bureaucracy, and enhancing transparency to create an environment conducive to investment. Weaknesses in the rule of law have a negative effect on FDI. An unreliable legal environment deters investors because of concerns regarding contract disputes and property rights. Strengthening legal frameworks, ensuring fair and transparent dispute resolution, and upholding property rights are critical to building investor confidence. Poor regulatory quality hinders the business environment and negatively affects FDI. SSA countries must prioritize regulatory reforms, streamline bureaucratic processes, and ensure consistent enforcement to create a business-friendly environment. Corruption has a detrimental effect on FDI. Lack of control over corruption erodes trust and discourages long-term investment. Anti-corruption measures, transparent governance structures, and accountability mechanisms are essential to attracting and retaining foreign investors.

Summarily, this study highlights the central role of governance in shaping the investment landscape in SSA countries. Addressing governance challenges and fostering a conducive environment for investment are pivotal for unlocking the full economic potential of the region, promoting sustainable development, as well as improving the quality of life for its citizens.

The general recommendation of this study is that one-size-fits-all solutions may not be effective for SSA countries. Policies and reforms should be tailored to the unique challenges and opportunities of each SSA country. Effective governance requires coordination across the sectors. Governments need to adopt a holistic approach to simultaneously address political instability, governance ineffectiveness, absence or poor implementation of the rule of law, poor regulatory quality, and corruption control. Thus, enhancing institutional capacity and investing in human capital are essential. Governments must prioritize education, training, and professional development to build the skills needed for effective governance. Collaboration with international organizations, neighboring countries, and the global community is crucial. Shared efforts to address common challenges will lead to positive outcomes for the entire region.

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