

# POLITICAL STABILITY AND ATTRACTING FOREIGN DIRECT INVESTMENT: A COMPARATIVE STUDY OF MIDDLE EAST AND NORTH AFRICAN COUNTRIES

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**ABSTRACT:** *The present study analyzes the impact of macroeconomic variables like business environment variables on foreign direct investment (FDI) inflows in selected countries in Middle East and North Africa. Therein, these countries were categorized into two groups, republican and monarchy countries in order to better examine whether political stability plays moderating role between macroeconomic variables, business environment variables and FDI. The study poses a new stream of research towards investigating the effect of PS as moderating variable through recognizing the importance of PS as a critical variable in the course of foreign investment. This study used annual data from the period of 2000 to 2016. The data was collected from the official sources such as UNCTAD and World Bank. This study used an application of the generalized least squares (GLS) estimation of the data using STATA statistical software packages. The findings of this study found strong influence of PS as a moderating variable between macroeconomic variables, business environment variables and FDI for the republican countries; unlike monarchy countries.*

**Keywords:** Foreign Direct Investment, Political Stability, Middle East and North Africa

## INTRODUCTION

Foreign Direct Investment (FDI) has been evidenced in theories as well as in practice as the driver of economic advantages to the country via the country's capital, foreign exchange, transfer of technology, organizational framework, managerial skills and exports opportunities by improving the access to foreign markets [1, 2]. Economists claimed that FDI can also lead to maximized domestic investment via its role in encouraging both innovation and economic growth of the country [3].

In the MENA countries, the political and social upheavals that followed the political unrest in 2011 continue to dominate economic activity and near term prospects. Despite the fact that transitions in the political climate often heralds greater liberalization of politics and economy, in the MENA region, the process is still short from completion and has been coupled by the increased political and macroeconomic turmoil in 2013. This is exemplified by the case of Egypt, where social and political tensions arose and by Syria, where civil war escalation brought about significant economic and human casualties, spilling over to its neighboring countries of Lebanon, Jordan and Iraq. In the MENA oil exporting countries, oil production has also took a dip owing to the security setbacks, issues in infrastructure and strikes. Through it all, the GCC oil exports attempted to counter the loss in oil production, while simultaneously supporting the regions transition economies through financial resources.

The situation in the MENA region was compounded by the political unrest in 2011, right in the heels of the recovery from the global financial and economic crisis in the late 2000s. This mitigated the foreign investment in the region. In addition, prior to this political unrest, the aggregate investment and FDI flows to the region was at par with the rest of the global countries. Initiating with a low base, FDI flows increased in the early 2000s, reached its peak in the second half of the same period, and dipped towards the end of the decade. While in the rest of countries, the FDI recovered after 2010, FDI flows to MENA region showed no development and continued decreasing with the worsening of the economic and political situation [4].

Logically, the case should be that political stability would have a significant positive impact on FDI. Political stability increases certainty in the economic environment, thereby increasing the incentives for foreign investors to invest in the host country.

Theoretically, there seems to be a relationship between political stability and FDI, which is precisely the analysis undertaken in the current study by examining the impact of political stability as moderator between macroeconomic variables, business environment variables, and FDI.

The selection of the years 2000 through 2016 in this study was significant for two important reasons. First, this timeline covered some significant events that changed the political landscape of the region. Second, this timeline reflected the aftermath of the US financial crisis of 2007-2008 that led to the worldwide economic slowdown.

## REVIEW OF LITERATURE

Consistent with the extant literature, the present study develops the following regression equation (subscript i refers to countries and t refers to time).  $FDI_{i,t} = \alpha + \beta_1 CPI_{i,t} + \beta_2 GTI_{i,t} + \beta_3 CRI_{i,t} + \beta_4 JEFI_{i,t} + \beta_5 RGG_{i,t} + \beta_6 GNI_{i,t} + \beta_7 GE_{i,t} + \beta_8 GRI_{i,t} + \beta_9 EX_{i,t} + \beta_{10} INF_{i,t} + \beta_{11} PSI_{i,t} + \epsilon_{i,t}$ .

The study's explanatory variables covered in the equation were selected with the help of a review of empirical literature.

A review of prior literature examining the relationship between Corruption Perceptions Index (CPI) and FDI shows that the studies reported mixed findings [5, 6]. A negative impact of CPI on FDI was revealed by [7], which was explained by the premise that foreign investors generally steer clear of investing in corrupted business environment as it lacks security and may lead to operational defects. Similarly, corruption perception played a major role in investment decisions [8] and overall corruption effect significantly and negatively impacted FDI inflows into the country [9].

Global Terrorism Index (GTI) has been added by many researches [10, 11] that evidenced that terrorism as well as the related activities negatively influence the inflow of FDI. Consequently, anti-terrorist security costs are incurred by the

economy and this mitigates its competitive potential while increasing the prices of products in the affected countries.

Crime (CR) as a measure of social stability has been added by few researchers [12], that illustrated that increases the investment risks along with its costs, and hence, lead to a depressed economy. More specifically, crime decreases investment by increasing the risks to company activities stemming from potential attacks, property destruction and threats.

Index of Economic Freedom (IEF) variable concerns the level to which economic freedom, referred to as market economy-oriented institutions and policies, issues concerning opportunity entrepreneurship and necessity entrepreneurship [13]. The studies revealed that economic freedom complete FDI, with the latter's effect more evident in the face of the variable of economic freedom. According to [14], this indicates that countries promoting higher economic activities freedom can leverage more from the existence multinational corporations (MNCs).

Several studies have been dedicated to the relationship between Real GDP Growth (RGG) and FDI in the context of developing nations. Accordingly, the findings of such studies [15, 16] revealed that RGG significantly impacts FDI among developing nations and demonstrated a positive impact of RGG on FDI.

The study by [17] indicated that Gross National Income (GNI) reflected that economic environment and the countries potential is significantly related to economic development measures.

Prior studies reported mixed results concerning the two variables relationship. [18] revealed a positive significant relationship between GNI and FDI, and [19] reported a negative relationship between the two. Meanwhile, no significant relationship was found between GNI and FDI. [20].

The Government's Expenditure (GE) such as, health, education and development expenditure have a significant positive long run relationship with the FDI, but the defense expenditure has a negative relationship in case of some developing countries [21].

At the same time, Government Revenues (GR) inequalities are more prevalent in the developing countries compared to developed ones. Therefore, findings derived from this developing countries are robust, more reliable and provide valuable policy implications and a positive reflection on attracting more foreign investment [22].

Some studies [23] confirmed a negative and significant relationship between Exchange Rate (EX) and FDI while others [20] reported an insignificant effect.

In another study, [24] found evidence that distortions in EX in the host country failed to negatively impact FDI inflows. In the context of Yemen, EX was found to be a negative short-run determinant of FDI [25].

Inflation Rate (INFR) is commonly utilized for the measurement of the price stability level and economic stabilization. It has a negative and significant relationship with FDI inflows in the context of Africa as evidenced by [26] and in MENA countries as evidenced by [27]. Contrastingly, a positive and significant relationship between INFR and FDI inflows was evidenced by [28] and while no

significant relationship was found between the two variables by several studies [29].

Stability (PS) is essential. Political risks greatly depend on political stability, and as such, political stability is significant in attracting FDI [20].

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Evidently, political instability is bad as it negatively influences the economic development and growth of the country through its unhealthy affect on the physical and human resources. With an adverse political stability, foreign investors often hesitate to invest in the country unless and until it is guaranteed that the business environment is stable and attractive [20].

Without any doubt, the predictors and causes of political unrest and rise of investment risks such as political regime alterations, government undue involvement in economic factors; rigid property and legislation procedures, red tape and so on can mark a severe adverse impact on foreign investments [30]. Moreover, global investors and the international organizations places great emphasis on their FDI decision process and the level of the governance index in the countries they are interested in.

This study uses PS as a moderator between macroeconomics determinants (RGG, GNI, GE, GR, EX, INF), business environment (CPI, GTI, CR, IEF) and dependent variable (FDI). This moderating variable affects the strength of the relationship between the independent and dependent variables.

## FINDINGS

### Data Collection Procedures

This study is based on the secondary data compilation. The relevant data for the analysis of FDI determinants and important issues covered by the study were taken from several authentic sources. Data used was obtained from the annual data for the years 2000 to 2016, with the major sources being the UNCTAD reports and World Bank reports.

### Data Analysis

Analysis of the data to examine the hypothesized relationship through deploying STATA version 14 was performed. Therein, some steps were taken pertaining to affirmation of data quality before conducting the main analysis. This included data cleaning, data screening [31]. In this study, the balanced panel data was used owing to its sensitive measurement of the changes that could occur between different time periods [32]. The generated results are also more accurate, consistent and stable to be able to be generalized to the whole population under study. This indicates that the samples represent the population more and that the results are accurate and reliable.

In order to achieve the research objective: "to examine the determinants of FDI through macroeconomic determinants, business environment and moderating role political stability", the researcher conducted a regression analysis. Prior to such analysis, the data was examined for the detection of any breach of the fundamental assumptions that underlie regression analysis, which are linearity, normality and homoscedasticity [33].

The performed analysis provided model specifications, with each model determined to be either random effects of the fixed effects model through the use of Hausman test. Relevant assumptions like heteroscedasticity, were tested. To determine whether or not the model is random or fixed, the result of the Hausman test was noted, in that if the result of the Hausman using a fixed effect model is significant, then it should be fixed. If on the other hand, the result is not significant, then the random effects model is used. However, in this study, the Hausman test result was insignificant for both.

**RESULT OF REGRESSION**

**Multiple Regression Analysis Results**

After all the regression assumptions were checked, no issues were found and therefore, this study ran the regression analysis to examine the predictive power of the hypothesized model. In other words, the main purpose of the multiple regression analysis is to determine the predictive power of each independent variable toward the dependent variable.

The multiple regression analysis performed and the results of group one are presented in Table 1. From the table, it can be concluded that CPI ( $\beta = 323706.3$ ,  $t=1.85$ ,  $p<0.1$ ) has a positive significant impact on FDI inflows at 0.1 level of significance and GNI ( $\beta = .058018$ ,  $t=4.11$ ,  $p<0.01$ ) has a significant positive impact on FDI inflows at 0.01 level of significance. On the other hand, PS ( $\beta = -432017.1$ ,  $t=-1.94$ ,

**Hierarchical Regression Analysis Results**

As stated earlier, this study employed hierarchical regression to examine the moderating effect of PS on the macroeconomic variables and business variables in FDI inflows in the two groups of the MENA countries.

Before proceeding to get the interaction terms to measure the moderating effect, all the variables meant to be used were standardized. This means that the mean of each variable was subtracted from all the values of that variable and subsequently all the values of the variable were divided by its standard deviations. As suggested by [34], the regression analysis was performed in several steps. In the first step, the independent variables were included to examine their predictive power against the dependent variable. The second step includes the moderator variable while the third step includes the interaction terms. This implies that the third step includes all the variables and the interaction terms.

In group one, the interaction terms between the macroeconomic variables, business environment variables and PS were examined to test the moderating effect. The results in Table 2 indicate that GE is a negative significant predictor of the FDI inflows at the 0.05 level of significance ( $\beta = -.2309698$ ,  $t=-2.05$ ,  $p<0.05$ ), GNI is a positive significant predictor of the FDI inflows at the 0.01 level of significance ( $\beta = .18736918$ ,  $t=4.64$ ,  $p<0.01$ ), CR is a positive significant predictor of the FDI inflows at the 0.01 level of significance ( $\beta = .171103.5$ ,  $t=2.36$ ,  $p<0.05$ ), and RGG is a positive significant predictor of the FDI inflows at the 0.05 level of significance ( $\beta = 95451.28$ ,  $t=1.97$ ,  $p<0.05$ ),  $p<0.1$ )

has a negative significant impact on FDI inflows at 0.1 level of significance and EX ( $\beta = -23.39529$ ,  $t=-3.70$ ,  $p<0.01$ ), has a negative significant impact on FDI inflows at 0.01 level of significance.

The results of group two in the Table 1 reveal that GE ( $\beta = -.1631208$ ,  $t=-3.33$ ,  $p<0.01$ ) is a negative significant predictor of FDI inflows to this countries at level 0.01. And GNI ( $\beta = .071854$ ,  $t=4.12$ ,  $p<0.01$ ), has a significant positive impact on FDI inflows at 0.01 level of significance.

**Table 1: Multiple Regression**

IVs.	Group One			Group Two		
	Coef.	t.stat	Sig.	Coef.	t.stat	Sig.
INF	-7818.835	-1.07	0.283	575.5138	1.00	0.319
CPI	323706.3	1.85	0.064*	-1803.721	-0.98	0.329
EX	-23.39529	-3.70	0.000***	.0058087	0.19	0.847
GTI	-64800.55	-1.27	0.206	-331.5462	-0.39	0.696
GE	-.0375973	-1.01	0.311	-.1631208	-3.33	0.001***
GR	-.0016023	-0.13	0.899	.033892	0.82	0.414
GNI	.058018	4.11	0.000***	.0671854	4.12	0.000***
CR	8738.199	0.41	0.682	-1714.578	-0.76	0.446
IEF	26877.53	1.39	0.165	-118.1932	-0.44	0.657
RGG	1634.821	0.08	0.934	244.0494	0.95	0.342
PS	-432017.1	-1.94	0.053*	-3482.408	-1.48	0.139
cons	-2135875	-2.13	0.034	16858.31	1.06	0.287
			R-squared=0.8795	R-squared=0.9854		
*, **, *** = p-value < .10, .05, .01						

The interaction terms between PS, macroeconomic variables, variables were examined. It was

found that while the interaction terms between CPI and PS was found to be negative and significant, These results indicated that political stability negatively and significantly moderated the effect of GE on FDI inflows.

The interaction terms between PS, business environment variables were also examined and the result highlighted that interaction between EX, GNI, CR, RGG and PS was positive and significant.

In group two, the interaction terms between the macroeconomic variables, business environment variables and political stability were examined to test the moderating effect. The results in Table 2 indicate that INF is a positive significant predictor of the FDI inflows at the 0.05 level of significance ( $\beta = 2034.121$ ,  $t=3.35$ ,  $p<0.01$ ), GE is a negative significant predictor of the FDI inflows at the 0.01 level of significance ( $\beta = -.246331$ ,  $t=-4.67$ ,  $p<0.01$ ), GNI is a positive significant predictor of the FDI inflows at the 0.01 level of significance ( $\beta = .117198$ ,  $t=5.08$ ,  $p<0.01$ ).

The interaction terms between PS, macroeconomic variables, business environment variables were examined. It was found that while the interaction terms between INF and PS was found to be negative and significant, PS is important in the relationship between INF and FDI in group two.

**Table 2: Hierarchical Regression**

Variables	Group One			Group Two		
	Coef.	t.stat	Sig.	Coef.	t.stat	Sig.
INF	-17232.31	-0.81	0.417	2034.121	3.35	0.001***
CPI	48838.97	0.42	0.676	-1243.496	-0.36	0.717
EX	13.18867	0.81	0.420	.0627679	1.12	0.264
GTI	66680.21	1.26	0.209	-1128.119	-0.94	0.345
GE	-.2309698	-2.05	0.040**	-.246331	-4.67	0.000***
GR	-.0562165	-1.01	0.312	-.0379935	-1.15	0.249
GNI	.1873691	4.64	0.000***	.117198	5.08	0.000***
CR	171103.5	2.36	0.018**	-2766.152	-1.43	0.153
IEF	7470.181	0.67	0.504	-197.4168	-0.46	0.649
RGG	95451.28	1.97	0.049**	-272.596	-0.54	0.592
PS	198151.2	0.24	0.810	191.0376	0.00	0.996
PS*INF	-3781.046	-0.47	0.638	-2535.792	-3.28	0.001**
PS*CPI	-325106.2	-2.32	0.020**	3900.271	0.96	0.335
PS*EX	25.5458	1.80	0.071*	-.0881792	-0.91	0.363
PS*GTI	69516.2	1.53	0.127	1728.929	1.07	0.284
PS*GE	-.1096153	-2.46	0.014**	.1125828	1.40	0.162
PS*GR	-.018532	-0.72	0.473	-.0266904	-0.52	0.603
PS*GNI	.0650427	3.94	0.000***	-.0254353	-0.77	0.441
PS*CR	56967.29	2.08	0.037**	5024.235	1.31	0.191
PS*IEF	-7226.6	-0.69	0.489	-.397.0187	-0.71	0.479
PS*RGG	42382.15	2.38	0.017**	884.4159	1.36	0.174
cons	-1734096	-2.69	0.007	19031.03	0.75	0.452
	R-squared = 0.9799			R-squared = 0.9880		
	*, **, *** = p-value < .10, .05, .01					

**CONCLUSION**

In this study, different issues were focused on and significant insight was provided to the FDI in MENA countries. In developing countries, this study is considered to be among the few studies that determined the influence of business environment and macroeconomic variables on the FDI inflows. In addition, this study attempted to expand the boundary of the current literature as it investigated the moderating effect of the PS on the relationship between macroeconomic variables, business environments and the FDI inflows by using the hierarchical regression analysis. By integrating the effect of macroeconomic factors, business environment, PS, the present study can claim significant relevant contributions to the literature besides entailing pragmatic suggestions for the considerations of the policy makers as well.

In this study, we find that in countries with republican governance, that political stability plays a major role in attracting FDI unlike monarchy states countries, where PS plays a lesser role as shown by the results above.

The insignificant outcome of PS on all independent variables, with the exclusion of inflation rate, shed light on the evident issue that exists in the countries led by monarchs. Political instability has long been evidenced to significantly and negatively impact and as such, foreign firms could be using their resources and capital to convince markets to lean towards their favor [35]. With the increase of political instability, FDI decreases.

Pertaining to limitations, the present study was focused on selected economies hence outlining limited scope. Accordingly, the model studied can be further extended through incorporating other variables keeping in view the

objectives and interests of the professionals. Conclusively, the present study aims to encourage future scholars in the area to shed further empirical light upon political stability and how it can influence FDI flows in other groups and economies across the globe.

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