

The Impact of Political Stability on Foreign Direct Investment in South Asian Countries Focusing On Afghanistan

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ABSTRACT

The main objective of this research paper is to postulate the relationship between political stability and Foreign Direct Investment through panel and time series data analysis for the period of 1996-2017 in South Asia and Afghanistan respectively. This study uses the multiple regression models represented by Generalized Method of Moments (GMM) for South Asia as well as VAR and OLS for Afghanistan. Foreign direct investment is taken as dependent variable and political stability as independent variable including key control variables such as control of corruption, trade openness, and government expenditure. The regression result based on GMM revealed that political stability has positive impact on FDI inflow in South Asia and the rest of control variables such as control of corruption, trade openness are also significant with negative and positive relationships in turn. Furthermore, the findings of VAR and OLS showed that political stability and control of corruption have positive and negative impacts on FDI inflow in Afghanistan but trade openness and government expenditures are not even marginally significant. It is suggested by the result of the study that South Asian countries including Afghanistan are supposed to increase the level of political stability for attracting more FDI inflows through establishing appropriate policies and mechanisms.

Key Words: Foreign Direct Investment (FDI), Political Stability, Control of Corruption, Trade Openness and Government Expenditures.

1. INTRODUCTION

South Asia consists of eight nations such as India, Bhutan, Afghanistan, Pakistan, Sri Lanka, Maldives, Bangladesh, and Nepal. This region is located in a key geographical position because it parts numerous land and sea connections with the Middle East, Central, and East Asia. South Asia is very prominent due to many religions, ethnic groups, cultures, languages that make South Asia notable of volatility in terms up income inequalities, religious conflicts, and other remarkable problems (JICA 2011). More to the

point, South Asia is attractive as the world rapid regional economy in providing high quality products and unique services in various fields. South Asia encompasses the world second most populated countries which over all covers 22% of world population. Besides, South Asia is a household of the highest level of illiteracy, poverty, conflict, scarcity, and disease. There have been weak and solid political and social issues such as war, legitimacy, democracy, governance, insurgency, and empowerment that affected the social and political environment (Asia 2008).

Afghanistan geographically a south Asian country is known to be a part of the central Asia recently due to its significant topographical location such that connects central Asian countries with South Asia and playing role as an untroubled shortcut overpass between the two regional spots in Asia. Although Afghanistan is known as the world poorest and insecure country but there have been seemed fewer economic and social developments recently. Due to political instability and security concerns, economic progress is slow down but only agriculture as the main source of economy that employs 80% of workforce and contributes less than half of GDP progressed in the last 16 years. There is also little progress in national manufacturing and service but still, it is not well enough to contribute in the empowerment of Afghan economy. The most remarkable issues in Afghanistan are insecurity, unemployment, weak economy, weak governance, weak law enforcement, and more corruption (Congress 2008).

Problem Statement

Foreign direct investment is noticed as the foremost stimulation to the economic growth especially in developing countries that mainly deals with financial deficiencies, technology, and skills. In fact, FDI contributes to the growth of host countries' economies via various channels such as involving internal resources for investment, transferring capital information, allocating technology, skills, innovations, capacity, organizational, and managerial practices to the host countries. Besides, it supports the implementation

and development of economic policies and strategies of regimes. FDI is also a vital basis for integrating domestic economies to global economies (Calderón 2016). In 2015, FDI inflow increased by 36% globally equals \$1.73 billion that most of the FDI was through extreme movement of cross border mergers and acquisitions in developed countries especially in United States (Imtiaz 2017).

The inflow of FDI in South Asia has been raised since 1980s with some ups and downs but later, it has got a gradual rise due to a few improvements in adopted policies. The strong push of FDI into South Asia had significant and positive impacts on economic and export growth beyond harming the domestic investment. The economic crisis of 2008 troubled the FDI inflow in South Asia such that low decline was noticed during the crisis (Sahoo 2006). South Asia became a key destination for FDI due to constant changes, and liberalizing approach to FDI in refining the FDI policy charters such as bilateral trade agreements, and investment incentives. It is worth mentioned that some foreign investors were not allowed because of some limitations in industries especially in manufacturing and services which were reserved and that is why there are still delays in FDI procedures. Thus, a huge volume of FDI inflow to South Asia is negligible recently (Shariat 2017). In one hand, South Asia is hungry of attracting more FDI for its economic benefits but on the other hand, South Asia applies strict legal and regulatory environment, and further, it lacks of proper policies implementation. In spite of all those attempts towards attracting FDI into South Asia, there are still basic and remarkable challenges for upsetting down the inflow of FDI. For example, lack of political stability, much diverse negotiation between governments and foreign investors, absence of physical infrastructure and skilled labor, shortage of promotional measures, challenges in visa and repatriation processes, deficiency of one window system, the non- activated board of investment, no monitoring of investment mechanism, and lack of transparent policies. Finally, one can argue that still, the inflow of FDI deals with challenges that must be removed or lessened (Sigdel 2004)

It has been a history that political instability became a major obstacle to the attraction of FDI inflow into South Asia. Numerous international investors are interested to invest in South Asia but due to political instability, they are discouraged to invest in spite of all other investment return risks. For instance, Zohaib Akhtar and Hafiz Muhammad

Yasin claimed in their research study that political instability in Pakistan, Sri Lanka, Nepal, and Bangladesh decreased the volume of FDI inflows. It is added that there have several terrorist attacks, political institutions, and volatile security situations that push out the desires of international investors. Besides, India seemed politically stable compared to other South Asian countries but still it is not trusted for safe FDI (Yasin 2015). Besides, Samridhi Bimal also proved that political instability is a major hitch for the FDI inflow in South Asian countries. He argued that current existence of political instability in South Asia discouraged more amount of FDI inflow recently because many investors are scared of volatile insecurity and political groups that are against states governments (Bimal 2017). So it should be argued that political instability is negative major factor of FDI inflow in South Asian countries.

Afterward, the long unceasing cold war and devastation, Afghanistan became a home for both internal and foreign direct investments because it is a virgin market and investors are the first movers but due to lack of financial deficiencies and security threats, it remained expelled. Afghanistan needs investment almost in every sectors such as industry, construction, exports, agriculture, and mining as they are suggested by the investment incentive policy of Afghanistan (U.S 2015). According to International Monetary Fund 2018 report, the overall FDI is 0.5% as total percentage of GDP which is seemed much more less compared to other countries in the same category (IMF 2018). Up to date, significant number of foreign countries invested in different economic sectors of Afghanistan such as South Africa, Turkey, United Arab Emirates, Canada, United States, Pakistan, Iran, England, China, Netherlands, and India, however, the volume of such FDI is not well enough to meet the needs of Afghan economic development (group 2005). In spite of all attempts toward attracting FDI into the country, Afghanistan still incapacitated to invite quit enough FDI because of inappropriate legal framework for investment, weak tax regime, poor reforms in custom administration, lack of good infrastructure quality and high costs, composite property market, lack of government effectiveness, insecurity and political instability, and fragile financial market (group 2005). The recent hopes and FDI opportunities are Turkmenistan- Afghanistan, Pakistan and India (TAPI) natural gas pipeline project, Chabahar Port agreement among Afghanistan, India, and Iran, the CASA 1000

electricity transmit project, Belt and Road, and special Railway transportation of commercial goods between Afghanistan and Uzbekistan (WBG 2016).

Political instability is the biggest concern toward FDI inflow into Afghanistan since long before. Afghanistan is insecure due to different insurgency groups and bad neighbor's interventions that made the country center of war and terrorisms. Afghanistan is the best option for FDI compared to other South Asian countries but due to political instability, it cannot attract FDI into the country. International investors are interested to invest in Afghanistan but afraid of security challenges. For example, Jehanzeb Khalil, Saima Perveen and Zahid Ali showed in their research study that Afghanistan incapable of attracting FDI due major security hitches. They put the example that China wants to invest in Afghanistan but hesitant due to widespread insecurity and corruption. They provided that Afghanistan is the best opportunity for international investors to invest in mines and infrastructures but it is complicated to ensure the security that affect the value and return of investment (Jehanzeb Khalil 2015).

The following table shows the FDI inflow in South Asian countries from 1996 – 2017.

Table: 1

FDI Inflow in South Asia in Millions of Dollars (1996-2017)								
Cou	AFG	Ban	Bh u	Ind	Mal	Ne	Pak	Sri
1996	0.7	231.6	1.4	2 525.	9.3	19.2	439.3	133.0
1997	-1.5	575.3	-0.7	3 619.0	11.4	23.1	711.0	433.0
1998	-0.0	576.5	-	2 633.0	11.5	12.0	506.0	150.0
1999	6.0	309.1	1.1	2 168.0	12.3	4.4	532.0	201.0
2000	0.2	578.6	-	3 588.0	22.3	-0.5	309.0	175.1
2001	0.7	354.5	-	5 477.6	20.5	20.9	383.0	81.9
2002	50.0	335.5	2.4	5 629.7	24.7	-6.0	823.0	192.0
2003	57.8	350.3	3.4	4 321.1	31.8	1.8	534.0	198.7
2004	186.9	460.4	8.9	5 777.8	52.9	-0.4	1 118.0	223.0
2005	271.0	845.3	6.2	7 621.8	73.2	2.5	2 201.0	272.0
2006	238.0	792.5	72.2	20 327.8	95.2	-6.6	4 273.0	480.0
2007	188.7	666.4	40.2	25 349.9	132.4	5.9	5 590.0	603.4

2008	46.0	1 086.3	10.1	47 102.4	181.3	1.0	5 438.0	752.2
2009	197.5	700.2	25.6	35 633.9	158.0	38.5	2 338.0	404.0
2010	54.2	913.3	75.5	27 417.1	216.5	86.6	2 022.0	477.6
2011	57.6	1 136.4	28.6	36 190.5	423.5	95.5	1 162.0	955.9
2012	47.2	1 292.6	49.1	24 195.8	228.0	92.0	859.0	941.1
2013	37.6	1 599.2	13.7	28 199.4	360.8	71.3	1 333.0	932.6
2014	43.5	1 551.3	31.6	34 582.1	333.4	30.2	1 868.0	893.6
2015	163.1	2 235.4	17.1	44 064.1	298.0	51.6	1 621.0	679.7
2016	85.7	2 332.7	-12.7	44 480.6	456.6	106.0	2 479.0	897.0
2017	53.9	2 151.6	10.3	39 916.1	517.5	198.0	2 806.0	1 374.9

Source: world Development Indicators:

<https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS>

According to table 1, India comes as the top country in South Asia in terms up attracting FDI, Pakistan second, and Bangaladish as the third FDI inflow influencer. On the other hand, Bhutan is the least FDI influencer in South Asia and Afghanistan comes as the second least influencer in South Asia. In general, the South Asian countries are not better in attracting FDI inflow because the current amount of FDI's inflow covers very less parts of their GDPs. One can argue that South Asia needs much more of FDI to meet its need for economic growth recovery.

Objective of the Study

The main objective of this study is to empirically explore the relationship between political stability and FDI inflow into South Asia as well as Afghanistan. There exists numerous factors that affect the FDI inflow in South Asia including Afghanistan but only a few control variables are included in the study such as control of corruption, trade openness and government expenditures. This study uses both panel and time series analysis for the period of 1996-2017 in both focused regions.

2. THEORETICAL FRAMEWORK

Hypothetically, political stability is referred to the capacity of governments for reaching into inland societies and exposing the dynamic resources to assist in the context of FDI. High level of political

stability infers that the government is capacitated in terms up of providing physical infrastructure, political institutions, and summon human capitals to confirm a suitable and profitable investment environment. Hence, political stability signals to invite international investors for favorable investments with freely moving capitals and receiving fair returns on investment (KUGLER 2008). Quan Li discovered a new theory regarding the political instability impact on FDI through three sub-sections. First, political instability and violence stimulate investment behaviors via rational expectations and uncertainty. Second, the new theory suggests the effects of various types of political violence such as civil war, regional war, and international terrorism. Third, FDI inflows are resulted from two different but correlated decisions such as the choice of location and the decision of investment amount. Besides, Mac Greggor and Walter (1977) and Aharoni 91996) verified that political risk and stability are central concerns in taking investment decisions (QuanLi 2006).

3. LITERATURE REVIEW

Huong Giang investigated the institutional determinants of FDI in Vietnam through a panel data analysis for the period of 2005-2015 using simple multiple regression model. The results rendered the conclusion that political stability positively affects the FDI inflow in Vietnam and it is worth mentioned that political stability is strongly significant in connection to FDI beside other factors affecting FDI (Giang 2017).

Petar Kurecic and Filip Kokotovic studied the relevance of political stability on FDI in small, developed and instable threatened economies through a VAR and ARDL models using Panel data analysis for the period of 1996 to 2014. The inferences of the paper found no relationship between political stability and FDI which concluded that political stability is not significant. The study does not suggest that political stability is supposed to attract the inflow of FDI in developed and large economies. On other hand, it is discovered that there exists a positive relationship of political stability with FDI in small economies which this result is very different and contradictory compared to other research studies (Kurecic 2017).

Zohaib Akhtar and Hafiz Mohammad Yasin conducted an analytical study to discover the impact of terrorism and political instability on FDI in Pakistan through a case study in South and East Asian countries. The panel data analysis for the

period of 1996 to 2010 was used by applying simple function and econometric multiple regression models. The findings of the study suggested that political instability mainly affects FDI inversely and obtained a strong and significant relationship. It is worth mentioned that countries with solid political stability attract large amount of FDI inflows (Yasin 2015).

Kim Haksoon reconnoitered the impact of political stability on FDI in high and low political stable countries via panel data analysis for the period of 1990 to 2002 using multiple regression model with significant different estimations test such as pooled, random and GLS tests. The result is completely different from other studies which states that host countries with high political stability tend to increase higher FDI outflow which is a positive relationship in terms up FDI outflow but countries with low level of political stability attracts high volume of FDI which is a negative relationship in terms up inflow (Haksoon 2010)

Abdul Malik Nazeer and Mansur Masih researched the impact of political instability on FDI and economic growth in Malaysia through a panel data analysis for the period of 1984-2013 using ARDL econometric model for the purpose cointegration. The study revealed that there exists a strong and a negative significant relationship between political instability and FDI such that political instability discourages FDI adversely. On the hand, political stability encourages FDI in high volume (Masih 2017)

Michal Madr and Ludek Kouba explored the answer for the question of "Does political environment affect inflows of FDI evidenced from emerging markets?" This study applied the panel analysis for the period of 1996-2012 using simple multiple regression model. The conclusion from the result suggests that political environment affect on FDI and elaborated that political instability is significant and inversely associated with FDI in emerging markets. It is worth mentioned that political instability discourages FDI in 78 countries studied in this research absorption (Kouba 2015).

Mashrur M. Khan and Mashfique Ibne Akbar studied the impact of political risk on FDI in 94 middle and high income countries through a panel data analysis for the period of 1986-2009 using simple multiple regression model. The result presented two different conclusions: First, the relationship between political risk and FDI is weak

and negative for high income countries but second, the relationship for upper middle income countries is strong and negative. The verdict of this paper advocates that political risk slows down FDI inflow in both high and middle income countries but differs in volumes (Akbar 2013).

Anwar Salem Musibah researched political instability and attracting FDI in a comparative analysis of Middle East and North African countries through a panel data analysis for the period of 2000-2016 using multiple regression model. This research provided that political instability is the core driver of FDI in either ways such that political stability increases FDI and political instability reduces FDI. This research paper determines that there exists a strong negative significant relationship between political instability and FDI and vice versa, strong positive relationship between political stability with FDI in focused African countries (Musibah 2017)

Ahmed Berhan Abdella, Navaz Naghavi and Benjamin Chan yin Fah discovered the effect of corruption, trade openness, and political stability on FDI in BRIC countries (Brazil, Russia, India, and China) through a panel data analysis for the period of 2002-2016 using ARDL analysis with several estimation tests. The researchers came up with a positive and significant relationship of political stability on FDI in the long run and suggested that political stability mainly drives up FDI in BRIC countries (Abdella 2018).

Ali Al-Sadig discovered a negative relationship between Corruption and FDI through studying the effect of corruption on FDI inflows in the panel data analysis for the period of 1984-2004 in 117 countries. The researcher used multiple regression model with significant estimation tests such as fixed effect and random effect models. The findings shows that the relationship of corruption is negative but insignificant when high income countries are included. On the other hand, it is significant when high income countries are excluded. The result states that the existence of corruption is a negative driver of FDI because it reduces the volume of FDI in focused countries. Besides, the control of corruption increases the attraction of FDI (Al-Sadig 2009).

Norashida Othman, Zulkorain Yusop, Moham Mansor Ismail and Gul Andaman investigated the impact of government expenditure on FDI inflows in Asian -5 countries (Malaysia, Indonesia,

Singapore, Thailand and Philippine) through a panel data analysis for the period of 1982-2016 using Pooled Mean Group (PMG) estimation method. The result of this study declares that government expenditure subsidizes a positive relationship with FDI and states that if the government expenditure is increased, the volume of FDI increases too. However, the relationship of government expenditure is negative in previous research studies (Othman 2018).

Adina Dornean and Dumitru Cristian Oanea explored the impact of fiscal policy on FDI in the context of the crisis evidenced from central and Eastern European countries through a panel data analysis for the period of 1995-2012 using multiple regression model. The conclusion from this research paper states that government expenditure has got a positive relationship with FDI which can attract more FDI for the purpose of regaining of economies affected by the crisis. However, this relationship is different compared to its previous literature review (Dornean 2014).

Tonia Kandiero and Margaret Chitiga investigated the relationship of trade openness with FDI in 50 African countries through a panel data analysis for the period of 1980-2001 using multiple regression analysis. The result of this paper states that more trade openness encourages more FDI in the focused countries and this declares a positive and significant relationship between trade openness and FDI. It is recommended that the relevant countries are supposed to focus on investment tax, wages, and institutional framework besides trade openness. The finding of this research paper is quite similar to other previous findings (Chitiga 2006).

Kunofiwa Tsaurai studied the impact of trade openness on FDI in Zimbabwe through panel data analysis for the period of 1980-2013 using cointegration test. The finding of this research paper is quite different compared other previous research. The result shows that there is no long relationship between trade openness and FDI inflow in focused country. Besides, the result of this research study is also different from its literature review (Tsaurai 2015).

Research Gap

Throughout literature review, the researcher found a few remarkable gaps in the study of the impact of political stability on FDI inflow in South Asian

countries including Afghanistan. First, this issue is not studied much especially in South Asia and also Afghanistan which is the first gap to find how political stability influences FDI inflow in South Asia. Second, many research conducted time series analysis in one country but this paper used both panel for South Asia and time series for Afghanistan in comparison to other South Asian countries. Third, numerous researchers found both statistically and economically insignificant relationships of political stability and FDI which is another big gap in this study. Fourth, fewer research studies found both negative and positive relationships between political stability and FDI but this paper observes the positive relationship. Fifth, this research paper is different in terms of time period which might affect the inferences compared to previous research studies. Sixth, the estimation method of regression in this research study is also different because GMM, ARDL, and VAR are various techniques that are not used in previous studies. Filling and finding these gaps is the motivation to work on this problem and suggest the appropriate policies implications.

4. RESEARCH METHODOLOGY

This research paper observes the secondary data through panel data analysis for South Asian countries because it studies the assigned title in multiple individuals (South Asian countries) in the period of 22 years (1996-2017). The data for the dependent variable such as FDI and independent variables such as political stability, control of corruption, total trade, economic growth, and general government expenditures are taken from the World Bank Indicators. Besides, there is also a special focus on discovering the relationship of political stability with FDI in Afghanistan. In order to explore this relationship, the time series analysis is used for the same period (1996-2017). It is worth mentioned that that panel data analysis contains “i” that stands for identity such as country and individuals and “t” for time period such that these make panel data analysis different from time series analysis. On the other hand, time series includes only “t” for time periods in the featured model and not “i” because there exists only one country or individual.

Econometric Model

This study practices the multiple regression models both for South Asia and Afghanistan because this research paper attempts to find the relationship of one dependent variable with multiple independent

variables. First, this study model expresses FDI inflows as a function of political stability (PolStab), control of corruption (ConCorrup), trade openness (TradeGDP), and government expenditures (GovExp). Second, to test the hypothesis and show the relationships, a simple multiple regression model is applied.

Model 1: (Panel Data Analysis) for South Asian Countries

Simple function: FDI = F (PolStab, ConCorrup, TradeGDP, GovExp)..... 1

Plain Form: $Y_j = \beta_0 + \beta_1 X_{1j} + \beta_2 X_{2j} + \dots + \beta_n X_{nj} + \varepsilon$ 2

Featured Form: $\beta_0 + \beta_1 (PolStab)_{it} + \beta_2 (ConCorrup)_{it} + \beta_3 (TradeGDP)_{it} + \beta_4 (GovExp)_{it} + \mu_i + U_{it}$... 3

Model 2: (Time Series Analysis) for Afghanistan

Featured Form: $\beta_0 + \beta_1 (PolStab)_t + \beta_2 (ConCorrup)_t + \beta_3 (TradeGDP)_t + \beta_4 (GovExp)_t + U_t$ 3

i: 1, 2....., N (8)

t: 1, 2....., T (22)

Where (Both Models)

β_0 : The intercept or constant amount

$\beta_1 - \beta_4$: The coefficients of the assigned regressors

***FDI**: Foreign Direct Investment measured in percentage of GDP*

***PolStab**: Political stability measured in the likelihood of political instability, violence, and terrorism which is measured as index*

***ConCorrup**: Control of corruption which is measured as an index*

***TradeGDP**: The trade openness measured in percentage of GDP*

***GovExp**: The government expenditure is measured in percentage of total GDP*

μ_i : The unobserved effect error

U_{it} : The general error term or idiosyncratic error

Hypothesis

H₀: There exists no significant relationship between FDI and political stability

H₁: There exists a significant relationship between FDI and political stability

Or

H₀: $\beta_1 = \beta_2 = \beta_3 = \beta_4 = 0$

H₁: at least one $\beta_i \neq 0$

Variables Justification and Expected Signs

Foreign Direct Investment is the inflow of investment into host countries that is the sum of short and long term equity capital and reinvestment earnings which is measured in percentage of GDP (World Bank 2019). Besides, FDI is believed as the foremost economic factor that affect the economic growth in countries that suffer from lack of economic growth. The attraction of more FDI inflows into the countries enhance labor skills, innovations, production, and technology. Countries that experienced high volume of FDI inflows are running the fastest economies in the world.

Political stability is the absence of violence and terrorism that is measured in the likelihood of political instability, violence, and terrorism ranked between -2.5-2.5 which means that a country with

2.5 marks contains complete political stability and vice versa (World Bank 2019). More importantly, political stability is positively related with FDI which means that the increase in political stability will increase the attraction of FDI into that country. Foyzur Rahman Jewel discovered in a research study in Bangladesh that political stability has positive impacts on FDI in the long run but it is also added that there is not relationship between political stability and FDI in the short run (Jewel 2015). Furthermore, Bakhtiar Molaie and Azad Ahmadi explored the relationship of political stability and FDI in three country groups such as developed, developing and least developing. He discovered that the effect of political stability on FDI is positive in both developed and developing countries but not in least developing countries. So based on these analysis, it is expected that political stability is positively correlated with FDI with positive coefficient sign (Bakhtiar Molaie 2013).

Control of corruption is the miss use of public power in terms up of private gain, petty and grand cash, and capture and it is ranked between -2.5-2.5. The more a country has marks close to 2.5, the more control of corruption exists in that country and vice versa (World Bank 2019). Although, it is believed that control of corruption is a positive factor of FDI, still, many researchers found out both positive and negative relationship between control of corruption and the inflow of FDI. Besides, strict mechanisms and investment policies also discourage FDI inflow in such countries. Leon Zurawic and Mohsin Habib discovered a negative relationship of control of corruption and FDI but argued that this relationship is different in the last

25 years of the study (Zurawicki 2010). Based on these indications, this study attempts to discover the negative relationship of control of corruption and FDI because tolerable level of corruption pays the way to pull FDI inflow into countries.

Trade openness is the sum of imports and exports of goods and services and it is measured in percentage of GDP (World Bank 2019). In other words, it is actually exports minus imports which equals to trade openness. Countries with high amount of trade have great benefits because it indicates that these countries are good in labor skills, technology, and production which justifies that these countries export a lot compared to imports. One reason could be the existence of high volume of FDI and vice versa. Still, it is believed that more trade in a country pulls more FDI into that country. Valeriano Martínez San Román, Marta Bengoa Calvo and Blanca Sánchez-Robles Rute came with the conclusion that an increase in trade openness enhances the inflow of FDI into European countries in a situation when all border bureaucracy and cross border barriers are removed. They discovered that there exists a positive relation between trade and FDI (Román 2009). So based on literature review and this analysis, the expected sign of total trade in this research paper is positive.

Finally, general expenditure is the expenses on investment, health, education, security, administration, and goods and services and it is measured in percentage of total GDP (WorldBank 2019). One can argue that more volume of government expenditure tends to decrease the level of FDI because the states themselves investing in different sectors which is why it discourages FDI inflow. If the states invest, then there will be no profitable opportunities for FDI into those countries. Ahmad Mohammad Obeid Gharaibeh discovered negative but insignificant relationship of government expenditures on specific sectors in the research study in Bahrain. He came with the argument that government expenditure is not significant but claimed that it may affect negatively the inflow of FDI in Bahrain (Gharaibeh 2015). On the other hand, Norashida Othman, Zulkornain Yusop, Gul Andaman and Mohd Mansor Ismail discovered in a research conducted in 5 Asian countries such as Malaysia, Indonesia, Singapore, Thailand and Philippine that the government expenditures have positive impacts on FDI inflow. This means that there is a positive relationship between government expenditure and FDI in Asian 5 countries. Although the relationship between

government expenditures and FDI is both negative and positive, this paper expects a negative relationship of government expenditures and FDI (Othman 2018).

Table 2: Summary of the Variables Description and Their Expected Signs

Variable	Description	Expected Sign	
		Pos +	Neg -
FDI	Foreign Direct Investment	√	
ConCorrup	Control of Corruption		√
PolStab	Political Stability	√	
TradeGDP	Trade	√	
GovExp	Government Expenditures		√

Source: Author self-made

5. DIAGNOSTIC-ESTIMATION METHOD

Significant diagnostics tests such as multicollinearity, autocorrelation, and unit root tests are used for the purpose of fitting the data into model but cointegration and Vector Autoregression tests are applied for discovering the short and long term relationships between dependent and independent variables. For the purpose of discovering good inferences, GMM estimation technique is applied through lagging step one because it is believed that general government expenditure is assumed to be endogenous however quit relevant instrumental variables are instrumented such as expenses on investment, education, and health which did not gave good inferences because they were not fitted instruments. In addition, the panel data analysis suggests fixed effect estimation for removing country individual fixed effect and time invariant variables that create endogeneity problem but random effect estimation for eliminating serial correlation and using time invariant variables. Since this data set did not have time invariant observations, and serial correlation, so that is why fixed and random effect estimations are not applied in this research study.

Multicollinearity (VIF)

The best way to assess multicollinearity is used to variance inflation factor (VIF) which shows that how much the variance of the coefficient of regressors is increased. If the VIF is equivalent to 1, there exists no multicollinearity, but if the VIF is

bigger than 1, then there is a slight multicollinearity. If the VIF for a variable is greater than 5 to 10, it shows a high multicollinearity which is a problem and must be removed from the model (Akinwande 2015). The VIF for a single predictor variable is expressed in following function:

$$VIF = r_{ii} + \frac{(1)}{1 - R^2}, i = 1, \dots, P$$

In the above function, R^2 is the coefficient of multiple correlation in regression between X_i and P-1 is predictor variables. In multiple regression model of P regressors (X_i), variance inflation factors are diagonal elements (r^{ii}) of the converse of the correlation matrix ($R_{p \times p}$) of the p regressors (Murray 2012).

Test for Stationarity

As per a researcher, it is important to check for stationarity and non-stationarity of the variables such that stationarity is the condition of Classical Linear Regression Model (CLRM). A variable that its statistical properties such as mean and variance do not change over time is called stationary variable, if not, is called non-stationary. The existence of non-stationary variable gives spurious regression result and besides, R-Squared and t- statistics will be overestimated and misleading (Lyócsa 2009).

Autocorrelation

Autocorrelation is a problem when the observation of one variable is correlated with another variable in their disturbances which the results of OLS are still linear, unbiased, and reliable but not efficient. This research paper uses the Wooldridge test which the decision rule for Wooldridge test is that Null hypothesis (H_0): there is not Serial correlation but H_1 : there is serial correlation. Besides, the null hypothesis is rejected when the p-value is less than significance level (5%) otherwise do not reject (Toturial 2018). If the variables are stationary or in other words, they are well defined values for both mean and variances, then the following function fits the definition:

$$R (s , t) = \frac{E\{(X_t - \mu t) (X_s - \mu s)\}}{\sigma t \sigma s}$$

Where E is expected value operative and the values should lie between (-1, 1,) which -1 points to anti-correlation and 1 shows perfect correlation. But if the X_t is the second order stationarity via first difference, then the following function time-lag

function justifies the definition (Autocorrelation 2008).

$$R(T) = \frac{E\{(X_t - \mu)(X_{t+T} - \mu)\}}{\sigma^2}$$

Cointegration (ARDL)

Cointegration is an econometric theory that discovers the short and long run relation between and among variables over time series through making solid algebraic and economic base for error correction model. Discovering cointegration is vital pace for clarifying expressive long run relationships. There exists several tests for cointegration but Autoregressive Distributed lag is as best among them. The best way to show ARDL in formula is as follow:

$$\Phi(L, P) = \sum \beta(L, q_i) X_{it} + \delta w_t + u_t$$

Where the X_{it} lag operative and W_t is vector of defined variables such as the intercept term, time trends, seasonal dummies, or exogenous variables with the fixed lags. In each case, the maximum order of lags is preferred by the researcher (Nkoro 2016).

Generalized Method of Moments Estimation (GMM)

Generalized Method of Moments Estimation (GMM) is adapted to a wide range of problems in econometrics such as heteroscedasticity, serial correlation, nonlinearities and lag instrumenting. Cragg (1983) discovered the improvement of OLS in the presence of neglected heteroscedasticity by using GMM. Hansen's (1982) proved that GMM gives reliable estimates under weak assumption and added that optional instrumental variables in all three types of data analysis such as panel, time series and cross sectional are casted as GMM estimator. The use of lagged values of both dependent and independent variables providemore sense when estimating rational expectations because afterward, the error term is not correlated with all variables in early time periods in the assigned equation. Finally, GMM could be applied often in models having unobserved effects when the regressors are assumed to be not strictly exogenous after controlling the unobserved effects. In such cases, GMM with supplementary moment conditions provides more reliable estimates than 2SLS method (M.Wooldridge 2001).

Vector Autoregression

Cooley and Dwyer stated that Vector Autoregressive (VAR) is an eye-catching study

tool for the purpose of distinguishing dynamic relations of between variables without taking to plea economic theory (AWOKUSE 2003). In fact, VAR lets scholars to study the importance of one variable in forecasting another variable through its past values which is specified as linear function of its own and another variable past lags (Stata 2013). Besides, VAR is very useful for catching the co- movements among variables in describing data, information, and interpretation of the regressors (McGuire 2011). In this research study, VAR is used to discover the long run relationship among variables and predicting their upcoming values. Furthermore, using VAR provides justification for the importance of assigned variables in the study of Afghanistan. Generally, VAR for given vector of X_t is expressed as below;

$$X_t = \sum_{i=1}^k B_i X_{t-i} + C Z_t + U_t$$

Where both X_t and U_t are random vectors but Z_t is the vector of non-stochastic variables and finally, B_i and C_t are the correct matrixes of coefficients (AWOKUSE 2003).

6. DIAGNOSTIC TESTS AND REGRESSION RESULTS

Summary statistics is a general and expressive summarization of all the focused variables such as means, median, standard deviation, and minimum and maximum number which is the first glance for a researcher to figure out a good understanding of the data. Besides, it helps a researcher that how big and small numbers are included in the data set that may affect or mislead the mean and median of a variable.

Table 3: Summary Statistics

Variable	Obs	Mean	Std.Dev	Min	Max
FDI	176	1.579528	2.22864	-1.19127	15.26593
ConCorrup	176	-.5183396	.77644	-1.6382	2.893845
PolStab	176	-.9687735	1.1678	-3.1099	1.283388
TradeGDP	176	60.12654	37.94966	0	184.0933
GovExp	176	9.554745	5.547751	0	21.94472

Source: Computed from WDI Data via Stata

The mean shows the central trend in a data set but still, there is not good or bad means because it just measures the central point in data set. Very big and very small means indicate that the observation contains big or small data points. In table 3, trade openness has the highest mean which is 60.12654 but the smallest mean is -.50183396 for control of corruption. The most remarkable point in summary statistics is the standard deviation that show how

much the data point is spreaded from its mean which the small is the best but the big is the worst. In the above table, trade openness has the highest standard deviations which is 37.94.

Table 4: VIF Test

VIF Test		
Variable	VIF	1/VIF
ConCorrup	4.47	0.223490
PolStab	3.08	0.324629
TradeGDP	2.10	0.476048
GovExp	1.06	0.945548

Source: Computed from WDI Data via Stata

Following table 4, it is seemed that the correlations of specified variables are lesser than the maximum limit of the VIF which is 5. This means that the assigned model does not suffer from multicollinearity problem. The highest correlation is expressed by control of corruption which is still not supposed to be removed from the model. Thus, multicollinearity is not existed in this regression model.

Table 5: Autocorrelation

Wooldridge Test for Autocorrelation in Panel Data	
H0: no first-order autocorrelation	
Prob> F=	0.1752

Source: Computed from WDI Data via Stata

Following table 5, the null hypothesis is not rejected in favor of alternative. Since the result of this research shows that p-value is greater than significance level and we do not have enough evidence to reject the null hypothesis. Finally, it is argued that the model does not have autocorrelation.

Table 6: Unit Root Test

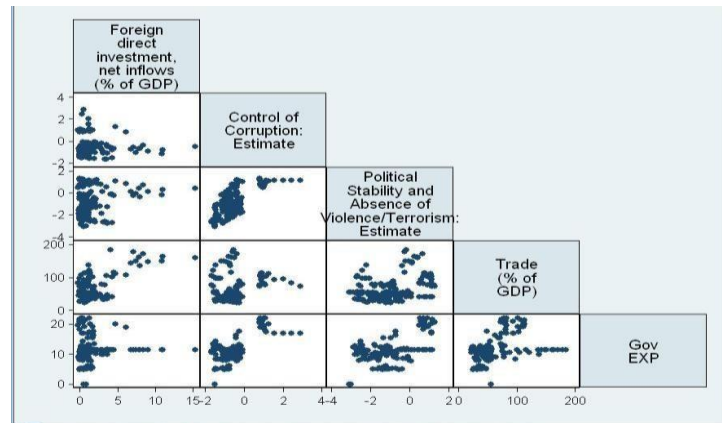
Variables	T-Statistic	P-value	Stationary Result
FDI	-5.6464	0.0000	1(0)
ConCorrup	-2.6216	0.0006	1(0)
PolStab	-2.9035	0.0029	1(0)
TradeGDP	-4.2020	0.0001	1(1)
GovExp	-3.5704	0.0002	1(0)

Source: Computed from WDI Data via Stata

According to table 6, all the variables except trade openness are stationary in levels because all the p-values are less than significance level which is 5% although it happens very rarely when all the variables are stationary. It is worth mentioned that if a variable is non-stationary, then it is vital to alter

the same variable to stationarity by the first difference method such as trade openness in this study.

Figure 1: The Correlation between Dependent and Independent Variables in Graph



Source: Computed from WDI Data via Stata

Beforehand, running other econometric analysis, it is very essential to show a graphical display of rough correlations between dependent and independent variables in selected regions. For this purpose, scatter plot matrix is the best way to exhibit this relationship. Regarding, Figure 1, the focused variable (political stability) and other control variables have a linear relationships with FDI but of course there exists some outliers too. It is rare to happen that all the data should be without outliers. Besides, one can picture the internal relationship of any two variables put side by side in diagonal shape but the very important pinpoint is the correlation between dependent and independent variables. It is believed that in this scatter plot matrix, the dependent variable (FDI) has acceptable correlations with independent variables such as control of corruption, trade and government expenditures in this study.

Table 7: Cointegration (ARDL) Result

FDI	Coef.	Std. Err.	Z	P> z
PolStab	.3970328	.3116519	1.27	0.203
ConCorrup	-.6517345	.3817745	-1.71	0.088
TradeGDP	-.0334097	.0152527	-2.19	0.028
GovExp	.1127242	.066414	1.70	0.090

Source: Computed from WDI Data via Stata

Following the table 7, it is revealed that control of corruption, economic growth, and government expenditures are significant except political stability but it is a stationary variable that is believed to have significant relationship with FDI in other estimation tests. The big concern is the

relationship of non-stationary variable such as trade openness but it is significant at 2.8% significance level which is assumed to have relationship in other estimation tests such as OLS and GMM too. Finally, it is argued that all the focused variables have fair connections with FDI especially in the long run which is an important assumption of linear regression model in econometrics.

GMM Estimation Result for South Asia

The rationale behind using GMM estimation is that both control of corruption and government expenditures were believed to be endogenous variables in OLS and that the result was not reliable for final decisions. Control of corruption is the index and that is why finding the correct instrument was a big challenge. Next, a few instrumental variables such as total investment, expenditures on education and health were tried as instruments through 2SLS for government expenditures but did not gave good inferences. So then it was very vital to apply GMM estimation which provided good reliable result. In the application of GMM, both control of corruption and government expenditure were taken as endogenous variables and the rest as exogenous variables with lagging 1.

Table 8: GMM

GMM Estimation						
Number of Obs: 176 Groups: 8 Prob > F = 0.0000						
FDI	Coef.	Std.Er r	T	P>/Z/	95% Intv	Conf
FDI L1	.4713476	.05524 42	8.53	0.000	.3630711 .5796242	
PolStab	.2920073	.16435 76	1.78	0.076	-.0301278 .6141423	
ConCorru p	-.4828432	.23917 86	-2.02	0.044	-.9516245 .0140618	
TradeGDP	.026589	.00368 1	7.22	0.000	.0193745 .0338036	
GovExp	-.0484943	.03804 68	-1.27	0.202	-.1230648 .0260761	
Cons	-.201441	.52178 49	-0.39	0.699	-1.224121 .8212385	

Source: Computed from WDI Data via Stata

The first important pinpoint in a regression result is to show the dimension of standard error because it shows that how much the data is spreaded from the mean of the data and it also affects directly the coefficient of the variable. The bigger the standard error, the bigger the coefficient of the variable and the worst the regression result for the relevant variable and the smaller the standard error, the better the result because it will give smaller

coefficient. In table 68, political stability has the biggest standard error but total trade has the smallest standard error.

According to GMM result, the political stability as the focused and main independent variable is significant at 7.6% significance level with a positive relationship with FDI which means that the increase in political stability will increase and attract more FDI into the South countries. This result is line with Huong Giang (Giang 2017), Ahmed Berhan Abdella, Navaz Naghavi and Benjamin Chan yin Fah (Abdella 2018), and Michal Madr and Ludek Kouba (Kouba 2015) who found that political stability is strongly significant such that political stability positively affects FDI inflow in Vietnam and Brazil, Russia, India, and China (BRIC) countries respectively. The researchers provided that the political stability consists a positive and significant relationship with FDI in the long run and suggested that political stability mainly pushes up FDI in Vietnam and Brazil, Russia India and China countries. On the other hand, many researchers such as Zohaib Akhtar and Hafiz Mohammad Yasin (Yasin 2015), Abdul Malik Nazeer and Mansur Masih (Masih 2017), Mashrur M. Khan and Mashfique Ibne Akbar (Akbar 2013) studied the same issue inversely like the impact political instability on FDI in Pakistan, Malaysia, high and middle incomes countries which came up with inverse relationship of political instability with FDI. The main conclusions from these research studies suggest that political instability is significant with weak and strong negative relationships with FDI. It is added that political instability discourages FDI inflow into the host countries which is the vice versa relationship of political stability with FDI. Furthermore, Kim Haksoon (Haksoon 2010) explored a different analysis of political stability in terms up FDI outflow and inflow in high and low stable countries. He exposed that host countries with high political stability tends to increase higher FDI outflow which is a positive relationship in terms up FDI outflow but countries with low level of political stability attracts high volume of FDI which is a negative relationship in terms up inflow. Petar Kurecic and Filip Kokotovic (Kurecic 2017) proved that no relationship exists between political stability and FDI in small, developed economies and threatened economies. He concluded that political stability is not significant and does not suggest that political stability is supposed to attract the inflow of FDI in developed and large economies.

The rest of control variables such as control of corruption is significant at 5% significance level with negative relationship with FDI as it indicates that an increase in control of corruption will tend to reduce the attraction of FDI into South Asian countries. The result of this research study is the same with research conducted by Ali Al-Sadig who discovered that corruption and FDI are inversely linked in 117 countries. Besides, it is justified that control of corruption is insignificant only in high income countries but significant when high income countries are excluded in the study. The author argued that the existence of control corruption is a negative driver of FDI because it reduces the volume of FDI in focused countries (Al-Sadig 2009).

More to the point, trade openness is significant at 1% significance level with positive relationship with FDI which means that an increase in trade openness will increase FDI in South Asian countries. A relevant research study conducted by Tonia Kandiero and Margaret Chitiga declared a positive and significant relationship between trade openness and FDI in 50 African countries. It is suggested that trade openness encourages more FDI in the focused countries. It is recommended that the relevant countries are supposed to focus on investment tax, wages, and institutional framework besides trade openness (Chitiga 2006). On the other hand, Kunofiwa Tsaurai came up with a different result which shows that there is not long relationship between trade openness and FDI inflow in focused country (Tsaurai 2015).

Finally, government expenditure is not significant even after removing endogeneity through GMM but it has negative relationship with FDI as it was expected. Adina Dornean and Dumitru Cristian Oanea indicated that government expenditure is significant and has got a positive relationship with FDI in central and Eastern European countries which can attract more FDI for the purpose of regaining of economies affected by the crisis (Dornean 2014). Although, it is not significant but still, one can argue that government expenditure tends to reduce the attraction of FDI in South Asian countries due its negative relationship with FDI. It is worth mentioned that the negative sign of government expenditures is important in this study and that is why it is not removed from the regression model. Overall, significant changes brought after running GMM compared to simple OLS such as decreasing the coefficient of control

of corruption and making government expenditures marginally significant.

7. FOCUS ON AFGHANISTAN

Table 9: Vector Autoregression

FDI	Coef.	Std. Err.	Z	P> z
PolStab	1.730415	.9349217	1.85	0.064
ConCorrup	-4.506796	1.090762	-4.13	0.000
TradeGDP	.0533163	.0102191	5.22	0.000
GovExp	.3790205	.1348408	2.81	0.005

Source: Computed from WDI Data via Stata

According to the result of VAR, all the four variables such as Political stability, control of corruption, trade openness and government expenditures are significant at less than 5% significance levels. This test provided that all the independent variables have the expected relationships with FDI except government expenditures. The conclusion from this test states that both macroeconomic and government policies play a significant role in attracting FDI into Afghanistan.

Table 10: Ordinary Least Squared Estimation

OLS Estimation						
Number of Obs: 176						
R-squared = 0.4871						
Adj R-squared = 0.3664						
Prob > F = 0.0000						
FDI	Coef.	Std.Err	T	P> Z	95% Conf Intv	
PolStab	.8579319	.3037126	-2.82	0.012	-1.498709	-.2171545
ConCorrup	-2.97065	1.459726	-2.04	0.058	-6.050403	.109104
TradeGDP	.0060191	.0792272	-0.08	0.940	-.1731739	.1611357
GovExp	.1532902	.1314436	1.17	0.260	-.1240316	.430612
Cons	-4.591681	2.142053	-2.14	0.047	-9.111019	-.0723432

Source: Computed from WDI Data via Stata

Since Afghanistan is one of the South Asian countries, that is why one of the main objectives of this study is to discover the impact of political stability on attracting FDI into Afghanistan. For this purpose, only simple OLS estimation is applied and remarkably, it provided fair results. The political stability as the focused independent variable is significant at 1.2% with positive relationship with FDI attraction which indicates that more political stability will increase the volume of FDI in Afghanistan which is quite the same as in South Asian countries. This result is the same with Huong Giang research findings conducted in Vietnam as it showed that political stability is extremely significant with positive relationship with FDI (Giang 2017). Besides,

Ahmed Berhan Abdella, Navaz Naghavi and Benjamin Chan yin Fah (Abdella 2018) and Michal Madr and Ludek Kouba discovered similar conclusions in the role of political stability in attracting FDI in Brazil, Russia, India, and China (BRIC) countries (Kouba 2015). They claimed that political stability is the major attracting determinant of FDI in BRIC countries. On the other hand, the result of this research paper is not the same with Petar Kurecic and Filip Kokotovic research work who proved that no relationship between political stability and FDI exists in small, developed economies and added that instability threatened economies (Kurecic 2017). It is concluded that political stability is not significant and does not suggest that political stability is supposed to attract the inflow of FDI in developed and large economies.

Moreover, control of corruption is significant at 5.8% significance level with negative coefficient sign which means that more control of corruption will reduce the volume of FDI in Afghanistan. Ali Al-Sadig concluded that corruption and FDI are inversely linked in 117 countries which the result is the same as in this research study, however, it is pointed out that control of corruption is insignificant only in high income countries but significant when high income countries are excluded. The author reasoned that the existence of corruption is a negative driver of FDI because it reduces the volume of FDI in focused countries (Al-Sadig 2009).

On the other hand, government expenditures and trade openness are not significant even at 10% significance level with positive and negative signs. The signs of both insignificant variables are the same as expected in this study. This means that government expenditures and trade openness do not attract the FDI inflow in Afghanistan. On the contrary, Tonia Kandiero and Margaret Chitiga studied the impact of trade openness on FDI in 50 African countries. It is concluded that trade openness encourages more FDI in the focused countries (Chitiga 2006). Finally, government expenditure is not significant in the study of Afghanistan but it has positive relationship with FDI similar to literature review. Adina Dornean and Dumitru Cristian Oanea showed that government expenditure is significant and has got a positive relationship with FDI in central and Eastern European countries (Dornean 2014). Although, government expenditure is not significant but still one can argue that government expenditure tends to increase the attraction of FDI

in Afghanistan due its positive relationship with FDI.

8. CONCLUSION

This study used the panel data analysis for discovering the impact of political stability in South Asian countries (India, Pakistan, Sri Lanka, Bhutan, Nepal, Maldives, and Afghanistan), and meanwhile a time series examination for studying the same issue in a special focus on Afghanistan for the period of 1996-2017. The assigned model is the multiple regression model in the study of both topographies. Various diagnostic tests for ensuring the data fitness and detecting model specification problems are applied such as VIF, autocorrelation, Unit root, and ARDL tests. For estimation purpose, simple OLS and GMM regressions are applied for South Asian countries but for Afghanistan, VAR and simple OLS estimation tests are used in this study.

The findings of this study in South Asian countries showed that political stability and trade openness are significant and have strong positive relationships with FDI but control of corruption is significant with a negative relationship with FDI which these results are similar with existed literature review. On the hand, government expenditures is insignificant but the negative expected sign is important in this study that is why it is not removed. It is suggested by the result of the study that political stability, control of corruption, and total trade openness attract FDI into South Asian countries except government expenditures. Focusing in Afghanistan, results indicated that only political stability and control of corruption are significant and showed positive and negative relationship with FDI respectively which this result is similar with previous literature review. The other two macroeconomic factors are insignificant and both showed positive relationships with FDI which are much different from existed literature review. One can argue that only social and political policies can attract FDI into Afghanistan, not macroeconomic determinants.

9. POLICY RECOMMENDATIONS

Since FDI becomes an important factor for economic development and globalization both in South Asia and Afghanistan, that is why, it is increase will enhance the economic status quo in both regions. As the study suggested that increasing political stability will increase the attraction of FDI in South Asia including

Afghanistan, so the relevant governments of South Asia and Afghanistan are supposed to increase the level of political stability for the purpose attracting FDI and contrariwise, the same regions should avoid any political barriers such as insecurity, violence and terrorist assaults that prevent the desirability of FDI. Besides, the relevant states should adopt policies and strategic mechanisms for conveying political stability into the focused countries.

More to the point, more control of corruption is believed to increase FDI attraction but it is vice versa. Due to strict rules, regulations, and policies toward FDI pull, it is discovered that the increase of control of corruption will decrease the desirability of FDI in South Asia and also in Afghanistan. So it is suggested by the results of the study that so much control of corruption is a problem for FDI attraction. So it is concluded that South Asia and especially Afghanistan are not supposed to completely remove the level of corruption because not much but a little corruption probability helps FDI attraction. This negative correlation is discovered in many previous studies conducted on the same issue.

Next, the increase in trade openness supports the FDI attraction in South Asian countries but it is not true in Afghanistan. It is worth mentioned that South Asian countries should provide facilities and appropriate mechanisms to increase the level of trade openness but Afghanistan is not supposed to do so, as it is suggested by the result of this study.

Finally, government expenditure is not significant both in South Asia and Afghanistan which the findings of this study do not suggest any recommendations toward the increase and decrease of government expenditure but in previous studies, the government expenditure discourages FDI in other research focused studies.

In sum, the governments of all South Asian countries are endorsed to provide and adopt specific policies and mechanisms for increasing political stability, controlling of corruption, and increasing trade openness because these are assumed to be the major FDI inflow influencers as suggested by this study.

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