The Determinants of Foreign Direct Investment Inflow in Afghanistan

MOHAMMAD NAZEEF
(PhD Scholar)
Lecturer at Al-Taqwa Institute of Higher Education

Abstract:- This research conducted for the purpose to explain the association between foreign direct investment and its determinants in Afghanistan. In addition, 21-years data of Afghanistan economic condition was used for this research study and the data period was 2000 to 2020. In addition, linear regression and correlation matrix is used for the statistical analysis in this research and the variables GDP, Inflation, exchange rate, trade openness and terrorism were included in the study as independent variables. Moreover, the foreign direct investment was dependent variable in this model and as results, the variables GDP and trade openness explored strong and positive association with foreign direct investment inflows of Afghanistan. However, the exchange rate and terrorism explored moderate association with foreign direct investment while inflation has weak association with foreign direct investment. And the research study further contributes that the variables GDP, inflation, exchange rate and terrorism were significant to foreign direct investment inflow in Afghanistan while the variable trade openness were insignificant to foreign direct investment inflow in Afghanistan. If we study the previous studies on foreign direct investment with it's determinates in Afghanistan. Hence most of the studies gave the same association with it's determinates as explained FDI mentioned above with some specific variables. The determinants of foreign direct investment inflow in Afghanistan is a versatile topic which can be discuss further more with different variable and different time period which can give a clear and understandable result to the researchers.

Keywords:- *FDI, GDP, Trade Openness, Inflation, Interst Rate, Terrorism.*

I. INTRODUCTION

The main objective of the this rearch study is to investiagte the major determinants of FDI in Afghanistan and to see the association of FDI with its determinants in Afghanistan as well as to test the significance of that major determinants toward FDI in Afghanistan so (FDI) stands for foreign direct investment and FDI is a controlling ownership in a business enterprise in one country by an entity based in another country or foreign direct investment (FDI) is a measure of foreign ownership of productive assets, such as land, mines and factories. Foreign investment is a versatile concept, which is been accepted all over the world. Foreign investment (FDI) is one of the main source of capital inflow and important factor for driving economic growth in many countries as well as foreign direct investment is also plays an important and extraordinary growing role in global business and as well as FDI have a huge and great contribution in the gross domestic products (GDP) of a country. Foreign direct investment takes place when the developing countries need resources and funds to run and begin their projects so for the decision to the foreigner investors in the developing countries provide higher return in their countries and then the investors of developed countries begin investing in that developing country for the purpose to make high return from that markets. However, before investing in that countries the investors first collect information about that development and about some factors, which can shake their investments. Foreigner investors try to invest in that developing country that has a decent infrastructure and encouraging policies, direction and regulation for investments. Foreign direct investment can facilitate a firm or corporation to access to new technology, cheaper production facilities, marketing channels, skills, new products and financing.

The host country firms means which receives the foreign direct Investment and FDI can facilitate them by capital, new products, management Skills, advance technology and as well as foreign direct investment to provide a strong move to economic Development.

Normally there are two modes of investments, financial investment and real investment, financial investment is an investment when an investor buying bonds or shares of a standing corporation and the buying of ongoing plants comes in financial investment, and financial investment will not boost the productive level of the country. But real investment an investment in which they investing in physical stock of capital which results in boosting the productive level of an economy like an investor capitalize in machineries, plants and building, etc.

In addition, there are two types of foreign private investments, foreign direct investment (FDI) and foreign portfolio investment (FPI). But the study just concentrated on FDI, and FDI has additional two categories, first is outward FDI and the second is inward FDI. Outward FDI based on direct investment in abroad and inward FDI based on the investment receive in host countries from other countries. For making safe the local companies government facilitate some subsidies to local firm, which construct a little problem for foreigner investors (outward FDI), but on the other side there are some economic determinates which inspire the outward FDI.

Many studies explored understanding proof that FDI exerts positive impact on growth. To boost the level of FDI, liberalization of trade and investment regime by comforting controls and offering spectacular and great incentives to foreign investors, such as tariff minimization and tax concessions, or exemptions and subsides for infrastructure is needed. Such policies have been helpful in accelerating FDI inflows to developing countries like Afghanistan. The domestic rule and policies opted by the host countries have a essential and critical impact on the decisions of foreign investment. To boost FDI, the recipient country should develop great and investor friendly policies and strong infrastructure and stable environment are the pre-requisite to restore the confidence of foreign investors.

Political factors show the stability of the governmental policies that are directly been connected to stable political environment. Instable political environment, along with common changes in the ruling system point out inconsistencies in governance and reflecting possible negative effect on business activities in the host country. Such uncertainties affect the performance and sustainability of governmental, contracts, and decisions

According Graham, (1982) foreign direct investment is the basis of acquisition by which a foreigner enterprise can take managerial control on a business of a host country. The fundamental benefit of FDI is to create opportunities and developed the growth in host country (Collins et. Al, 1999). The World Bank, (2006) announced that more than 60% of private investment flows is going toward developing countries.

In 2003, the United Nations Conference on Trade and Development explain in their report that the FDI inflow decreased by 17.5 % as compared to preceding year. (Hanif, 2001). They were just 40% of the FDI in 2000. Nevertheless, later due to some mergers and acquisitions across the border and economic growth, FDI also grew. Then in 2004 the FDI situation shown a little improvement and then in 2006 and 2007 the FDI reached to the highest point of 1411 and 1833 Billion $ (UNCTAD, 2008).

And in Afghanistan previous two decades have seen mixed trends of FDI in Afghanistan. Afghanistan has obtained very little FDI during 1990 because of debt dependency (Ghumro and Hukro, 2007).But after 1990 the FDI increased from 322million in 2000-2001 to 3.52billion in 2005-2006. Moreover, in 2007 the FDI in other developing countries represent 7.5% capital inflow of total GDP of those countries. In addition, at that time FDI in Afghanistan only represent 4% capital inflow of total GDP that later again fall in 2009 and again increased after some time. These fluctuations in FDI came because of some determinants and factors of FDI in Afghanistan. Nowadays terrorism is the most significant determinant toward that ups and down of FDI in Afghanistan and other factors can be trade openness, interest rate, inflation, market size, GDP, domestic investment and tax etc. which can impact the inflow of FDI in Afghanistan.

Problem Statment:

The foreign direct investment plays an important role and contributes in a large amount in GDP. Most of the time the FDI has seen in developing countries and Afghanistan is also one of developing country in the world. Moreover, the problem behind this research study was to identify and analyze the major determinants of FDI and to test the statistical association between FDI and its major factors in Afghanistan.

The significance of this study is that it has some contribution to existing knowledge about foreign direct investment and its major determinants in Afghanistan, which can help and facilitate the researchers, local firms, foreign investors, and the people who are interested to know about foreign direct investment and its factors in Afghanistan. Foreigner investors can use it for their investment decisions in Afghanistan because the results is completely base on the real data of Afghanistan and researchers can use it as literature in their researches

II. LITERATURE REVIEW

Azam (2010) also studied the association of economic factors with FDI in Turkmenistan, Kyrgyz Republic and Armenia. In addition, OLS method was used on data for statistical analysis for the year 1991-2009 and the variables development assistance, inflation, and market size were included in the model. And showed that variables market size and official development assistance were positively associated with foreign direct investment inflows in that specific countries while the variable inflation was negative associated with foreign direct investment explained that the inflation discourage the foreign direct investment inflows in that specific countries.

Shenand Hsiao (2003) also explained the association between foreign direct investment and gross domestic product and as results; they explained that two-way association exist amongst foreign direct investment and GDP.

Hooda (2009) investigated a study to identify the major factors of foreign direct investment in Indian economy. And as results he explained some major factors of foreign direct investment like exchange rate, labor cost, inflation, political stability, interest rate, corporate taxes and infrastructure were the major factors of foreign direct investment in Indian economy.

Yuqing (2004) conducted a study on the association between exchange rate and foreign direct investment in China and he explained that exchange rate was high associated with foreign direct investment in China.

Manop Undom Kerdmondkol (2006) also conducted a study to investigate the association between exchange rate and foreign direct investment inflow. In addition, the result showed negative association of exchange rate with foreign direct investment inflow. It means that when there is devaluation in currency then foreign direct investment inflow rises and when there is appreciation in currency value then foreign direct investment inflow decrease.

Tettey and Coleman (2008) conducted a study on the association of exchange rate and foreign direct investment inflow in a country. Moreover, the results showed that exchange rate is negative associated with foreign direct investment inflow. It indicated that overvalued currency will cause to decrease the inflow of foreign direct investment in a country.

Khan and Nawaz (2010) used the OLS technique for analysis using the data from the year 1971 to 2005. They conducted a study on the top most economical factors that can affect the foreign direct investment in Pakistan. In their findings, their top most factors that an affect foreign direct investment were export of goods, exchange rate, wholesale price index, market size and custom duty on imports. According to their results, all variables were found to be positively correlated with foreign direct investment but exchange rate was negatively correlated with foreign direct investment in Pakistan.

Another study was conducted on the same topic is the study of Rehman et al (2011). They too studied the effect of key factors on foreign direct investment in Pakistan. Their results showed that the key factors that affect foreign direct investment in Pakistan were exchange rate, infrastructure and market size. The time-series selection for their data was from 1975 to 2008. It almost the same time series as Reman et al (2011) but their methods of analysis were different. They used ECM and ARDL methods their data analysis and their results showed that the factors market size and infrastructure were positive correlated with FDI and found statistically significant to the inflow of foreign direct investment. This is exactly the replica of the study of Rehman et al (2011) but one thing is different in this study and that is the exchange rate that found negative correlated with foreign direct investment but it is significant not only in short run but in the long run as well.

Market size is the most important determinant for foreign direct investment inflow (Mughal and Akram2011). They used the data from 1984 until 2008 and their methods of analysis were ECM and ARDL for their data analysis. And they found that market size is highly significant and positively correlated to foreign direct investment inflow while the exchange rate found significant but negatively correlated with foreign direct investment inflow but corporate tax has very low impact on foreign direct investment inflow in Pakistan.

Afza and anwar (2013) conducted a research study investigate the association of foreign direct investment with its effecting factors in Pakistan using the data over from the year period of 1980-2010. And investigated variables were electricity generation, GDP, exchange rate, inflation, political stability, trade openness, the cost of war against terrorism and incentives offered to investors.

Anwar et al. (2013) conducted a research to find the association between foreign direct investment inflow and its causing factors. Using the data for the period of the first decade of 21st century(2000-2010) of the agricultural sector of Pakistan found the factors that impact the foreign direct investment inflow were the size of the market, trade openness, debts of the government, inflation and exchange rate. They used OLS regression method for their research analysis and found that the size of the market and trade openness is the factors, which were significantly been correlated with inflows of foreign direct investment. They argued that government debts are significant but it has been negatively correlated with inflow of foreign direct investment. They concluded that the variables exchange rate and inflation are insignificant to foreign direct investment inflow in agricultural sector of Pakistan.

Awan (2010) investigated the association of inflation with foreign direct investment during the period of year 1971 to 2008. And he explored a positive and significant association amongst inflation and foreign direct investment in Pakistan.

Pardeep et al. (2011) explored a study to investigate the association of foreign direct investment with its factors that were included in research as independent variables are inflation, literacy, GDP, unemployment and per capita income. Moreover, the variable GDP found significant and positive associated with foreign direct investment in Pakistan.

Hafeez and sattar (2012) studied the association of foreign direct investment with its effecting factors. In addition, the determinants that investigate dare exchange rate, GDP and inflation and he showed a long-term association amongst the exchange rate and foreign direct investment in Pakistan.

Williams and Wint (2002) studied the association amongst inflation and foreign direct investment in Pakistan. In addition, they showed a significant association amongst inflation and foreign direct investment in Pakistan. Moreover, they further argued that stable economies boost the foreign direct investment inflow and the low inflation economy is an ideal environment for foreign direct investment inflow.

Omankhanlen (2011) investigated the association of foreign direct investment with exchange rate and inflation. And he explored a significant impact of exchange rate on foreign direct investment while inflation had a negligible impact on foreign direct investment in Pakistan.

Shumaila et al. (2012) also investigated the association of foreign direct investment with export inflation in Pakistan. And the both variables inflation and export found significant and positively associated with foreign direct investment in Pakistan.

Sadaf et al. (2013) investigated a study to identify the association of foreign direct investment with its determinants economic growth and inflation in Pakistan. And inflation found as significant and positive correlated with economic growth while GDP found as significant but negative correlated with economic growth in Pakistan.

Stein and Froot (1991) explored the association between foreign direct investment and exchange rate in Pakistan and they found a significant negative association of exchange rate with foreign direct investment. It means the depreciation in host country currency boost the foreign direct investment.

Rashid and Hafeez (2012) investigated a research to evaluate the association amongst foreign direct investment and exchange rate in Pakistan. In addition, as results they suggest a significant association amongst exchange rate and foreign direct investment in long run in Pakistan.

Hypothesis development:

The past empirical studies and literature found and investigate the number of factors of foreign direct investment in Afghanistan and different researchers have different views about those factors association with foreign direct investment and some factors are more repeated in past studies. Therefore, the main objective of this research is to investigate and explore those factors that are the main determinants of the foreign direct investment but not much repeated in past studies and those factors are:

Gross Domestic Product (GDP):

The first independent variables were gross domestic product and most of the studies especially in Afghanistan explore that there is significant impact of GDP on foreign direct investment because the GDP is a common determinant that boost the foreign direct investment in host country throughout the world. And foreign direct investment is work as force for economic growth of the concern country because the maximum inflow of foreign direct investment always increases in economic growth (Pardeep et al, 2011).

H_1: there is a significant impact of gross domestic product on foreign direct investment in Afghanistan.

Inflation:

Another independent variable is inflation and most of the researchers explore that there is a significant impact of inflation and foreign direct investment and some where it explores negative correlated with foreign direct investment. However, in Afghanistan inflation has a significant impact on foreign direct investment inflow, because the foreigner investors will face low cost if the inflation increase (Anwar et al, 2013).

H_2: there is a significant impact of inflation on foreign direct investment in Afghanistan.

Exchange Rate:

Another independent variable is exchange rate. And most of the previous researchers investigated that exchange rate is negative impact with foreign direct investment inflow in short run as well as in long run. Because when the host country's currency is appreciating then it creates a problem for foreign investor in case of payment in different currencies (Anwar et al, 2013).

H_3: there is a negative impact of exchange rate and foreign direct investment inflow in Afghanistan.

Trade Openness:

The next independent variable is trade openness and many researches especially in Afghanistan have explored that there is significant impact of trade openness and foreign direct investment. The trade openness is one of the main determinant that boost foreign direct investment in host country and throughout the world and foreign direct investment is work as force for economic growth of the concern country the maximum inflow of foreign direct investment always increases in economic growth (Afzal and anwar, 2013).

H_4: there is a significant impact of trade openness on foreign direct investment in Afghanistan.

Terrorism:

The last independent variable was terrorism and the previous researchers investigated that terrorism has a negative impact on foreign direct investment inflow. Because when terrorism increases the foreign direct investment inflow decrease and in case of Afghanistan the terrorism has a negative impact on foreign direct investment inflow (Afzal and anwar, 2013).

H_5: there is a negative impact of between terrorism and FDI inflow in Afghanistan.

III. METHODOLOGY

This study identifies those major factors of foreign direct investment that have impact on foreign direct investment inflow in Afghanistan. Some variables of them are the portion of this study and this study is being based on the impact of foreign direct investment with its effecting factors and to know that the predictor variables are significant to foreign direct investment inflow or not.

There are five independent variables and one dependent variable in this study. And this study based on a sample of 21-year data from the period of 2000 to 2020 of Afghanistan economy. The independent variables are GDP, trade openness, inflation, exchange rate and terrorism and dependent variable is foreign direct investment inflow.

The correlation matrix for to find the association between dependent and independent variable and The linear regression was used for to check the significance of the predictor variables.

Research model:

$$FDI = a + \beta_1 GDP + \beta_2\ IF + \beta_3\ EXR + \beta_4\ TO + \beta_5 TER + e$$

Where:

FDI = Foreign Direct Investment Inflow, GDP = Gross Domestic Product, INF = Inflation,

EXR = Exchange Rate, TO = Trade Openness TER = Terrorism, e= Error Term

IV. ANALYSIS, AND FINDINGS

Correlations Analysis

		FDI	GDP	Inflation	Exchange Rate	Trade openness	Terrorism
FDI	Pearson Correlation	1	.826**	.401	.556**	.623	.541*
	Sig. (2-tailed)		.000	.072	.009	.010	.011
	N	21	21	21	21	21	21
GDP	Pearson Correlation	.826**	1	.399	.869**	-.289	.837**
	Sig. (2-tailed)	.000		.073	.000	.203	.000
	N	21	21	21	21	21	21
Inflation	Pearson Correlation	.401	.399	1	.037	.486*	.576**
	Sig. (2-tailed)	.072	.073		.874	.026	.006
	N	21	21	21	21	21	21
Exchange Rate	Pearson Correlation	.556**	.869**	.037	1	-.630**	.711**
	Sig. (2-tailed)	.009	.000	.874		.002	.000
	N	21	21	21	21	21	21
Trade openness	Pearson Correlation	.623	-.289	.486*	-.630**	1	-.176
	Sig. (2-tailed)	.010	.203	.026	.002		.446
	N	21	21	21	21	21	21
Terrorism	Pearson Correlation	.541*	.837**	.576**	.711**	-.176	1
	Sig. (2-tailed)	.011	.000	.006	.000	.446	
	N	21	21	21	21	21	21

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

The above Correlation table show the association of foreign direct investment inflows with its predictor variables. So the variables GDP and trade openness are positive and strong correlated with foreign direct investment inflow. While the variable terrorism and exchange rate shown a moderate positive correlation with foreign direct investment but the variable inflation shown weak positive correlation with foreign direct investment. Therefore, the result found that these variables boost or encourage the foreign direct investment inflow in Afghanistan. Because the variables GDP and trade with values of 82.6% and 62.3 respectively, show high degree of association with FDI inflow. while the variable terrorism and exchange rate showed a moderate relationship with FDI inflow with the values of 54.1% and 55.6% degree of association but the variable inflation showed a weak relation with FDI with the value of 40.1%.

Regression analysis

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0.939[a]	0.882	0.843	0.66251	1.91

The above result found that there is 93.9% relationship between independent and dependent variables and as far as the rule of thumb is concern for R, the above relationship is high. Because as per rule of thumb when the value is above than 50% then the relationship is strong, so as in our result the relationship between variables are strong because 88.2% of the variation explained by the predictor variables. Overall, a good percent of variation has been explained, as there is only 11.8% of the variation remains unexplained.

This remaining 11.8% of the variation is due to those factors (error term) which have not been included in this study. Durbin-Watson test has been used to detect the problem of autocorrelation.

The value of Durbin-Watson is 1.91 shows that there is some positive autocorrelation exist but this value is very near to no Autocorrelation value that is 2. So it can be said that this model is free from autocorrelation problem.

ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	49.332	5	9.866	22.479	0.000[b]
Residual	6.584	15	.439		
Total	55.916	20			

a. Dependent variable: FDI
b. Independent variable: GDP, Inflation, Exchange rate, Trade openness, Terrorism

The above ANOVA table result explored that the p value is 0.00 which is less than 0.01 which indicate that model as a whole is significant.

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.192	1.088		-1.095	0.291
GDP	0.065	0.013	1.748	5.158	0.000
Inflation	0.012	0.064	-0.030	-.180	0.060
Exchange Rate	-0.078	0.027	-0.866	-2.880	0.011
Trade Openness	0.027	0.032	0.251	.853	0.407
Terrorism	-2.605	3.500	-0.460	-2.173	0.046

Above regression table found that if there is no change occur in all independent variables means that if (predictor variables= 0), the FDI will decrease by 1.192 Billion Dollars. As far as predictor variables are concern, the result showed if one unit change in gross domestic product will increase the FDI by 0.065 Billion Dollars and this change is significant at 0.00%. Further this study accepts the H_1 which was there is significant impact of gross domestic product on foreign direct investment.

One percent change in inflation will increase the FDI by 0.012 Billion dollars and this change is significant at 10.0%. Hence our study accepts the H_2 which was there is significant impact of inflation on foreign direct investment.

One unit change(one Afghani rupee to US dollar increase) in Exchange Rate will decrease the FDI by -0.078 Billion Dollars and this change is significant at 0.50%.subsequently our study accepts the H_3 which was there is significant impact of exchange rate on foreign direct investment.

Trade openness is insignificant at 10.0%. The current study reject the H_4 which was there is significant impact of Exchange rate on foreign direct investment.

One attack of Terrorism will decrease the FDI by -2.605 Billion Dollar and this change is significant at 0.50%. The result accept the H_5 which was there is significant impact of Terrorism on foreign direct investment.

The standardized beta column shows that GDP is the most leading factor that affects the foreign direct investment positively as the value of GDP is 1.748. Other factor that affects the foreign direct investment positively in Afghanistan is its trade openness which value is 0.251. Exchange rate is the least factor that affects FDI in Afghanistan according to above data while terrorism is the second least factor. Both values are -0.86 and -0.460 respectively.

V. CONCLUSION

The research is based on association of foreign direct investment inflows with its factors and the past researches explained many factors that can affect the inflow positively as well as negatively but this research just contain a few factors of foreign direct investment in model. FDI is the dependent variable, the determinants GDP, inflation, exchange rate, Trade openness and terrorism are independent variable in the model, the sample data is used for analysis in this research from year 2000 to 2020 of Afghanistan economy. The correlation matrix and linear regression model are used as statistical tools in this research and the purpose of this study was to explore the association of foreign direct investment with its determinants and to investigate that these factors are statistically significant to foreign direct investment inflow or not. and as the results of correlation matrix and linear regression the research suggest that the variables GDP, and Trade openness were strongly correlated with foreign direct investment inflow in Afghanistan and the two variables exchange rate and terrorism were moderate correlated with FDI and the variable inflation is weakly correlate with foreign direct investment in Afghanistan.

The variables GDP, Inflation, Exchange rate and terrorism were found as significant to foreign direct investment in Afghanistan and the variable Trade openness were found insignificant with foreign direct investment in Afghanistan.

The Research explored that the variables GDP, and trade openness found highly associated to foreign direct investment but Inflation have weak Correlation with FDI and found significant.

Therefore, the variables GDP, inflation and trade openness contribute with a high percentage and the remaining variable Exchange rate and Terrorism have negligible impact on foreign direct investment.

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