The Mediator Role of FDI in North Africa: Case of Egypt

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Abstract—The main purpose of this paper is to examine the various factors that attract Foreign Direct Investment (FDI) in North Africa countries, in order to find answers to the following question: What are the determinants / impediments of FDI inflow to North Africa countries? The study investigates the relationship between FDI and the economic growth in the North African countries, covering the period 1961-2012. Results from the analysis suggest that FDI is explained by some economic determinants but has non-significant effect on GDP growth. The study also investigates FDI Behavior in Egypt and explaining this behavior.

Index Terms—foreign direct investment, economic growth, North Africa, Egyptian FDI behavior

I. INTRODUCTION

Although, it is rolling among economists that Foreign Direct Investment (FDI) positively affect economic growth, but they did not specify who benefit more home country or host country?[1] As a result an empirical finding was misleading sometimes. Also there is no general consensus among the economists on the determinants of FDI. Through this theoretical controversy there are three questions dominating the FDI literature 1. Why FDI inflow is biased towards only to a few countries? 2. What are the determinants of FDI inflow? 3. What is an Impact of FDI on economic growth? Thus, Study Objectives are: 1. Identify the most important determinants of FDI inflow. 2. Solve the controversy over the impact of foreign investment on the growth of the host country. 3. Study Egyptian FDI behavior Case. Our study hypotheses

H1: countries with large size of GDP are attracting FDI more than other countries

H2: Countries with business friendly environment are attracting FDI more than other countries

H3: FDI positively affects the GDP growth rate

The study will be organized in three sections as follows: First: Theoretical and Literature Review of the determinants of FDI inflow and Impact of FDI on economic growth. Second: Analyze FDI inflow position in Egyptian Economy. Third: Comparison study between North African countries on the most effective determinants of FDI inflow and Impact of FDI on economic growth. Finally, results and recommendations.

II. FDI DETERMINANTS LITERATURE REVIEW

The Economic literatures have discussed and identify the determinants and impacts of FDI. Some economists adopt the idea that foreign direct investment (FDI) produces economic benefits to the host countries by providing capital, advanced technology, competition and access to foreign markets. Also, FDI can enhance domestic investment and innovation (Brooks and Sumulong, 2003). Thus, developing countries use FDI as treatment of savings-investment mystery. Most of developing countries has low savings rate, which lead to low investment rate and therefore, low per capita income growth rate, may escape from this trap by importing capital from abroad in the form of foreign direct investment (Hayami, 2001). The others adopt the idea that foreign direct investment (FDI) produces economic benefits to the mother countries more than host countries by using the cheap resources and labor also enjoy the investment incentives provided by host countries without providing real help to support the development process. In the same time, there is a recent study shows that FDI has positive effects on developing countries economy because: 1. FDI provides capitals needed for developing countries and prevent undesirable effects associated with other forms of capital flows. 2. FDI doesn't provide only necessary funding to developing countries, but also the modern technology and most effective management techniques. 3. FDI is stable funding methods compared with other funding methods such as hot money transfer and Stock market investments.

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In fact, most of the developing countries are competing with each other to attract reasonable amount of FDI by adopting different attraction policies, such as liberalizing trade system, offering incentives to the foreign investors and establishing special economic zones (Ruffin, 1993). Some other economists interpret FDI determinants divided to two schools

First: FDI Determinants from stand point of microeconomics, which explain the company motivation to access foreign markets. This school has some assumptions: 1. Companies aim is maximizing profits, it means that FDI is a function in return on investment between different countries, which was prevails in the fifties [2]. 2. There is a negative relationship between FDI and political risk degree [3]. 3. There is a positive relationship between FDI and foreign trade volume [4]. 4. There is a positive relation between FDI and investment incentives, small businesses has a positive relation more than large companies which have more experience in developing countries markets [5]. 5. There is a positive relation between FDI and the cost of labor wages, the study proved that the low cost of labor is the most important determinants attracting FDI to Taiwan [6].

Second: FDI Determinants from standpoint of macroeconomic, which explain the overall characteristics of the receiving countries to invest. Which represent factors attract the FDI flow into country or factors push domestic investment to be foreign direct investment another country. There are many studies such as (Akhtar 1993, Asiedu 2002, Dbwona 2001, Collier and Pattillo 2000) has been identify the most important determinants for attracting FDI in (Infrastructure-market size-human capital-proximity to major markets-the degree of openness to the outside world-exchange rate-tax incentives-political stability-monetary policy, investment environment, regulatory framework, bureaucratic hurdles and red tape, judicial transparency, and the extent of corruption in the host country). Wheeler and Mody, found that political risk and administrative efficiency are insignificant in determining FDI [7]. While Root and Ahmed found that political strikes and riots and regular constitutional changes in government significantly determine FDI inflow [8]. The mixed result might stems from the problems of getting reliable proxies for the qualitative phenomena, such as political instability [9] and International Business Cycle Movement [10]. Other study by Bhattacharya, Montiel, Sharma has proven that the rate of market growth measured by the rate of growth of GDP is the most important factors determinants in attracting FDI in sub-Saharan [11]. While Mbekeani Support standpoint that the market size presented by the Growth Domestic Product-itself-is the most influential factor [12]. Another study by Bende-Nabende divide the determinants into four types: The first is linked to cost side, The second is linked to improvement of the investment and business environment, The third is linked to the level of macroeconomic variables, The fourth is linked to development strategy pursued by governments [13].

III. FDI EFFECTS LITERATURE REVIEW

On the other side, there are several studies addressed the impact of FDI on the economic growth.

First, studies those find a positive unconditional effect for FDI on growth. Such as Bashir, A.M., test the degree of association between FDI and economic growth in a sample of six Middle East and North Africa countries. Explain that FDI has a positive relation with economic growth, where FDI leads to economic growth [14], Gao tests the effect of FDI on income growth. The study finds that in all cases, FDI has a positive statistically significant coefficient [13]. Obwana (1996) explores that FDI had a positive impact on Uganda's growth, although the FDI coefficient was insignificant. Lensink and Morrissey, contribute to the literature on FDI and economic growth by introducing measures of the volatility of FDI inflows. They find that while FDI has a positive effect on growth, the volatility of FDI has a negative impact. Another important finding of the study is that the evidence on the positive effect of FDI on output growth in the recipient country is not conditional on any other explanatory variable [15].

Second, studies that find an ambiguous role for FDI alone on economic growth, but find that FDI when combined with other conditions like a minimum level of human development, financial market development, etc. contributes positively to growth. Such as Carkovic and Levine [16], examine the relationship between FDI and growth based on World Bank and IMF datasets; they find that FDI inflows do not exert an independent robust positive influence on economic growth. They show that while sound economic policies may encourage output growth and FDI, FDI does not have a positive impact on output growth that is independent of other growth determinants. Lipsey surveys the most important economic empirical literature on the effects of FDI, and determines that the studies of the effects of FDI inflows on national economic growth are inconclusive. Almost all studies find positive effects in some periods or among some groups of countries, in some specifications, with some controlling variables, but these effects cannot be universal as there are circumstances, periods and countries where FDI has insignificant relation with output growth [17].

IV. THE MODEL

To examine Hypotheses (H1& H2) we assumed that countries with large size of GDP and with business friendly environment are more likely to be successful in attracting FDI compared to other countries. The variables which represent business friendly environment was High Industry value added, large size of trade, more International relations openness, High national reserves, low Inflation rate, Large Government Expenditure, Labor force. The following equation will be estimated:

 $ln (FDI) = \beta 0 + \beta 1 ln(GDP) + \beta 2 INV + \beta 3 Tr + \beta 4$ ln(Opene) + \beta 5 Inf+\beta 6 ln(Reserve)+ \beta 7 ln(GE)+ \beta 8 Empit + \beta (1) To examine Hypotheses (H3) we assumed that countries with large volume if FDI will have positive affects the GDP growth rate. The following equation will be estimated:

$$GDPg = b0 + b1 \ln(FDI) + \mathcal{E}$$
(2)

With this model we examine North Africa countries excluding Libya Because Libya passed through political pressure and international embargo which have uneconomic reasons affecting FDI Inflow. We will examine Egypt, Tunisia, Algeria and Morocco economic data. The Fig. 1 shows it in detail shows it in detail.



Figure 1. Dependent variable LnFDI.

V. METHODOLOGY

In order to validate our conceptual model, a data base was prepared and spreads over 50 years (from 1961 to 2012). This data base was collected from UNCTAD FDI Inflows data base and World Bank Data (WDI) [18] and concerns four countries of the North Africa which are Egypt, Tunisia, Morocco and Algeria. We used multiple linear regressions to test the relationship with a statistic confidence level of up to 10%.

VI. DATA ANALYSIS

As a first part of our analysis, we exhibit the main factors that attract FDI in each country (Egypt, Tunisia, Morocco and Algeria) by using multiple regressions which test the effects of a multiple independent variables on one dependent variable. The following table shows the outputs for each country with their beta (weight effect) and their statistical significances (see Table I).

In Table I, it presents the estimated regression models explaining the determinants of FDI. Random effect estimation process has applied for the estimation purpose. To identify the determinants of FDI for studied countries, variables are included in a multiple regression model.

The model consists of the following variables: natural log of GDP, Industry value added, Trade, natural log of openness, natural log of reserves, and natural log of General government expenditure, Employment to population ratio, 15+, and Inflation. As shown in the above table, variables that have effects on FDI differ from one country to another.

Thus, concerning Egypt, the main variables those attract more the FDI are, with an order of importance, GDP, economic openness, General Government expenditure and Employment with R^2 of 66%. For Tunisia the main variables those attract more the FDI are,

with an order of importance, GDP, economic openness and inflation are the main factors that explain FDI by 55%. The third country which is Morocco the FDI is attracted mainly, with an order of importance, by economic openness, General Government expenditure, Industry value added and Employment. The variation rate is about 46%. Finally, concerning Algeria, the main variables those attract more the FDI are, with an order of importance, Inflation, GDP, economic openness and Trade explained the attraction of FDI by a variation of 56%.

TABLE I. DEPENDENT VARIABLE LNFDI

Independen t variables	Egypt	Tunisi a	Morocc o	Algeri a
LnGDP	1,912* *	4,519* **	0,997	1,672*
Industry, value added (% of GDP)	0,244	0,192	0,309** *	0,319
Trade (% of GDP)	0,140	0,465	0,028	0,048* **
LnOpen	1,462* *	4,048*	3,019** *	0,219* **
Inflation, consumer prices (annual %)	-0,084	- 0,426*	-0,096	2,055*
LnReserv	0,302	0,351	0,085	0,179
LnGE	0,741*	1,121	1,789** *	0,129
Employmen t to population ratio, total (%)	0,241* **	0,021	0,271**	1,672
The R square test	0,658*	0,555*	0,463*	0,564*

*Significant at 0,01 **significant at 0,05 ***significant at

On the other hand and following a horizontal reading of the results, we found that all the independent variables used in our study explain averagely the attraction of FDI in the four countries with a rate slightly loud in Egypt.

As a second part of our analysis, we show the result of the effect of the FDI on the growth of the GDP as presented in the Table II.

TABLE II. INDEPENDENT VARIABLE LNFDI

Dependent variable	Egypt	Tunisia	Morocco	Algeria
GDPg	-,039	,05	,032	0,078
The R square	0,002	0,003	0,001	0,006

*Significant at 0,01 **significant at 0,05 ***significant at 0,10

Thus, the outputs confirmed that the FDI has very weak and non-significant effect on GDP growth. This means that the FDI doesn't contribute to the economy growth for the all four countries.

VII. WHERE FDI INFLOW GOES?

After reviewing literature review of FDI determinants and its impact on economic growth, we must study the direction of FDI inflow which gives us an idea about FDI behavior and direction of the flow towards to developed and developing countries and countries of transition economy according to continents also (see Fig. 2).



Figure 2. FDI inflows to developed, developing & transition economies.

According to UNCTAD reports [19]. In 2000 total FDI inflow in the world was 1413 billion USD, of which developed countries received 80.8% of the total FDI inflow in the world, whereas in the same year developing countries received 18.8% of the total FDI inflow in the world and countries in transition economies received 0.5% of the total FDI inflow in the world. Thus, developing countries and countries in transition economies are dominated by the developed countries in attracting FDI. But in 2012 case has been changed, the total FDI inflow in the world was 1350 billion USD, of which developed countries received 41.5% of the total FDI inflow in the world, whereas in the same year developing countries received 52.1% of the total FDI inflow in the world and countries in transition economies received 6.4% of the total FDI inflow in the world.

If we got a sample 80 countries are divided into two groups based on the amount of FDI they have received. First group consists of top 40 FDI recipient countries and second group consists of 40 low FDI countries. We found uneven pattern of FDI inflow into the world.

Among the top 40 FDI recipient countries, in 1991 there are two countries from Africa, 13 countries from Asia, 16 countries from Europe, 3 countries from north America, one country from Australia, 4 countries from Latin America and one country from Oceania. Where represent 21 countries from developed economies, 19countries from Developing economies and nothing from Transition economies. In 2007 there is one country from Africa, 12 countries from Asia, 18 countries from Europe, 3 countries from north America, one country from Australia and 5 countries from Latin America. Where represent 21 countries from developed economies, 16countries from developing economies and 3 countries from Transition economies. in 2012 there is one countries from Africa, 13 countries from Asia, 16 countries from Europe, 3 countries from north America, one country

from Australia and 6 countries from Latin America. Where represent 17 countries from developed economies, 20countries from developing economies and 3 countries from Transition economies.

Among the last 40 FDI recipient countries, In 1991 there are 22 countries from Africa, 8 countries from Asia, 4 countries from Latin America, 6 countries from Oceania and nothing from Europe. North America or Australia. Where represent 40 countries from developing economies but nothing from developed economies or transition economies. In 2007 there are 17 countries from Africa, 6 countries from Asia, 5 countries from Latin America, 12 countries from Oceania and nothing from Europe, North America or Australia. Where represent 40 countries from developing economies but nothing from developed economies or transition economies. In 2012 there are 13 countries from Africa, 5 countries from Asia, 11 countries from Latin America, 11 countries from Oceania and nothing from Europe, North America or Australia. Where represent 40 countries from developing economies but nothing from developed economies or transition economies.

VIII. FDI BEHAVIOR IN EGYPT

Egypt was chosen as a case study because it has a significant increase in FDI Inflow during the past period, followed by a significant deterioration. According to UNCTAD reports, FDI inflows to Egypt economy fluctuated between some hundreds of US\$ millions and one thousands of US\$ millions till 2003 it start to increase to reach 12 US\$ billion in 2007 then FDI inflows declaim to be negative in 2011 (see Fig. 3).



Figure 3. Egypt FDI inflows.

In this research, we will focus on Egypt FDI between 1990 and 2012 with special consideration on last five years (Fig. 4 and Fig. 5)



Although Egypt has made many efforts to attract FDI to Egypt since the mid-nineties, the low flows of FDI in the 90s were mainly due to two factors (see Fig. 4):

First, the lack of professionalism promotion of FDI in Egypt due to absence of political and economic vision which cause lack of a secure environment to FDI which led to decrease the flow of FDI to Egypt, especially with global competition to attract FDI.

Second, decrease the government spending due to Economic Reform and Structural Adjustment Program (ERSAP) launched in 1991. Plus adverse shocks in the second half of the 90s such as Luxor massacre 1997 and East Asian economic crisis in 1997-1998, result a modest FDI flows.



Figure 5. Egypt FDI inflows from 2000 to 2012.

As shown in Fig. 5, FDI flows to Egypt fluctuated during the period from 2000 until 2010, when new cabinet appointed in 2003, FDI inflows to Egypt was decreasing to reach US\$ 237.4 million, which is the lowest amount since 70s. If we took a depth look, we found that ascent of FDI to Egypt started in 2004, and continued uninterruptedly until reaching its peak in 2007, not just for improving investment climate but as a result of large privatizations and mergers and acquisitions of public enterprises. Then situation changed in 2008, FDI inflows to Egypt fell uninterruptedly to reach US\$ 6.38 billion, while 2009 had biggest decline in FDI to reach US\$ 6 billion as a result of negative effects of global financial crisis, in 2011, due to political uncertainty, unprecedented security challenges and widespread labor protests that accompanied the January 25 Revolution have interrupted the trend of FDI inflows to Egypt, which made a negative inflow to reach US\$ -482.7 million, but in 2012 the inflow soared to 2.8 billion due to the Qatar political support.

By studying the structure of FDI inflow to Egypt, found that since 2007 to 2012 (see Fig. 6), FDI flows into Egypt have been diversified and distributed in different industries such as Petroleum and natural gas extraction and related activities accounted for 58.32% of total FDI inflows. Financial services have managed to attract sizeable amounts of FDI Inflow, approximately 8.08% of the total over the same period, mainly as a result of large privatizations and mergers and acquisitions. Communications & IT, which soared from 5.67% in 2009 to 11.82% in 2012 with average of 5.43% of total FDI inflow during the period. Manufacturing which dropped from 8.64% in 2009 to 6.23% in 2012 with

average of 7.13% of total FDI inflow during the period. Agriculture fluctuated from 0.23% in 2007 and 2.38% in 2010 to 0.69% in 2012 with average of 0.79% of total FDI inflow during the period. Construction fluctuated from 0.46% in 2007 and 2.38% in 2008 to 1.08% in 2012 with average of 1.64% of total FDI inflow during the period. Real estate fluctuated from 0.30% in 2007 and 2.77% in 2010 to 0.73% in 2012 with average of 1.44% of total FDI inflow during the period. Tourism, dropped from 3.28% in 2007 to 0.35% in 2012 with average of 1.57% of total FDI inflow during the period. Other services which soared from 2% in 2007 to 3.95% in 2012 with average of 3.32% of total FDI inflow during the period. Undistributed, fluctuated from 15.8% in 2007 and 21.95% in 2008 to 4.88% in 2010 then soared to 13% in 2012 with average of 12.28% of total FDI inflow during the period.



Figure 6. Distribution of inward FDI flows, by industry, 2007-2012.

However, following the global trend, high value-added activities such as manufacturing, financial services, construction and real estate were hit hard by the international financial crisis in 2008. Consequently, not only has there been a decrease in the absolute amount of FDI inflows attracted by these industries but also in their relative shares.

We must distinguish between two types of FDI in terms of easy escape in case of political and economic unrest. The first type is the investment that works in service areas and other investments which can be liquidated or temporarily frozen. The second type is the heavy investment, which cannot be filtered or frozen easily, such as investments in the industrial production sectors, agricultural, hotel or real estate sector, these investments does not have a choice except to stay in the market until conditions improve It is noted that investment tends trend toward service activities with increased instability forecasting, which is what happened in Egypt since 2007.

IX. CONCLUSIONS

In this paper we attempted to explain the results obtained in the empirical literature on FDI's determinants and effect on growth in host countries, using evidence from North Africa countries with analyzing Egypt data as case study.

The sample period for the research undertaken is 1961-2012, analyzing Egypt data period from 2000 to 2012. Since then two major developments have shaken the FDI Inflows to the region. First, the Global Financial Crisis that started 2008 has had a major impact on Middle Eastern economies. Second, the beginning of Arab Spring revolutions 2011 and its disturbances of political straggle till now.

We found that the determinants that attract FDI are varying from country to another in the countries under research. In general, countries with large trade market potentials and relatively higher contribution of industries to GDP are more likely to be successful in attracting FDI. Also, countries with skilled labor power, high Government expenditure and low Inflation rate are more likely to be successful in attracting FDI. Countries have more openness with other countries are more likely to be successful in attracting FDI. This could lead us in the future studies to consider new variables that could explain the attraction of the FDI. On the other hand we found that FDI has very weak and non- significant effect on GDP growth. These findings are important for policy making to design FDI promotional policies.

During the second half of the past decade, Egypt became a major recipient of FDI among emerging markets. Not just favorable external conditions coinciding with major internal reforms were the main drivers of growing FDI inflow that reached a record high both in absolute terms and relative to GDP during this period, but also large privatizations and mergers and acquisitions of public enterprises in this period. The recent financial and economic crisis which started 2008 brought an end to this upswing and continue deterioration in receiving FDI as a result to foggy and uncertainty of political situation, unprecedented security challenges and widespread labor protests that accompanied the January 25 Revolution then followed by power struggle and lack of Legitimacy.

We must give attention to the quality of foreign investment. We note that the experience of Egypt with such investments is not all positive. For example, 60% of FDI in Egypt go to the sectors are not labor-intensive (Petroleum and Energy Sectors). More precisely, it does not create jobs and thus do not contribute much to solve the problem of unemployment, which reached almost 12% this year, which was the primary reason the revolution of January 25.

We should not overlook the fact that the main reason for the ineffectiveness of the FDI in the GDP growth was the absence of an investment map of most promising geographical areas in Egypt plus The absence of flexible attractive policies and effective in dealing with investor to attract more investments, as well as the proliferation of bureaucracy, obstacles facing investment, lack of skilled, trained personnel required for the projects. In addition, we noticed that there is ineffectiveness of distribution of FDI inflow to economic sectors, FDI inflow dominated by petroleum, gas and tourism sectors while the industrial and agricultural sectors are negligible.

X. RECOMMENDATIONS

Based on empirical findings, we suggest to adopt and creating business friendly environment through a reduction in corruption and the expansion of infrastructural facilities. Also, government should facilitate and clarify the laws and procedures governing the business and develop some necessary institutions to reduce the extent of corruption and to control the factors that increase both visible and invisible business start-up costs.

Despite the competition to attract FDI, we shouldn't rush towards attracting FDI and going for its quantity against its quality. Thus, we get the investments aimed at a quick profit and benefit from the deformation of the price structure which weaken the body economic rather than strengthen it.

Despite the weakness of the impact of FDI on growth, government should put good policies during its quest to attract foreign investment Rely on quality more than quantity to increase the economic impact of FDI. This means that the Government should:

- Care about FDI diversified among various economic sectors. And ensure that the FDI is not focus in a particular sector.
- Give preference to FDI which help to reduce imports (imports substitutes) where helps to improve the exchange rate of the local currency.
- Give importance to medium or long-term FDI projects, rather than short-term to ensure a serious foreign investor and ensure the stability of the investment climate.
- Give importance to FDI projects which invest in capital goods where help to increase technology transfer.
- Give preference for FDI which have high wages component to maximize the employment opportunities where contribute to the equitable income distribution.

Through develop an effective plan to attract FDI by the following steps:

- Review incentive systems and regulatory frameworks for FDI and improve the investment environment in general through creation of appropriate economic and political environment.
- We shouldn't support FDI that do not serve development goals and do not reflect country priorities.
- Determine a pivotal sector to attract FDI which responds to country development priorities.
- Create a FDI map which meet the needs of economic development in the country and strive to develop attractive sectors in addition to traditional sectors such as energy, manufacturing, service sector and high-tech knowledge.

- Activate partnership agreements and economic integration to attract FDI if it helps in GDP growth.
- Find alternative ways to transfer technology and modern management, where can these methods represent an incentive for foreign direct investment in the future where Tax incentives and low wages are no longer alone sufficient incentives to attract foreign investment, thus, we should focus on other factors can attract FDI inflow
- Support promotional institutions for attracting foreign direct

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