



## INSTITUTIONAL QUALITY AND FOREIGN DIRECT INVESTMENT INFLOWS IN ECOWAS

### ABSTRACT

*There is no doubt that several studies have examined the linkage between institutional quality and foreign direct investment, but the fact remains that institutional quality as a measure of governance effectiveness cannot on its own provide remedy towards facilitating capital inflow. It is on this note that this study examines the impact of institutional quality on foreign direct investment (FDI) in the Economic Community of West African States (ECOWAS) Sub-region, with an underlying focus on the mediating role of economic openness in the link between institutional quality and foreign direct investment (FDI) inflows. Using annual panel data covering 12 ECOWAS countries from 2010–2024, the study employed Structural Equation Modelling (SEM). Results reveal that rule of law exert a negative direct effect on FDI inflows, reflecting persistent instability, weak policy implementation, and investor concerns about political risk across the sub-region. However, trade openness provides a modest but significant mediation effect, suggesting that market access can partly offset the deterrent impact of governance challenges. The study concludes that legal and institutional reforms alone are insufficient to attract investment. ECOWAS governments should complement reforms with robust trade and commercialization policies to foster a more enabling environment for sustainable FDI.*

**Keywords:** Institutional quality, foreign direct investment (FDI), Economic openness, Rule of law, ECOWAS, Structural Equation Modelling (SEM), Panel data

### 1.0 Introduction

The gains from foreign direct investment (FDI) are believed to be most effective in a nation characterised by quality institutions. However, when a nation's institution is unstable, confidence in the system may be eroded (Okoh, 2024). While many emerging countries have experienced the continuous influx of capital, such capital has yet to translate into reducing unemployment due to weak institutional quality (Ikani, 2024).

The lack of adequate internal capital in many less developed countries (LDCs) particularly in the Economic Community of West African States (ECOWAS) sub region have crested the dominance of the informal sector characterized by widespread poverty. For instance, gross domestic savings, an underlying determinant of internal capital generation has been volatile across periods in the ECOWAS sub region.

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The Organisation for Economic Co-operation and Development [OECD] (2024) emphasized that attracting a sustainable and development-oriented foreign direct investment is especially important, given the need for infrastructures and persistent investment in the ECOWAS region.

There is no doubt that the lack of access to technological know-how, adequate internal capital and international market have the potential of severely hampering the influx of FDI in developing nations of the world. However, the capacity of FDI to stimulate sustainable development depends largely on the institutional framework of the host country (Faruq, 2023). While sound institutions often characterized by their improvement in terms of rule of law, regulatory quality, political stability, control of corruption, and government effectiveness, it definitely provide an enabling environment for investment inflows by reducing transaction costs, mitigating risks, and enhancing investor confidence. Conversely, weak institutions often lead to policy uncertainty, rent-seeking behavior, and inefficient allocation of resources, which discourage long-term and productivity-enhancing investments (Wandeda et al., 2022). Despite having abundant natural resources, large market, and various regional integration efforts among member states, the ECOWAS region has faced unpredictable foreign direct investment (FDI) inflows over the last two decades (OECD, 2024). This unpredictability is partly due to weak institutions, including corruption, poor enforcement of contracts, political instability, and bureaucratic delays. According to the World Governance Indicators (World Bank, 2024), many ECOWAS countries frequently score below the global average in important areas like the rule of law and corruption control. The implication does not call for or result in a total stoppage of FDI inflow, rather it promotes the inflow of resource-seeking FDI whose objectives might not directly align with the broad objective of the states in which its investment is located. Aluko et al. (2024) stressed that efficiency-seeking and market-seeking FDI are less likely to commit substantial long-term investment in a nation characterised by a fumbling institution due to unpredictable and lack of transparent business climate.

Empirical evidence has tremendously shown that institutional quality significantly influences the magnitude and sustainability of FDI inflows (Bhujabala et al., 2024; Okoh, 2024). Countries with strong property rights protection, transparent regulatory systems, and low corruption levels have the tendency of attracting higher volumes of FDI, predominantly in manufacturing and services sectors, which are considered more sensitive to governance conditions. In contrast, resource-rich but institutionally weak countries often experience the “resource curse” phenomenon, where foreign investments are concentrated in extractive industries with limited developmental impact without due consideration of other industries (Bothner, 2024).

According to the World Bank (2024) report, FDI as a percentage of GDP in some ECOWAS countries such as Benin rose to around 2.3% in 2023, Cape Verde recorded about 6.2%, Ghana and Burkina Faso saw an improvement from roughly 0.3% and 0.01% in 1990 to 1.6% and 0.61 in 2023 respectively. In contrast, Nigeria, considered Africa’s giant remained low during past decades, standing at approximately 0.6% of GDP in 2023 to 2024. These trends suggest the limiting role of FDI inflow across the region. Similarly, the International Institute for Strategic Studies (2023) notes that although FDI inflows have stagnated in the region, Cote d’Ivoire’s net FDI reached nearly 1.9% of GDP in 2023, a figure that is considered below the average for its income group. Furthermore, after reaching \$83 billion in 2021, FDI to the African continent dipped to around \$53 billion in 2023 (a 3 % decline), though it rebounded strongly to \$97 billion in 2024, a 75 % jump, mainly due to large infrastructure and urban development deals in North Africa (UNCTAD, 2025). These patterns of FDI trends reflect large variability as ECOWAS overall has experienced rising FDI, the gains have however been uneven and sensitive to institutional variations across countries. This uneven distribution is partly attributed to variations in institutional quality, as countries with stronger governance indicators tend to secure more

diversified and sustainable investments, while weaker institutional environments are more vulnerable to short-term speculative capital and politically motivated investments (OECD, 2022).

Although the literature shows a link between institutions and economic performance (Acemoglu & Robinson, 2012), relatively few studies have focused on the ECOWAS sub-region in relation to FDI. While much of the existing research revolves around sub-Saharan Africa into a single panel estimation, which hides the unique institutional, political, and economic factors within ECOWAS (see, Asante, Kamasa, & Bartlett 2022; Oshota & Wahab, 2022). In addition, most studies look at overall institutional indices without examining the specific effects of different governance indicators, such as political stability, regulatory quality, and control of corruption, on FDI inflows. This oversight leaves a gap in understanding not only which institutional factors are crucial for attracting and sustaining FDI in ECOWAS, but also how these effects may be transmitted through the openness of the economy.

The study's major objective is to examine how institutional quality influences foreign direct investment (FDI) in the ECOWAS sub-region, with particular attention to the mediating role of economic openness. It argues that institutional quality alone may not be sufficient to attract FDI, but when complemented by greater economic openness, it can help offset the negative effects of weak governance and policy instability. Using annual panel data from 12 ECOWAS countries covering the period 2010 to 2024, the study employs Structural Equation Modelling (SEM) to analyse both the direct and indirect relationships, offering valuable insights into how governance effectiveness and trade policies jointly shape investment flows in West Africa.

The remainder of this paper is structured as follows: section two review the relevant theoretical and empirical literature. Section three presents the methodological framework adopted for the study. Section four contains the presentation, analysis, and discussion of results. Finally, section five concludes the study and offers key policy implications and recommendations based on the findings.

## **2.0 Literature Review**

### **2.1 Conceptual Review**

#### **2.1.1 Institutional Quality**

Institutional quality is a terminology that defines the effectiveness and efficiency of a country's political and legal frameworks in promoting rule of law, protection of property rights, ensuring contract enforcement, and maintaining accountability and transparency in governance. There is no doubt that strong institutions are categorically characterized by low corruption, high bureaucratic efficiency and legal systems that have the ability to foster a nation's economic stability and social inclusion (Acemoglu & Robinson, 2012). Institutional Quality like every index, can be measured quantitatively, for instance the World Governance Indicators (WGI) developed by the World Bank relatively captures institutional quality through dimensions such as control of corruption, government effectiveness, political stability, regulatory quality, rule of law and voice and accountability. However, in the context of the Economic Community of West African States (ECOWAS), institutional quality remains an underlying determinant of the economic integration, investment magnet and sustainable development that promotes inclusivity in the region. Though, ECOWAS region, like most other regions of the world presents a heterogeneous institutional landscape, ranging from strong institutions to relatively weaker institutions. Above all, the region is shaped by differences in colonial heritage, governance structures, political stability, and policy frameworks. For example, countries like Cape Verde, Ghana, and Senegal consistently score higher on WGI index for political stability and control of corruption compared to countries such as Guinea-Bissau, Mali and Nigeria, where political instability, corruption, and weak legal enforcement remain a persistent challenge (World Bank, 2024).

The region also faces institutional challenges that emphasize the shaky root in governance and its fragility coupled with weak judicial independence, and limited bureaucratic capacity. According to Nzeh et al. (2021), several institutional weaknesses present in the ECOWAS region often undermine policy continuity and hinders the enforcement of trade agreements, all of which are factors capable of discouraging foreign direct investment inflow into the region. Similarly, Fofana (2022) highlighted that resource-rich ECOWAS economies often experience an epidemic referred to as the “resource curse” effect, a situation where rent-seeking behavior of political actors and multinationals deliberately erode institutional effectiveness for personal gain. Despite the many challenges faced in the region, there have been notable regional efforts put in place to improve institutional frameworks. For instance, ECOWAS protocols on democracy and good governance such as the 2001 Supplementary Protocol, seek to promote political stability, strengthen the rule of law and ensure free and fair elections across member states. In addition, anti-corruption drives in countries like Liberia and Sierra Leone, as well as public sector reforms in Ghana and Côte d’Ivoire, reflect several attempts to align domestic institutions with regional integration goals. However, as Olaopa (2025) note, these reforms often suffer from weak implementation and inadequate monitoring mechanisms, thus limiting their long-term impact.

### **2.1.2 Foreign Direct Investment (FDI)**

Foreign Direct Investment (FDI) refers to cross-border investments made by an entity from one country into a business located in another country, FDI in a nation can take the form of establishing operations through the acquisition of assets, or entering joint ventures with significant management control (OECD, 2023). FDI, unlike portfolio investment, that involves passive holdings of financial assets, often entails a long-term interest and influence in the operations of the investment enterprise. Two category of FDI exist, the first is greenfield investments, an investment that warrant the establishment of new facilities and secondly, mergers and acquisitions (M&A), an alternative investment that promote the purchase of existing businesses. Capital inflow is one characteristic feature of FDI, as it plays a pivotal role in promoting economic growth and structural transformation in regions where foreign capital is mobilized. According to the United Nations Conference on Trade and Development (UNCTAD, 2024), developing regions such as West Africa rely heavily on FDI to bridge the dwindling domestic savings-investment gaps, enhance productivity and stimulate industrial development in the region. However, the magnitude and distribution of FDI inflows are influenced by several factors, including macroeconomic stability, political atmosphere and infrastructure availability. These factors in return depends on the quality of the nation's institution.

In a nutshell, FDI inflows have been uneven across member states. For instance, Nigeria, Ghana, and Côte d’Ivoire have historically attracted the largest shares due to their resource endowments, market size, and relatively more developed infrastructures compared to other member state. In contrast, countries such as Guinea-Bissau, Liberia, and Sierra Leone have received smaller inflows, due to the many challenges present in the state, these challenges have led to political instability that is orchestrated by weak institutions and infrastructural deficits (World Bank, 2024; Transparency International, 2024). It is however worth noting that much of the FDI in ECOWAS is resource-seeking, (that is, their influence is usually concentrated in extractive industries such as oil, gas, gold, and bauxite from resource-rich members). This pattern of investment by foreigners has raised serious concerns about the limited diversification of investment and its low spillover effects on manufacturing and services sectors in the states most affected (ACET, 2025). Moreover, Institutional quality has been identified as a critical determinant of FDI in ECOWAS. As strong governance systems that illuminate effective legal frameworks and transparent regulatory environments are major factors encouraging long-term investment, while corruption, policy uncertainty and weak contract enforcement seen in the path of a weak institution often deter foreign investors from allowing their capital to flow freely. In alignment with the aforementioned, the study of Shittu et al. (2020) argue that in many ECOWAS countries, the benefits of FDI are undermined by governance weaknesses, leading to low domestic

development and minimal employment creation. Initiatives such as the ECOWAS Common Investment Code (ECIC) and the Protocol on Free Movement of Persons (FMP), Right of Residence and Establishment (RRE) aim to harmonize investment policies, reduce barriers to entry, and create a more predictable investment climate.

## **2.2 Theoretical Review**

### **2.2.1 Dunning's Eclectic Paradigm (OLI Framework)**

The Dunning's Eclectic Paradigm, also known as the Ownership–Location–Internalization (OLI) framework, was first proposed by John H. Dunning (1980) as a comprehensive theory that tend to not just explain but answer the question of “why firms engage in foreign direct investment rather than other modes of international expansion such as exporting or licensing?”. The paradigm posits that multinational enterprises (MNEs) will continually choose to invest abroad when three conditions are fulfilled. These three conditions include ownership-specific advantages denoted as (O), location-specific advantages represented as (L), and internalization advantages signified as (I). In subsequent refinements, Dunning (1988) emphasized that these three conditions operate jointly to determine the scale, form, and geographical distribution of FDI to abroad. The theoretical rationale for the OLI framework rests on the interplay of these three conditions. While ownership-specific advantages implies that firm-specific assets such as proprietary technology, brand reputation and managerial expertise that give the MNE a competitive edge in foreign markets will not be severely affected. The location-specific advantages pertain to country-level characteristics that attract investment, including natural resources, market size, labour costs, infrastructure, and most importantly favourable regulatory business environment because underlying evidences have shown that strong governance accompanied by political stability, transparent regulations, and effective legal systems have greater tendency of reducing transaction costs and investment risks, thereby make the location attractive. Finally, Internalization advantages explains that firms from abroad invest in a country where it is easier for them to control operations directly rather than the analytic complexity that rigorously involves local licensing or partnerships, as they (firms) see this condition as a means of not just safeguarding proprietary knowledge but also reducing uncertainty and avoiding market failures (Dunning, 1988). However, critiques of the paradigm highlight its broad and somewhat descriptive nature, arguing that it lacks predictive precision and may underemphasize dynamic, firm-level strategic considerations (Narula, 2010).

### **2.2.2 Institutional Theory**

Institutional Theory, as developed within the framework of New Institutional Economics, draws heavily on the work of Douglass North (1990), who defined institutions as the “rules of the game” in a society that comprises of both formal rules (domestic laws and regulations) and informal norms (cultural values and traditions) that structure how humans interact with one another and with the properties of another or the state. The theory ensues that institutions have tendency of shaping economic performance in all ramification by not just reducing uncertainty but also influencing incentives and lowering transaction costs. There is no doubt that the effectiveness of foreign direct investment (FDI) depends the quality of institutions in the host country and as result, investors are often aware of the fact, which plays a very pivotal role in shaping their decisions regarding market entry, scale of investment or sectoral focus. The major position of the institutional theory rests on the idea that strong, well-functioning institutions protect property rights, enforce contracts and ensure transparent regulatory processes while weak institutions is characterized by corruption, political instability, and policy unpredictability that pose a threat to FDI inflows (North, 1990; Acemoglu & Robinson, 2012). Within the ECOWAS region, countries differ significantly in institutional framework, while some have some member state maybe able to control corruption to some extent, some other member states are characterized as being corrupt and this have led to varying levels of investor confidence. MNEs tend to

favor countries where institutional arrangements lower operational risks and enhance the enforceability of agreements.

### 2.3 Empirical Review

Asamoah, Mensah, and Bondzie (2019) examined the role of institutions as an interactive factor in the FDI–trade–growth nexus in 34 sub-Saharan African countries over the period 1996–2016, employing the Structural Equation Modelling (SEM) technique. The results indicated that the negative effect of FDI on economic growth diminishes when institutions are excluded, while institutional quality positively influences trade openness and growth. However, no significant institutional effect was found on FDI. Additionally, human capital development, financial development, and resource rents were found to exert positive effects on economic growth in the region. The study recommends that targeted improvements in institutional quality are essential for enhancing economic growth and development in sub-Saharan Africa.

Akinlo and Okunlola (2021) examined the interactive effect of trade openness and institutional quality on economic growth in 38 sub-Saharan African countries over the period 1986–2015. Using pooled OLS, fixed effects, and dynamic GMM estimation techniques, the study adopted a nonlinear growth regression specification that interacted trade openness with measures of law and order, bureaucratic quality, corruption, government stability, and democratic accountability. The results exposed corruption, government stability, law and order, and bureaucratic quality, as indicators of institutional quality negatively influenced economic growth. However, the interaction between trade openness and institutional quality variables exerted a positive and significant impact on growth, the study therefore suggest that for economic performance to be at its peak, the government in SSA must prioritize trade openness policies.

Alika and Oladipo (2022) studied the short- and long-run impacts of institutional quality and foreign direct investment (FDI) inflows on economic growth in ECOWAS member countries from 1990 to 2020. Employing time series data gotten from the World Bank, UNCTAD, and Freedom House, the study implemented the Autoregressive Distributed Lag (ARDL) model and further explored whether the impacts were homogeneous across the region. The results indicated a positive relationship between FDI inflows and economic growth in ECOWAS, although the effect was not statistically significant in the short run. The institutional quality variable of political regime was found to be insignificant in both the short and long run, while the occurrence of coups had a negative and statistically significant effect at the 10% level in both periods. The analysis also revealed heterogeneity across ECOWAS member countries. The study recommended that policymakers implement FDI-attractive policies, institutionalize democracy, and establish effective checks and balances to control the excesses of government institutions.

Asante et al. (2022) investigated the interactive effect of corruption and foreign direct investment (FDI) on economic growth in the Economic Community of West African States (ECOWAS). The study used panel data from 15 member countries covering the period 2000–2019. The study employed the system-GMM estimator, which combines regressions in difference and in levels to address the problem of endogeneity. The results revealed that while FDI independently promotes economic growth, control of corruption has no direct effect on growth in the region. However, the interaction between FDI and control of corruption showed a complementary relationship, indicating that improvements in corruption control enhance the growth impact of FDI. Specifically, the growth effect of FDI was larger and stronger when control of corruption improved across the 1st, 5th, 10th, and 25th percentiles. thus recommending that to boost investor confidence, increase FDI inflows, and maximize their economic benefits, ECOWAS countries must adopt effective measures to improve transparency and strengthen political will to rigorously investigate and punish corruption.

The study by Limazie and Woni (2024) inspected the effect of foreign direct investment (FDI) and governance quality on carbon emissions in the Economic Community of West African States (ECOWAS) over the period 2005–2016. Using panel data sourced from the World Development Indicators (WDI) and World Governance Indicators (WGI), the study employed the generalized method of moments (GMM) as the primary estimation technique. In addition, the panel-corrected standard errors (PCSE) method was applied to four subgroups of the overall sample to assess the stability of the results. The findings revealed that FDI inflows exert a negative effect on carbon emissions in ECOWAS, and that the interaction between FDI inflows and governance quality also has a negative effect on carbon emissions. These results implies that enhancing institutional quality can help reduce environmental degradation in the region. However, the results from the country subsamples displayed both similar and differing patterns. Based on these findings, the study recommends that policymakers in ECOWAS countries strengthens environmental policies while promoting environmentally friendly FDI.

Okoh (2024) conducted a study in 8 emerging African economies, Nigeria, Botswana, Ghana, Kenya, Mozambique, Tanzania, Uganda, and Zambia for the period 1990 to 2020, and examined the effect of institutional quality and foreign direct investment (FDI) on sustainable economic growth. Employing the panel fixed effect regression model, based on Hausman test results, the study used GDP per capita, FDI, domestic investment, corruption perception index, political stability, and exchange rate as variables. The findings revealed that institutional quality proxied by corruption perception index with political stability and FDI both have a significant relationship with sustainable economic growth in the sampled countries. The study therefore recommends that governments create a conducive environment to boost FDI inflows, reduce corruption to the barest minimum, promote political stability, and ensure exchange rate stability in a bid to attract both domestic and foreign investments.

Nguyen and Ho (2025) examined the role of institutional quality in the FDI–growth nexus for nine ASEAN countries from 2002 to 2020, employing a threshold regression model. The findings revealed a nonlinear relationship in which FDI negatively influenced economic growth when institutional quality was below a specific threshold, but contributed positively once the threshold was exceeded. With the exception of Laos, most ASEAN countries experienced growth-enhancing effects of FDI under high institutional quality conditions. The study concluded that institutional quality is a key determinant of the extent to which FDI inflows can stimulate economic growth, and emphasized the need for institutional reforms to maximize the benefits of foreign investment.

Illo, Oladipo, and Azu (2025) investigated the mediating role of institutional quality in the relationship between foreign direct investment (FDI) inflows and economic growth in Nigeria over the period 1981 to 2022. Using annual time series data on GDP per capita, FDI inflows, political rights, civil liberties, labour force participation, and financial development, the study employed the Autoregressive Distributed Lag (ARDL) model to capture both short- and long-run dynamics. The discoveries revealed that FDI inflows exerted a negative effect on economic growth, reducing it by up to 56.4% in the short run and 30.6% in the long run. However, political rights positively moderated the FDI–growth relationship, enhancing growth outcomes by approximately 123% in the long run. In contrast, civil liberties negatively moderated this relationship in both the short and long run. The study concluded that without institutional reforms, particularly in the area of political rights, FDI is unlikely to generate its anticipated economic benefits. Thus, recommending that Nigeria strengthens its institutional frameworks to fully harness the growth potential of FDI that have the tendency to promote inclusive, long-term economic development.

Across the aforementioned empirical studies reviewed, institutional quality has been explored mostly through direct effects or its interaction with other indicators like trade openness. But this study argues that institutional quality alone cannot realistically promote FDI inflows and that the possibility that its

influence on FDI might operate indirectly through economy openness which most of the stated reviewed study failed to acknowledge. Thus, leaving a clear methodological and empirical gap that this study seeks to fill.

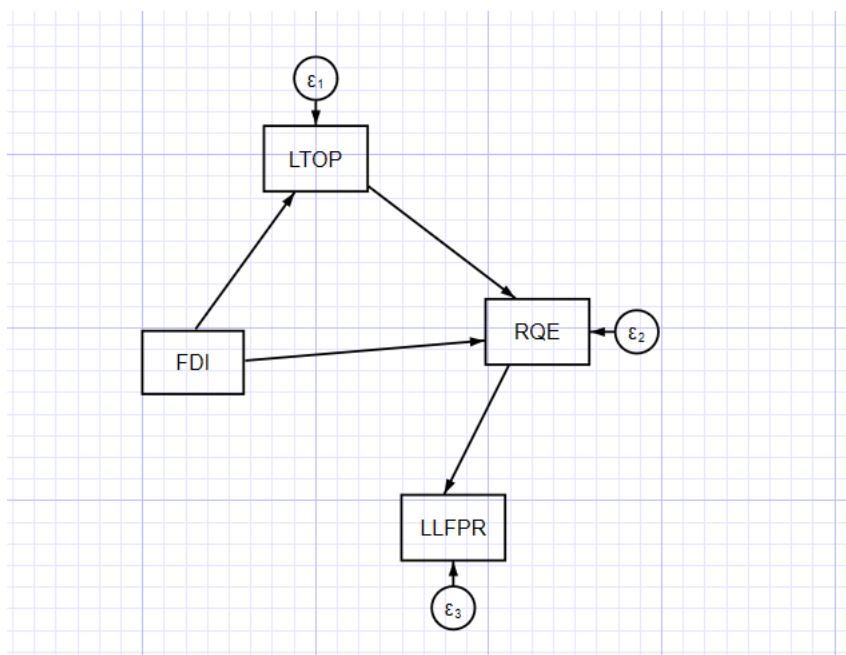
### **3.0 Methodology**

#### **3.1 Clarification of Variables**

This study utilises a balanced panel dataset of 12 countries within the ECOWAS region. These countries include Benin, Burkina Faso, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria and Senegal. Covering the period from 2010 to 2024. The data utilised for the study is sourced from the World Bank (2024) World Development Indicators and World Governance Indicators database. Foreign direct investment (FDI) is considered the outcome indicator in alignment with the study's objective. The main explanatory indicator is regulatory quality estimate (RQE) and the mediator indicator is trade openness (TOP), the labour force participation rate was included as one control indicator to test the robustness of the overall results.

On an a priori basis, regulatory quality (RQE), trade openness (TOP), and labour force participation rate (LFPR) are expected to exert an asymmetric effect on foreign direct investment (FDI). Regulatory quality is very likely to stimulate FDI inflows when the state government make sound policies and effective regulations that have tendency of reducing uncertainty and political instability, but its effect may turn negative if government policies fail to address threats to national prosperity such as corruption, nepotism and so on. Trade openness, in principle, have a predisposition of promoting liberalization and market access that attracts foreign investors. However, excessive openness may also expose domestic industries to foreign competition, create macroeconomic vulnerabilities, or generate instability in trade policy, all of which can deter FDI. Likewise, a higher labour force participation rate may encourage investment by signalling the availability of a productive workforce, yet it could have the opposite effect if increased labour supply is not matched with the appropriate skills to actualize productivity or institutional support, thus leading instead to higher unemployment, social pressures and most sadly, reduced investor confidence. These expectations are grounded in institutional theory and the eclectic paradigm (Dunning, 1988; North, 1990; Narula, 2010). As it provides a guide for empirical assessment of how trade openness, regulatory quality, and labour market dynamics shape the inflow of foreign investment within ECOWAS economies.





**Figure 3.0 Mediation modelling of foreign direct investment (FDI), trade openness (LTOP), and regulatory quality (RQE).**

**Note.** The diagram displays the mediation model with labour force participation rate (LFPR) included as a control variable. Path coefficients are shown on the arrows, while  $\varepsilon_1$  and  $\varepsilon_2$  denote error terms. Source: Author's computation (2025) using Stata 17.

### 3.2 Analytical Plan

This study argues that institutional quality, measured by regulatory quality estimate (RQE), has both direct and indirect implications for foreign direct investment inflows (FDI) in the ECOWAS region. The idea that stronger regulatory frameworks have the tendency of reducing uncertainty, promoting investors' confidence and stimulating FDI has been widely supported by bulk of literatures. Conversely, weak or inconsistent regulation may deter investment by increasing risks and transaction costs. The indirect pathway is assumed to operate through trade openness (TOP), since sound regulatory systems are expected to facilitate liberalisation, lower trade barriers, and create a more predictable market environment that eventually encourages foreign investors. The conceptual framework as illustrated in Fig. 3.0 therefore highlights a core mediated relationship in which regulatory quality estimate not only affects FDI inflows directly but also exerts an indirect effect through trade openness. The mediation analysis seeks to examine the core objective of this study which resides on whether economic openness (measured by TOP) serves as a significant channel in the RQE–FDI link, thus refining our understanding of how institutional quality really translates into investment outcomes. Put differently, the framework provides an answer to the fact that regulatory quality through trade openness have the potential of indirectly impacting FDI in contrast to the conventional direct impact. This setup as positioned in fig 3.0 follows conventional mediation modelling approaches (Baron & Kenny, 1986; Judd & Kenny, 1981; MacKinnon et al., 2007).

### 3.3 Empirical models

As highlighted in the “Literature Review” section, prior empirical evidence (see, Nguyen & Ho, 2025; Okoh, 2024; Limazie and Woni, 2024) empirically demonstrates important links between institutional quality and foreign investment inflows. Building on the aforementioned literature, this study proposes a mediation hypothesis in which trade openness (TOP) serves as the channel through which regulatory

quality (RQE) influences foreign direct investment inflows (FDIIN). In other words, the study seeks to evaluate both the direct and indirect effects of regulatory quality on FDI using a mediation framework. It is worth noting that three main approaches are commonly applied in statistical mediation analysis: the first of this approach is the causal steps method. Second is the difference-in-coefficients method. And third is the product-of-coefficients method (MacKinnon et al., 2007). Consistent with recent empirical studies (see Pei et al., 2019). This study adopts the product-of-coefficients approach, which enables estimation of both the direct pathway from RQE to FDI and the indirect pathway operating through TOP. Accordingly, the three models below are specified to further give credence to the aforementioned approaches to analysing the statistical mediation analysis

$$LFDI_{it} = \psi_0 + \psi_1 RQE_{it} + \psi_2 M'_{it} + \gamma_t + e_{it} \quad (1)$$

$$LTOP_{it} = \beta_0 + \beta_1 RQE_{it} + \beta_2 M'_{it} + \gamma_t + \varpi_{it} \quad (2)$$

$$LFDI_{it} = \alpha_0 + \alpha_1 RQE_{it} + \alpha_2 LTOP_{it} + \alpha_3 M'_{it} + \gamma_t + \phi_{it} \quad (3)$$

In the three empirical models specified above, equation (1) and (3) serve as the determinative equations of foreign direct investment inflows, while equation (2) specifies the determinative equation of trade openness. In these equations,  $\psi_0$ ,  $\beta_0$ , and  $\alpha_0$  are the intercepts. All indicators except RQE were logged to stabilize variance. LFDI represents the dependent variable measured by net inflows of foreign direct investment (current US\$), RQE is the independent variable measured by the World Governance Indicators' regulatory quality estimate, LTOP is the mediating variable measured by trade openness (exports + imports / GDP at current US\$ \* 100);  $M'$  is a vector of covariates obtained from World Development Indicators (e.g., Labour force participation rate (LFPR) which serve as a control variable);  $\gamma_t$  captures the time fixed effects and  $e_{it}$ ,  $\varpi_{it}$ , and  $\phi_{it}$  denote the error terms. In simple terms,  $\psi_1$  in equation (1) measures the total effect of regulatory quality (RQE) on foreign direct investment inflows (LFDI). In equation (3),  $\alpha_1$  represents the direct effect of RQE on LFDI controlling for LTOP, while  $\alpha_2$  measures the effect of trade openness on FDI while holding RQE constant.

### 3.4 Estimation Approach

This study applies the mediation modelling approach within the structural equation modelling (SEM) framework to achieve its underlying objective. Satorra (1990) and MacKinnon et al. (2007) noted that SEM is widely employed in social, behavioural, and economic sciences to evaluate complex linear relationships among variables. The mediation modelling technique examines how the predictor variable influences the outcome variable both directly and indirectly through a mediating channel (Hayes, 2013; Baron & Kenny, 1986). In this study, the predictor variable is institutional quality (proxied by the regulatory quality estimate), the outcome variable is foreign direct investment inflows (FDI), and the mediating mechanism is trade openness.

SEM is preferred because it produces unbiased and efficient estimates of both direct and indirect (mediation) effects (Cheung & Lau, 2008). Following the two-step procedure of Anderson and Gerbing (1988), the estimation proceeds as follows:

- i. Structural model (equation 2): tests the hypothesized relationship between the predictor variable (Regulatory quality estimate) and the mediator (trade openness).
- ii. Regression model (equation 3): tests whether trade openness mediates the relationship between institutional quality and FDI.

Given that the data distribution might depart from normality, the Satorra–Bentler robust standard error technique as introduced in the study of (Satorra, 1990) is employed to test the statistical significance of

mediation effects. This approach provides more reliable estimates of sampling variability and model fit under non-normality. lastly, the goodness-of-fit of the models is tested using widely accepted SEM fit indices. These fit indices include Comparative Fit Index (CFI), Tucker–Lewis Index (TLI) and the Root Mean Square Error of Approximation (RMSEA) as reported in the study of (Hu & Bentler, 1999). RMSEA is considered an absolute fit index, that evaluates how closely a hypothesized model approximates a perfect model. In contrast, CFI and TLI are incremental fit indices that compare the hypothesized model against a baseline model with the poorest possible fit.

## 4.0 Result and Discussions

### 4.1 Descriptive Statistics of the Variables

Foreign direct investment (FDI) in the ECOWAS region tends to be weak, with the overall average at about –0.82 billion USD and a relatively large spread across countries ( as indicated by the standard deviation (SD) of 1.28 billion USD). The most striking case is Nigeria, which experienced a dramatic outflow of nearly –8.0 billion USD in 2011. In the same year, Togo attracted close to 0.54 billion USD, the largest positive entry in the dataset. Beyond these extremes, inflows are generally subdued or negative. For example, Guinea’s –2.4 billion in 2016 represents the lowest point recorded, while The Gambia’s small outflow of –0.02 billion in 2012 shows how some of the smaller economies are relatively insulated from dramatic swings. Turning to regulatory quality (RQE), the regional average stands at –0.65, though the experiences of member states differ sharply. Nigeria’s performance reflects the difficulties of managing institutional effectiveness within a large, complex economy, whereas Togo has registered some gradual, though modest, improvements. At the upper end, Cabo Verde reached 0.39 in 2024, pointing to relatively stronger governance capacity. On the other side, Guinea-Bissau posted –1.95 in the same year, which highlights persistent fragility in state institutions.

When looking at trade openness (TOP), the bloc’s average is about 60% of GDP, but the picture is far from uniform. Nigeria is the least open, recording just 21.36% in 2016, consistent with its inward-oriented trade structure and reliance on domestic demand. By contrast, Togo’s economy is shaped by its position as a trading hub, naturally giving it a more outward profile. Guinea’s 109.35% in 2020 illustrates the other extreme, where dependence on external trade is exceptionally high. The pattern is also uneven in labour force participation (LFPR). On average, the region records around 41%, but the spread is wide (SD  $\approx$  12). Nigeria, with a rate of 65.1% in 2024, reflects the role of its large and youthful population in sustaining active labor market participation. Meanwhile, Togo’s 24.6% in 2020 marks the other end of the scale, capturing the structural limits on employment engagement in smaller economies.

**Table 4.1 Descriptive Statistic Output**

	N	Mean	SD	Min	Max	Kurtosis	Skewness
FDI	180	-8.219e+08	1.275e+09	-8.000e+09	5.400e+08	9.997	-2.412
RQE	180	-.651	0.428	-1.946	.385	2.585	.028
TOP	180	60.26	19.081	21.361	109.354	2.889	.577
LFPR	180	40.677	12.217	24.569	65.058	1.941	.463

Source: Author’s computation (2025) using Stata 17.

### 4.2 Correlation Matrix

The results of the pairwise correlation of the variables is revealed in Table 4.2. The result indicates that none of the correlations among the independent variables (RQE, LTOP, and LLFPR) are significantly strong. The highest negative correlation as shown in the result is between regulatory quality and trade openness (–0.282), followed by regulatory quality and labour force participation (–0.254). The correlation between trade openness and labour force participation is weakly positive (0.107), thus, far

below the usual rule-of-thumb threshold (of -0.75 to 0.75) that would raise concern for multicollinearity.

**Table 4.2 Correlation Matrix Output**

Variables	(1)	(2)	(3)	(4)
(1) LFDI	1.000			
(2) RQE	-0.126	1.000		
(3) LTOP	-0.188	-0.282	1.000	
(4) LLFPR	-0.303	-0.254	0.107	1.000

Source: Author's computation (2025) using Stata 17.

### 4.3 Unit Root Test

The panel unit root results as indicated in Table 4.3 was tested using the fishers cross sectional Augmented Dickey Fuller (ADF) and Philip-Peron (PP) test technique indicate that RQE is stationary at level, meaning it is integrated of order zero, I(0). By contrast, LFDI, LTOP, and LLFPR are non-stationary at level but become stationary after first differencing, showing they are integrated of order one, I(1). This mixture of I(0) and I(1) variables implies the need for cointegration techniques in subsequent analysis.

**Table 4.3 Unit Root Output for Augmented Dickey-Fuller and Philip Peron Approach**

Variables	ADF T-Bar	PP	Remarks
LFDI	0.0117 (0.0122) **	0.0100 (0.0121) **	I (1)
RQE	0.0117 (0.0164) **	0.0111 (0.0131) **	I (0)
LTOP	0.0029 (0.0041) ***	0.0028 (0.0000) ***	I (1)
LLFPR	0.2317 (0.0004) ***	0.2577 (0.0004) ***	I (1)

**Note.** This table reports results of the Fisher-type ADF and PP unit root tests. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively, while p-values are reported in parentheses. LFDI is log of foreign direct investment inflow, RQE is regulatory quality index, LTOP is log of trade openness, and LLFPR is log of labour force participation rate. Source: Author's computation (2025) using E-Views 12.

### 4.4 Kao Cointegration Test

In Table 4.4 the Kao test results are considered. The Dickey-Fuller t-statistic (-3.1027, p = 0.0010) and the unadjusted versions of both the Modified Dickey-Fuller t (-8.7889, p = 0.0000) and Dickey-Fuller t (-9.6456, p = 0.0000) are all highly significant, while the Augmented Dickey-Fuller t-statistic (-1.3972, p = 0.0812) shows significance at 10%. By contrast, the Modified Dickey-Fuller t-statistic (0.8024, p = 0.2112) is not significant. Taken together, the significant results from most Kao test statistics indicate rejection of the null hypothesis of no cointegration at the 1% level, confirming the existence of a long-run equilibrium relationship among the variables.

**Table 4.4 Kao Cointegration Test Output**

Cointegration Test	Statistics	P-Value
Kao Test	Modified Dickey-Fuller t	0.8024
		0.2112

Kao Test	Dickey-Fuller t	-3.1027	0.0010
Kao Test	Augmented Dickey Fuller t	-1.3972	0.0812
Kao Test	Unadjusted Modified Dickey-Fuller t	-8.7889	0.0000
Kao Test	Unadjusted Dickey-Fuller t	-9.6456	0.0000

**Note.** The table reports the Kao panel cointegration test statistics with corresponding p-values in parentheses. The null hypothesis is no cointegration. Rejection of the null at the 1% significance level indicates the presence of a long-run relationship among the variables. Source: Author's computation (2025) using Stata 17.

#### 4.5 Structural Equation Model

From the structural model output in Table 4.5, the coefficient of LFDI is negative and statistically significant at the 5% level. This indicates that a percentage change in LFDI is significantly associated with a decrease in LTOP by approximately 1.25%, on average, *ceteris paribus*. The constant term is positive and significant, suggesting that, holding other factors constant, the baseline level of trade openness is relatively high in the absence of changes in the explanatory variable. This outcome aligns with related studies on the mixed role of foreign direct investment in small, integrated regional blocs where capital inflows can sometimes replace rather than complement trade activities.

The regression model as indicated in Table 4.5 further reveals that with regulatory quality (RQE) as the dependent variable, the coefficient of LFDI is negative and significant at the 1% level, indicating that a percent increase in LFDI is associated with a decline in RQE by about 0.59 unit in the index. Similarly, LTOP has a negative and statistically significant association with RQE at the 1% level. This suggests that a percentage increase in trade openness is significantly associated with a decrease in regulatory quality by approximately 0.097 unit in the index. Additionally, log of labour force participation rate (LLFPR) exerts a negative and statistically significant effect, implying that a rise in labour participation is linked to a decline in regulatory quality by about 0.43 unit in its index.

The negative association between both LFDI and LTOP on RQE contradicts theoretical expectations of institutional improvement through globalization (Rodrik et al., 2004) and supports findings from some African-focused studies (for instance, Asiedu, 2006), which highlight that in weaker institutional environments, external economic integration may exacerbate governance challenges. For the most part, these findings suggest that in the ECOWAS region, external openness and capital inflows may undermine rather than enhance institutional quality, possibly due to governance instability, weak regulatory enforcement, or the prioritization of short-term economic gains over institutional strengthening by the region's respective government

**Table 4.5 Structural Equation Model Output**

VARIABLES	COEF.
<i>Structural Model: Dep. Var: LTOP</i>	
LFDI	-1.2523 ** (-2.55)
C	33.0905 *** (2.97)
<i>Regression Model: Dep. Var: RQE</i>	
LFDI	-0.5884 *** (-3.85)
LTOP	-0.0967 *** (-4.41)
LLFPR	-0.4264 *** (-4.33)
C	14.7773 ***

	(4.10)
<b>Observations</b>	<b>180</b>
<b>Log-likelihood</b>	<b>-357.0896</b>
<b>LR Test vs Saturated chi2(2)</b>	<b>0.53</b>
<b>Wald Test (LTOP)</b>	<b>1.5925</b>
<b>Wald Test (LFDIINI)</b>	<b>0.1368</b>

**Note.** Dependent variables: LTOP (trade openness) in the structural model and RQE (regulatory quality index) in the regression model. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Figures in parentheses are z-statistics. Source: Author's computation (2025) using Stata 17.

#### 4.6 Decomposed Effects

The results in Table 4.6 decomposes the total effects of regulatory quality (RQE) on foreign direct investment (FDI) inflows into direct and indirect components. The direct effects are represented by the coefficient of RQE on FDI inflows. The findings show that the direct effect of RQE on FDI is negative and statistically significant at the 1% level (−0.588), implying that a one-unit improvement in regulatory quality reduces FDI inflows by about 0.59%, on average. The mediation effect through trade openness (TOP) is positive and statistically significant at the 5% level (0.121). This indicates that RQE indirectly increases FDI inflows via its effect on trade openness by about 0.12%. In other words, while stricter regulatory quality directly discourages FDI inflows, it simultaneously promotes trade openness, which in turn attracts more FDI.

The total effect, which combines both the direct and indirect pathways, remains negative and statistically significant at the 1% level (−0.467). This suggests that, overall, the adverse direct impact of regulatory quality on FDI inflows outweighs the positive indirect contribution through trade openness. These results are consistent with arguments in the African institutional literature, which highlight that in contexts of weak governance, regulatory tightening may deter capital inflows, even though openness to trade can partly mitigate this effect by generating sufficient market spillovers.

For the diagnostics, having deployed the Satorra–Bentler robust standard errors, the goodness-of-fit of the model is evaluated. Hu and Bentler (1999) suggested the following criteria for a good model fit: RMSEA < 0.06, CFI and TLI > 0.95. The results show that RMSEA = 0.000 (90% CI: 0.000–0.177, *pclose* = 0.559), which satisfies the threshold for good fit. Both CFI (1.000) and TLI (1.058) exceed the recommended 0.95 benchmark, further indicating excellent model fit. The SRMR value of 0.018 is well below the 0.08 cut-off, reinforcing the conclusion of a good fit. Overall, it is concluded that the specified model is not statistically different from the hypothesized model ( $\chi^2(1) = 0.525$ , *p* = 0.469). Finally, the Wooldridge test for autocorrelation reports a *p*-value of 0.492, suggesting that serial correlation is not a concern in the panel structure of the data.

**Table 4.6 Decomposed Effects**

VARIABLES	COEF.
<i>Dep. Var: LFDI</i>	
<b>Direct Effects</b>	-0.5884 ***
Z stat	(-3.85)
<b>Mediation Effects</b>	0.1211 **
Z stat	(2.21)
<b>Total Effects</b>	-0.4672 ***
Z stat	(-2.96)
<b>DIAGNOSTICS / GOODNESS OF FIT TEST</b>	
<b>RMSEA</b>	0.000
<b>Comparative fit index (CFI)</b>	1.000

<b>Tucker-Lewis index (TLI)</b>	1.058
<b>StD. root mean squared residual</b>	0.018
<b>Wooldridge Autocorrelation Test</b>	0.492

**Note.** Direct, mediation, and total effects of foreign direct investment (FDI) on regulatory quality are reported. Coefficients are estimated using structural equation modelling (SEM). Robust (Satorra–Bentler) standard errors are applied. \*\*\* $p < 0.01$ , \*\* $p < 0.05$ . Goodness-of-fit indices (RMSEA, CFI, TLI, and SRMR) confirm excellent model fit. The Wooldridge test indicates no evidence of autocorrelation ( $p = 0.492$ ).

## 5.0 Conclusion and Recommendations

This study examined the relationship between foreign direct investment (FDI) inflows and regulatory quality (RQE) in ECOWAS countries, while accounting for the mediating role of trade openness (TOP). The findings revealed that the direct effect of FDI on regulatory quality is negative and statistically significant, suggesting that higher FDI inflows tend to undermine institutional quality in the region. However, the indirect effect through trade openness is positive and significant, implying that FDI can improve regulatory quality when it operates through enhanced trade integration. Despite this mediating effect, the total effect remains negative, demonstrating that the harmful institutional consequences of FDI outweigh the potential governance gains through trade openness. Overall, the results align with perspectives in the African institutional literature, which argue that in weak governance settings, liberalisation and capital inflows may erode regulatory standards, even as trade-related spillovers create some institutional improvements. Given the study's result, it is recommended that;

1. ECOWAS countries prioritize building strong, transparent, and independent regulatory frameworks to ensure that FDI inflows do not undermine governance quality.
2. Since the indirect effects of FDI through trade openness are positive, governments should encourage FDI projects that are linked with export diversification, technology transfer, and regional value chains, thereby fostering institutional spillovers.
3. Policymakers should shift away from unconditional FDI attraction policies and instead adopt selective frameworks that prioritize investments in sectors with high potential for institutional learning and sustainable development.

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