

Institutional Development and Capital Inflows in Selected Ecowas Countries

¹Ekere, Edobot, ²Chukwu, Sancho Nwobuisi & ³ Ewubare, Dennis Brown & ⁴Amadi, Sonny Nwonodi

^{1,2*3*4} Department of Economics,
Faculty of Social Sciences, Rivers State University,
Nkpolu-Oroworukwo, Port Harcourt, Rivers State, Nigeria.

Corresponding author: edobot.ekere@ust.edu.ng
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Abstract

This paper examines how institutional development affects capital inflows to the selected ECOWAS countries between 2002 and 2024. The specific objectives are to determine the effects of government effectiveness, regulatory quality, rule of law, control of corruption, and political stability on foreign aid. Given the nature of this study, panel datasets were obtained from the World and IMF Financial Statistics. Descriptive statistics, cross-sectional dependence test, panel unit root and cointegration tests, as well as heterogenous panel model estimation, comprising mean group (MG) and pooled mean group (PMG) were used for the data analysis. The cross-sectional dependence test indicates that there is no cross-sectional dependence across the panels. The panel unit root test results showed evidence of mixed integration in the series. The panel regression estimates indicate that government effectiveness has a significant positive effect on foreign aid in the long run. The estimated parameter indicates that a one-unit improvement in government effectiveness increases foreign aid inflows by about 7.35 units in the long run. The results also showed that regulatory quality has a significant negative effect on foreign aid in the long run. Evidence of a significant effect of the rule of law on foreign aid inflows was established in the long run. Given the findings, this study recommends that governments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract foreign aid.

Keywords: Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption, Political Stability, Foreign Aids

1. Introduction

Capital inflows remain an indispensable source of development finance for emerging and developing economies, particularly where domestic savings are insufficient to support the investment required for sustainable economic growth. In ECOWAS countries, capital inflows in the form of foreign direct investment, official development assistance, foreign portfolio investment remittances, and other private financial flows contribute significantly to infrastructure development, industrialization, technology transfer, employment generation, and regional economic integration. However, attracting and sustaining these inflows depends not only on macroeconomic stability but also on the level of institutional development. Increasingly, investors

and development partners consider the quality of institutions before committing financial resources because sound institutions reduce investment risk, strengthen policy credibility, and improve the overall business environment. Consequently, institutional development viewed from various experts. According to Rodrik (2021) defines institutional development as the continuous strengthening of governance structures, legal systems, public sector effectiveness, and regulatory frameworks that enable governments to formulate and implement policies conducive to sustainable economic development. Similarly, the World Bank (2023) describes institutional development as the process of improving government effectiveness, regulatory quality, rule of law, accountability, political stability, and control of corruption to enhance public sector performance and economic outcomes. Likewise, the OECD (2024) conceptualizes institutional development as reforms that improve governance systems, strengthen regulatory institutions, enhance transparency, and promote policy consistency, thereby creating an enabling environment for investment and sustainable development. Collectively, these definitions suggest that institutional development represents the strengthening of formal institutions that improve governance quality, reduce uncertainty, enforce contracts, protect property rights, and promote investor confidence. Institutional development plays a fundamental role in attracting capital inflows because well-developed institutions lower transaction costs, reduce information asymmetry, enhance contract enforcement, minimize corruption, and provide policy certainty.

Consequently, countries characterized by effective governance, regulatory quality, and political stability are more likely to attract both private and official capital than countries with weak institutional frameworks. Within the ECOWAS region, however, institutional quality differs considerably across member states, thereby contributing to substantial disparities in capital inflows despite similar market opportunities and natural resource endowments. According to the United Nations Conference on Trade and Development (UNCTAD, 2025), Africa attracted a record US\$97 billion in foreign direct investment in 2024, representing a 75 percent increase over the previous year. Nevertheless, investment remained concentrated in relatively few countries, while many West African economies continued to attract comparatively low levels of foreign capital because of persistent governance and institutional challenges. Accordingly, empirical evidence also demonstrates the importance of institutional development in attracting capital inflows. Akhtaruzzaman (2025) investigated the influence of good governance on Official Development Assistance (ODA) in the Asia-Pacific region using Pooled Ordinary Least Squares, Random Effects, and Control Function Models based on data spanning 2000–2023. The findings revealed that good governance significantly influences the allocation of ODA, implying that improvements in institutional quality increase the likelihood of attracting external development finance.

Similarly, Abegaz and Gebreeyesus (2020) examined the determinants of aid flows to Sub-Saharan Africa and found that weak governance, corruption, and political instability significantly reduce aid inflows, whereas stronger institutional quality enhances donor confidence and improves capital allocation to recipient countries. These studies provide empirical support for the proposition that institutional development constitutes a critical determinant of international capital movements. Ideally, ECOWAS countries are expected to maintain strong institutional systems characterized by effective governance, transparent public administration, efficient regulatory institutions, strong legal frameworks, political stability, and effective anti-corruption mechanisms capable of attracting sustainable capital inflows necessary for industrialization, infrastructure financing, employment creation, and inclusive economic growth. Such institutional conditions increase investor confidence by ensuring contract enforcement, protecting property rights, guaranteeing

policy consistency, and reducing investment uncertainty. Consequently, stronger institutional development should position ECOWAS as one of Africa's most attractive investment destinations. Despite numerous governance reforms undertaken by ECOWAS member states over the years, institutional weaknesses remain pervasive across the region. Challenges such as corruption, weak regulatory quality, political instability, bureaucratic inefficiency, weak judicial systems, and inconsistent policy implementation continue to undermine investor confidence and constrain capital inflows. The OECD (2024) notes that fragmented regulatory systems, weak governance structures, and inconsistent investment policies continue to reduce the competitiveness of ECOWAS in attracting international investment. Similarly, the World Bank's Worldwide Governance Indicators (2023) reveal that many ECOWAS countries continue to record relatively low performance in government effectiveness, regulatory quality, rule of law, and control of corruption, all of which are key institutional determinants of foreign investment decisions. Furthermore, empirical findings on the relationship between institutional development and capital inflows remain inconclusive. While Akhtaruzzaman (2025) and Abegaz and Gebreeyesus (2020) conclude that improvements in governance significantly enhance capital inflows, Hammack (2025) reports statistically insignificant evidence regarding the interaction between corruption, foreign aid, and regional development in selected African countries, suggesting that institutional effects may vary across countries and development contexts. Likewise, Paranata et al. (2023) demonstrate that corruption perception strongly influences the sustainability of foreign aid in Indonesia, whereas Barber (2025) finds that declining corruption enhances the effectiveness of foreign aid through improvements in institutional quality. These divergent findings indicate that the relationship between institutional development and capital inflows remains unresolved in the empirical literature. More importantly, existing studies have largely focused on Asia, individual African countries, or Sub-Saharan Africa as a whole, with relatively limited attention devoted specifically to ECOWAS countries despite their unique institutional characteristics and regional integration agenda. This creates an important empirical gap regarding how institutional development influences capital inflows across ECOWAS member states. It is this gap that motivates the present study to investigate the effect of institutional development on capital inflows in ECOWAS countries, with a view to providing evidence-based policy recommendations

2. Methodology

This study utilise panel data comprising cross-sectional units and time series. Specifically, the cross-sectional units include the selected countries in the ECOWAS region, such as Côte d'Ivoire, The Gambia, Ghana, Liberia, Mali, Nigeria, Senegal, and Togo. Thus, the dataset covers 8 countries, including the anglophone and francophone countries, over the period 2002-2024. This period allows us to analyse the behaviour of capital inflows in response to changes in institutional quality before and after the global financial crisis (2008-2009). Capital inflows data was taken from the International Financial Statistics of the IMF and the World Bank Development Indicators (WDI). These sources allow for the disaggregation of capital inflows into FDI, portfolio investments, foreign aid, remittances, and foreign loans. Additionally, to assess the role of governance quality as a determinant of capital inflows, a set of governance variables from the Worldwide Governance indicators was utilised. These include annual time-series data on governance quality, including government effectiveness, regulatory quality, rule of law, corruption control, and political stability.

Model Specification

This study closely follows the works of Al Sayed, Omar & Khaled (2025), Ohonba & Akinola (2023), Shammah et al. (2024), Wu et al. (2024) and Bekana (2023). with some improvements. In particular, the models was augmented by expanding the governance quality indicators to include political stability and rule-of-law indexes, which were previously ignored. The functional specifications of the models are presented as follows:

$$FAI = f(GEF, REQ, RUL, COC, PST) \quad 1$$

Where: FAI = FAI = foreign aid

GEF = government effectiveness, REQ = regulatory quality, RUL = rule of law, COC = corruption control, PST = political stability

Following the nature of this study, the static panel models involving pooled, fixed effects and random effects shall be specified accordingly:

i. Pooled Regression Model

$$FAI_{it} = \beta_0 + \beta_1 GEF_{it} + \beta_2 REQ_{it} + \beta_3 RUL_{it} + \beta_4 COC_{it} + \beta_5 PST_{it} + \varepsilon_{it} \quad 2$$

Where: β_0 = Intercept, $\beta_1 - \beta_5$ = slope parameters, ε_{it} = error term

$i = 1, \dots, N$. $t = 1, \dots, T$

i = cross-sectional units, including the selected countries (Côte d'Ivoire, The Gambia, Ghana, Liberia, Mali, Nigeria, Senegal, and Togo) in the ECOWAS

t = time dimension (2002 to 2024)

A Priori Expectation

A priori expectation is a theoretically based prediction regarding how economic variables are related, including their direction and nature. In line with the a priori expectation, government effectiveness, regulatory quality, and rule of law are expected to positively affect capital inflows. Given the following, the a priori expectations based on the regression coefficients are expressed as: $\beta_1 > 0$, $\beta_2 > 0$, $\beta_3 > 0$, $\beta_4 > 0$, and $\beta_5 > 0$.

Variable Description and Measurement

Foreign aid: This refers to the financial, technical, or material assistance received by a developing country from other countries, especially rich and developing countries. It was measured in this study by net official development assistance (ODA) received as a percentage of gross national income (GNI).

Government effectiveness (GEF): This refers to perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The estimate for government effectiveness is in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, government effectiveness is expected to positively affect capital inflows.

Regulatory quality (REQ): Regulatory quality refers to perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. The estimate for regulatory quality is measured as an aggregate indicator, in units of a standard normal distribution, ranging from approximately -2.5 to 2.5, as provided by the WGI. A priori, regulatory quality is expected to positively affect capital inflows,

as sound, transparent, and predictable regulatory frameworks lower investment risk, improve market efficiency, and boost investor confidence.

Rule of law (RUL): This includes perceptions of how much agents trust and follow societal rules, especially regarding the quality of contract enforcement, property rights, the police, and the courts, as well as the chances of crime and violence. It shall be measured by the rule of law index, comprising a composite indicator in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, improvements in the rule of law are expected to boost capital inflows, as strong legal institutions enhance property rights protection, reduce uncertainty, and improve investor confidence.

Control of corruption (COC): This encompasses perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests. The estimate for control of corruption is in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, improvements in anti-corruption are expected to positively affect capital inflows, as enhanced institutional quality boosts investor confidence and reduces investment risk.

Political stability (PST): This defines perceptions of the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism. It shall be measured by the political index, a composite indicator expressed in units of a standard normal distribution, ranging approximately from -2.5 to 2.5. A priori, political stability is expected to positively affect capital inflows, as a stable political environment reduces uncertainty and improves the investment climate.

3. Results and Discussion

Descriptive Statistics

The descriptive analyses focused on the mean, standard deviation, and range, including the minimum and maximum values of each variable. The summary of the descriptive statistics is presented in Table 1.

Table 1: Summary of descriptive statistics

Variable	Observation	Mean	Std. Dev.	Minimum	Maximum
FAI	184	8.599	11.76	.308	92.127
GEF	184	-.781	.4994	-1.71	.23
REQ	184	-.633	.374	-2.11	.01
RUL	184	-.637	.459	-1.89	.28
COC	184	-.634	.396	-1.69	.36
PST	184	-.748	.8043	-2.56	.48

Source: STATA 15 Output

Table 1 presents descriptive statistics based on 184 observations. Foreign aid averaged 8.599% of GDP, with substantial variation (SD = 11.76), ranging from 0.308% to 92.127%. Foreign loans recorded the highest mean at 58.95% of GDP, with a high standard deviation of 82.54, indicating considerable differences in borrowing across countries and periods. The governance indicators generally recorded negative mean values, suggesting relatively weak institutional performance. Government effectiveness averaged -0.781, regulatory quality -0.633, and control of corruption -

0.634. Rule of law averaged -0.637 , while political stability recorded -0.748 . Political stability showed the greatest variation ($SD = 0.8043$), reflecting substantial differences in political conditions across the sampled countries.

Panel Unit Root Test

The Pesaran Cross-Sectional Dependence test results provide the basis for choosing the first-generation panel unit root test method. In particular, the IPS panel unit root test method was employed in this study. The results are presented in Table 2.

Table 2: Summary of the IPS unit root test results

Variable	Z-t-tilde-bar at levels	Z-t-tilde-bar at 1st difference	Order of integration
FAI	-3.212*** (0.0007)	-	I(0)
FOL	-0.907 (0.1822)	-6.4369*** (0.0000)	I(1)
GEF	0.4184 (0.6622)	-7.266*** (0.0000)	I(1)
REQ	-0.872 (0.1915)	-6.571*** (0.0000)	I(1)
RUL	-1.499 (0.0669)	-7.058*** (0.0000)	I(1)
COC	-0.207 (0.4180)	-6.351*** (0.0000)	I(1)
PST	-3.024*** (0.0012)	-	I(0)

Source: STATA 15 output

Note: *, **, * denote significant at 1%, 5% and 10% levels, respectively**

The IPS panel unit root test results reveal a mixed order of integration. Foreign aid (FAI) is stationary at levels (-1.807 ; $p = 0.0354$) and is therefore I(0), as is political stability (PST) (-3.024 ; $p = 0.0012$). In contrast, government effectiveness (GEF), regulatory quality (REQ), rule of law (RUL), and control of corruption (COC) are non-stationary at levels but become stationary after first differencing, making them I(1), with first-difference p-values of 0.0000. The variables are a mixture of I(0) and I(1), with none integrated of order two, I(2). This satisfies the requirements for cointegration testing and panel ARDL estimation, including the PMG and MG estimators.

Panel Cointegration Test

The panel cointegration test for each model was conducted using the Kao method, given evidence of mixed integration in the series. The results are presented in Tables 3

Table 3: Kao panel cointegration test results

Series: FAI GEF REQ RUL COC PST			
Ho: No cointegration		Number of panels	= 8
Ha: All panels are cointegrated		Number of periods	= 21
Panel means:	Included	Kernel:	Bartlett
Time trend:	Not included	Lags:	1.50 (Newey-West)
AR parameter:	Same	Augmented lags:	3
		Statistic	p-value

Modified Dickey-Fuller t	1.8041**	0.0356
Dickey-Fuller t	1.0394	0.1493
Augmented Dickey-Fuller t	2.3788***	0.0087
Unadjusted modified Dickey-Fuller t	-10.757***	0.0000
Unadjusted Dickey-Fuller t	-7.2218***	0.0000

Source: STATA 15 output

Note: *, **, * denote significant at 1%, 5% and 10% levels, respectively**

Table 3 presents the Kao panel cointegration test for foreign aid and the governance indicators. Four of the five test statistics are statistically significant: MDF (1.8041; $p = 0.0356$), ADF (2.3788; $p = 0.0087$), unadjusted MDF (-10.757; $p = 0.0000$), and unadjusted DF (-7.2218; $p = 0.0000$). Although the DF statistic is insignificant ($p = 0.1493$), the overall evidence supports rejecting the null hypothesis of no cointegration. Thus, foreign aid and the governance indicators share a stable long-run equilibrium relationship across the sampled countries.

Model Estimation

The model estimation is segmented into the long-run and short-run dynamics. The long-run coefficients show the equilibrium relationship between each capital inflow and the governance quality variables, while the short-run coefficients capture how short-term changes in the explanatory variables affect each capital inflow across the sampled countries. The Hausman test results provide the basis for choosing between the PMG and MG estimators.

Table 4: Summary of MG and PMG results

Dependent variable: FAI		
	(1)	(2)
Variables	MG	PMG
Ec	-0.862*** (0.000)	-0.5227*** (0.000)
D.GEF	4.502 (0.523)	-6.556 (0.297)
D.REQ	1.5398 (0.514)	3.430 (0.327)
D.RUL	-8.216 (0.538)	-3.176 (0.689)
D.COC	-9.800* (0.166)	4.845 (0.447)
D.PST	7.061* (0.154)	5.906 (0.255)
GEF	-1.914 (0.897)	7.354*** (0.001)
REQ	-14.632** (0.038)	-9.045*** (0.000)
RUL	14.155 (0.379)	-2.981* (0.102)
COC	11.564 (0.256)	.1309 (0.956)
PST	-5.248*	1.705***

	(0.161)	(0.000)
Constant	8.341**	4.196**
	(0.037)	(0.023)
Observations	176	176

Source: Author's computation (2026) from STATA 15

Note: *, **, * denote statistically significant at 1%, 5%, and 10% levels, respectively**
Figures in brackets are corresponding p-values of the parameters

Table 5: Hausman test results for model 4

Variable	Mg	Pmg	Difference	S.E.
GEF	-1.914175	7.353683	-9.267858	14.58927
REQ	-14.63258	-9.045177	-5.587399	6.824574
RUL	14.15573	-2.98063	17.13636	15.9792
COC	11.56396	.1309509	11.43301	9.898368
PST	-5.247533	1.705281	-6.952814	3.707632
chi2(5) = 3.02				
Prob>chi2 = 0.6967				

Source: Author's computation (2026) from STATA 15

The Hausman test results show a Chi-square statistic of 6.06 ($p = 0.6967$), supporting the PMG estimator for Model 4. The long-run results indicate that government effectiveness has a positive and significant effect on foreign aid, with a one-unit improvement increasing aid inflows by about 7.35 units. Similarly, political stability has a positive and significant effect, increasing aid inflows by approximately 1.71 units. These findings suggest that donors favour countries with effective institutions and stable political environments. In contrast, control of corruption has a positive but insignificant effect, while rule of law has a negative but insignificant effect on aid inflows. Regulatory quality has a significant negative effect, with a one-unit improvement associated with about a 9.05-unit reduction in foreign aid, possibly reflecting reduced dependence on external assistance as domestic institutions improve. In the short run, none of the governance indicators significantly affects foreign aid inflows. The error correction coefficient of -0.5227 , significant at the 1% level, indicates that approximately 52.27% of deviations from long-run equilibrium are corrected each year, confirming a stable long-run relationship between governance quality and foreign aid.

Discussion of Findings

The results show that government effectiveness has a positive and significant long-run effect on foreign aid inflows. This suggests that countries with stronger administrative capacity, effective public services, and better policy implementation are more likely to attract development assistance. The finding is consistent with the institutional perspective of North (1990) and Acemoglu, Johnson, and Robinson (2005), which emphasises the role of effective institutions in shaping economic outcomes. It also agrees with recent evidence linking good governance to foreign aid allocation and effectiveness (Akhtaruzzaman, 2025; Adhikari, 2025). Effective institutions may therefore give donors greater confidence that aid resources will be properly managed and translated into development outcomes. Political stability also has a positive and significant long-run effect on foreign aid inflows. This indicates that donors are more likely to provide assistance to countries with relatively stable political environments, where development programmes can be implemented with less disruption. Political stability reduces uncertainty, supports policy continuity, and lowers

the risks associated with aid-funded projects. This finding is consistent with the broader institutional literature, which identifies political institutions and stability as important conditions for effective economic activity and external resource mobilisation (Rodrik, 2011; Sabir et al., 2020). It also complements evidence that institutional conditions influence international capital flows (Al Sayed et al., 2025). The results further show that control of corruption has a positive but insignificant effect on foreign aid inflows. Although better corruption control is expected to improve aid effectiveness and donor confidence, the insignificant result suggests that corruption control alone does not determine aid allocation in the ECOWAS region. Donors may also consider poverty, humanitarian needs, development priorities, strategic interests, and existing commitments. This finding is consistent with the view that the relationship between governance and aid is complex and multidimensional (Barber, 2025; Hammack, 2025). Nevertheless, the importance of reducing corruption should not be overlooked, as corruption can weaken the effectiveness and sustainability of foreign assistance (Paranata et al., 2023). In contrast, regulatory quality has a significant negative effect on foreign aid inflows. Although this finding differs from the expectation that better institutions should attract more external resources, it may reflect a reduction in aid dependence as domestic economic and institutional capacity improves. Better regulatory systems can promote investment, entrepreneurship, and private-sector development, thereby expanding domestic sources of finance and reducing reliance on external assistance. This interpretation is consistent with the institutional development perspective of North (1990) and evidence linking institutional quality to improved economic performance (Adegboyega & Arikewuyo, 2020; Abdulkarim, 2023). Thus, the negative relationship may indicate that improvements in regulatory quality strengthen domestic capacity rather than directly increasing aid dependence. The rule of law has a negative but insignificant effect on foreign aid inflows. This suggests that improvements in legal institutions and enforcement mechanisms do not independently determine aid allocation in the sampled ECOWAS countries. Although strong legal institutions are important for accountability, transparency, and economic development, donors may place greater emphasis on broader institutional capacity, development needs, and political conditions when making aid decisions. The finding therefore supports the view that governance dimensions can affect external financial flows differently rather than producing uniform effects (Scott, 2014; Al Sayed et al., 2025). Finally, the short-run results show that none of the governance indicators significantly affects foreign aid inflows. This suggests that aid allocation does not respond immediately to changes in governance quality. Institutional reforms require time to become credible and to influence donor assessments, while aid commitments are often based on long-term programmes, existing agreements, and development priorities. The absence of short-run effects therefore does not diminish the importance of governance; rather, it indicates that its influence on aid flows is primarily long-term and gradual. The findings suggest that government effectiveness and political stability are the most important governance dimensions for attracting foreign aid in the long run, while improved regulatory quality may reduce aid dependence as domestic capacity strengthens.

5. Conclusion and Recommendations

Conclusion

This study examined the effect of institutional development on capital inflows in the ECOWAS region, focusing on five major components of institutional development (government effectiveness, regulatory quality, rule of law, control of corruption, and political stability) and their influence on capital inflows, (FAI). The findings reveal that the relationship between institutional

development and capital inflows in the ECOWAS region is multifaceted and varies considerably across the different forms of external capital. The indicate that government effectiveness has a significant positive effect on foreign aid s in the long run. The estimated parameter indicates that a one-unit improvement in government effectiveness increases foreign aid inflows by about 7.35 units in the long run. The results also showed that regulatory quality has a significant negative effect on foreign aid in the long run. Evidence of a significant effect of the rule of law on foreign aid inflows was established in the long run. Given the findings, this study recommends that governments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract foreign aid

Recommendations

- i. Governments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract remittances, foreign aid, and foreign official loans.
- ii. The ECOWAS member states should promote regulatory harmonization and policy coordination to enhance regional integration, facilitate cross-border investment, and create a more attractive and predictable business environment in the region.
- iii. Policymakers in ECOWAS governments should prioritize reforms aimed at strengthening the rule of law through improved judicial system, effective contract enforcement, protection of property rights, and the consistent application of legal framework to create a predictable legal environment that supports for increased inflow of foreign capital.
- iv. The ECOWAS governments should strengthen anti-corruption institutions and promote transparency and accountability in the public sector to increase investor confidence and encourage greater greater inflows to the region.
- v. Finally, The ECOWAS member states should continue to promote political stability through the strengthening of democratic institutions and inclusive governance practices to creating a conducive environment for attracting foreign capital from various external sources.

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