

## A Review on the Effects of Globalization and Terrorism on the Economic Development of Selected Member Countries (MENA)

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**Abstract.** Nowadays one of the topics under discussion, is the phenomenon of globalization. Globalization, is the fusion and integration of national economies into the global economy. Its effects can be observed in increased international trade, globalization of production and the flow of foreign direct investment. Studying the wide effects of this process on different aspects of human life such as political, economic, social and cultural effects has drawn the attention of scholars, politicians, economists and the world's cultural custodians. These studies, first of all need to quantify this phenomenon and construct and use appropriate indexes for its measurement. The aim of the present research is to study the effect of globalization on attraction of foreign direct investment in selected member countries of MENA. Another aim of this research is to study the effects of shocks made by gross domestic product variables, trade liberalization degree and the level of terrorist events on attraction of foreign direct investment in these countries. The model of the research was estimated using panel econometric modeling techniques such as panel unit root, panel co-integration and generalized method of moment (GMM) estimator. The results of the study suggest that there's a positive and significant relationship between globalization and foreign direct investment. Also the market size index, and human capital index have a positive and significant effect and the population index has a negative effect on the attraction of foreign direct investment. The results of this study suggests that terrorism shocks have a negative effect on attraction of foreign direct investment. In contrast, shocks made by gross domestic product, and trade liberalization, have a positive effect on the attraction of foreign direct investment.

**Keywords:** Globalization, Terrorism, The Mena Region, Foreign Direct Investment, Economic Development

### 1. INTRODUCTION

Globalization, a common term in 1990s, is one of the most controversial topics in the social sciences that although there have been a lot of discussion about it, no comprehensive definition is provided that could encompass all aspects of this phenomenon, and still abundant disputes and ambiguities can be observed about its definition.

Some authors, believe that globalization is a stage of recent capitalism and modernity and some believe that it is a new way of thinking. However, sometimes we are faced with relatively precise definitions that could not completely wipe out uncertainties on this word and that despite some overlaps are very different (Scholte 2000).

(Perraton 1997) believes that globalization is a process of evolution that has faded the political and economic boundaries, expanded communication, and increased interaction between cultures. In his view, globalization is a multidimensional phenomenon that can be extended to social, economic, political, legal, cultural, military and technological activities. Social activities also affect environment. Globalization is a social process in which the constraints of geography that has overshadowed social and cultural ties is destroyed and people increasingly get aware of the reduction of these constrains (Azizoleslam 2002).

Globalization, is the process of integration of national economies in a comprehensive global economy in which production factors (labor and capital), technology and information, freely

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pass geographical borders, and products (including goods and services) also freely enter into the markets of different countries. The main feature of this process is greater reliance on the market system and the privatization and liberalization in its various aspects, including trade liberalization, financial markets and foreign direct investment.

Following the deregulation in financial markets around the world and growing development of information technology, the financial markets quickly liberalized and by increasing internationalization of services such as banking, insurance, advertising, accounting, public relations and media, the consumption and demand patterns around the world was changed and with the presence of multinational companies the means to integration in the global economy has been provided (Behkish, 2010).

Factors affecting the absorption of foreign investment (FDI) can be divided into economic, social and political factors. Regarding the performance of developing countries in the field of economic factors it can be pointed out that governments in a wide competition with each other through changing the key elements of economic policies, such as domestic labor market conditions, taxes, tariff barriers, subsidies and privatization attempt to improve their country in attracting foreign direct investment. Besides offering various incentives such as tax exemptions, trade liberalization, establishment of special economic zones and other economic incentives for foreign investors, developing countries compete with each other to attract foreign investment.

The status of developing countries in relation to political factors is slightly different from their status and performance on economic factors. Economic structure of countries, especially developing countries is most vulnerable to the domestic adverse factors. Political instability as the most important internal factor, has the closest interaction with the concept of economic security in affecting the production factors. In developing countries, the uncertainty that occurs in the political instability and unsystematic violence, leads to the reduction of investments, and inability of the country to attract foreign investment and capital flight. The phenomenon of terrorism is one of the political instability indices that is raised today as one of the critical issues of the international community, especially the developing countries and its effects on international political and economic relations developments is wide.

## **2. LITERATURE REVIEW AND THEORETICAL FOUNDATIONS**

Nowadays the flow of foreign investment is one of the most important features of economic globalization of the countries. In the light of globalization process, the capitals easily and in large amounts move around the world with the aim of more profit. And this fluid flow provides the ground for important economic developments in different countries and ultimately the dynamism and survival of global capitalist system (Azarbaijani 2012).

With globalization, the capital will move with greater freedom at international level. As a result, if there are potential grounds for production, the capital will go there in seeking to take advantage of the talents. In addition, globalization has also faded away the importance of government's role in direct intervention in economic activities. For example, in the macroeconomic level, government intervention decreases on the movement of capital and on determining the rates of interest, foreign exchange and prices (Bromandfar 2009).

Increase of foreign investment in the world and its positive effects on economic growth, has caused an increase in the competition among nations to attract foreign investment. Therefore the rules and laws of countries to gain a higher share of foreign investment are being facilitated day by day. As a result of change in this approach, the stock markets of industrialized and developing countries are opened to foreign investment, commercial and industrial free zones are developed in different countries and the activities of foreign investors are facilitated. These activities have been important measures in the world since late twentieth century so far (Pelimenscu and Radulesco, 2009).

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Economic theories on foreign direct investment and its risk factors are in two forms. First: Study of foreign direct investment as part of the investment, as the classical theory of economics consider investment as one of the economic growth factors, but new economic theories in addition to maintaining a historical role for investment, believe that science, technology, and new methods of management which are partly obtained through foreign direct investment are affective in economic growth. The flow of foreign direct investment in addition to removing capital deficiency in the host country, by having two new factors of growth, is of great importance in recent theories (Frawsen and Josefsson 2003).

Some economists examined foreign direct investment as a part of international trade. In this approach, foreign direct investment is subordinate to international rules, and according to the theory of ownership advantages, spatial advantages and internalization benefits (OLI) that is known as the theory of international production of Dunning, the flow of foreign direct investment is subordinate to spatial situations.

This theory was proposed by Dunning in 1981. If the investment is to access the market of the host country and produce for the same market, it is considered to be market-oriented and if it is to produce with a lower cost for export to target markets, then it's export-oriented. According to the modified gravity model (1997 Chunlai) which is originated from the theory of spatial advantage (OLI) of Dunning, the determinant factors of foreign direct investment are subordinate to spatial situations and origin, destination advantages and communicative factors.

It is noteworthy that in the past, there were different views and beliefs about the consequences of the entry of FDI to the host country, and some countries due to the risk of economic independence, needed political adjustments and cultural consequences, faced the attraction of this capital with uncertainty and doubt, but today, most countries believe that the attraction of foreign capital is also associated with deficiency of capital, knowledge, technology and new management techniques. Therefore, most countries in the world, even the developed ones, try to identify the factors affecting foreign capital to adapt it to their own situation to fit the context for its entry. Therefore identification of factors affecting the flow of foreign direct investment is important and perhaps the only way to enjoy the benefits of the international flow is capital (Shahabdi and Mahmoudi 2006).

Also according to studies of (Nunnenkamp and Spatz 2004) and (Jang 2001) since foreign direct investment leads to employment and investment, exports and production, the access to resources, such as management, skilled labor, international production networks and establishment of brand names is provided. It also provides the ground for benefiting from the overflow effects and technology transfer to the host country. Therefore, foreign direct investment can be an engine for the economic growth in the host country. Therefore, according to the benefits of foreign investment, studying the effects of inflow foreign investment on economic growth especially with regard to the issue of globalization is of great importance (Farzin et al 2012).

Factors often used to explain FDI flows can be divided into three groups including political risk and country risk, tax policy, tariff barriers and government regulations, strategic and long-term factors. Among the above mentioned items, the political risk and country risk are more related to the subject of the present research, so in this part first a definition of the concept of political risk is presented and then the relationship between political risk, particularly terrorism as an index of political risk and the flow of foreign direct investment will be examined.

A simple and direct definition of political risk is to consider it as part of country risk which is related to political factors. In fact, sometimes the broader concept of country risk is used instead of political risk which refers to the potential adverse environmental effects of a country on capital flow that is originated from FDI. Country risk itself is due to political risk factors and the

economic risk or financial factors, and therefore political risk is known as a subset of the country risk.

There are several factors that lead to political risk in a country. Factors or sources of political risk are presented with their different manifestations and are classified under 13 titles by Wafo (1998) in Table 1. It should be noted that in the opinion of researchers in political science, among the components mentioned, terrorism is proposed as one of the most important elements of political instability in various countries and a constant source of tension in the entire world after World War II (Blomberg et al ., 2004). Terrorism can impose costs to the country in which they emerged. Terrorist events have economic consequences through capital flight, diversion of foreign direct investment, destruction of infrastructure, direction of public investment funds towards securing or restricting trade (Keefer and Loayza, 2008).

**Table 1.** Sources of political risk.

<b>Factors</b>	<b>Manifestations</b>
Restrictions on the entrance of foreign investors	Restrictions on a percent of the stocks that the foreign investors can keep Restrictions on a variety of professions that foreign investors may take charge Restrictions on ownership
Agencies for monitoring the FDI flows	Outlawing a series of selected industries Vague criteria about official confirmation of FDI High tax and weak incentives Restrictions on the equity of the company owners Locality of the content of the required regulations
Restrictions on foreign exchange	Restrictions on the capital and profit return Restrictions on return through net value Restrictions on return through foreign exchange
Governmental intervention	Controlling Prices Controlling monopolies Largeness of the governmental section
Social instability	Fragile social structures Weak organizational levels in society Corruption
Social violence	Terrorism activities, crime, civil war, civil disobedience, Riot
Governmental inability	Inability in organizing economic and executional modifications, lack of institutions and a democratic morale
Undesirable relations with international organizations	Turbulent relations with the International Monetary Fund and the World Bank Undesirable relations with the UN
Lack of commitment to international environment and labor principles	
Undesirable relations with foreign investors in recent five years	Lack of commitment to mutual investment rules Trickish confiscation of earned profits
Hostile attitude of the parties and society to FDI	Hostile claims of parties Hostile programs
Hostile attitude to foreigners	Violence against foreigners Intolerance against foreigners Restrictions on the aliens labor
Hatred of host countries toward disclosing reliable data	Lack of transparency Secrecy about most of political and economic decisions

### 3. EXPLAINING THE MODEL

In this study according to the conducted explanation based on the impact of globalization on foreign direct investment in dynamic panel data (foreign direct investment, according to the generalized method of moment estimator (GMM) is expressed as follows:

$$\begin{aligned}
 FDI_{it} &= \alpha FDI_{it-1} + \beta_1 \log KOF_{it} + \beta_2 \log GDP_{it} + \beta_3 \log TRADE_{it} + \beta_4 \log SCHOOL_{it} + \\
 &\beta_5 \log POP_{it} + V_{it} + u_i \quad (1) \\
 i &= 1, 2, 3, \dots, N \\
 t &= 1, 2, 3, \dots, T
 \end{aligned}$$

In models in which there is a lagged dependent variable on the right hand of the equation, dynamic integrated model is used in order to estimate the equation. One of the benefits and applications of integrated data is better understanding of the dynamics by the researcher. Dynamic relationship is modeled with the presence of lagged dependent variables among the explanatory variables.

In Equation 1,  $FDI_{it}$  is the net flow of foreign direct investment as a share of GDP,  $FDI_{it-1}$ , is the lag of net flow of foreign direct investment,  $\log KOF_{it}$ , is the logarithm of globalization economic indices which is actually the generalized openness index of trade (OPEN). In addition, to investigating the effect of the desired variable in attracting foreign direct investment it's required to investigate other affecting factors on attracting foreign direct investment besides the globalization index variable.  $\log GDP_{it}$  is the logarithm of domestic production per capita at current prices of U.S. dollar as the size of the market index,  $\log TRADE_{it}$ , index is related to foreign trade, logarithm of export as a share of GDP,  $\log POP_{it}$ , the logarithm of the number of people living in urban areas, as the index for population,  $\log SCHOOL_{it}$ , as an index of human capital in the form of logarithm of total gross enrollment in high school (the gross enrollment means all enrolled subjects in that grade to the total population of that age group in accordance with that grade).  $u_i$ , indicates the special effects of each country and  $V_{it}$ , is the vector of disturbing components.

In this study in order to study the reaction of FDI to terrorism shocks, the analysis of the impulse response function was used and accordingly the main revised model and its summarized form can be expressed as follows:

$$Y_{it} = \Gamma(L)Y_{it} + V_{it} + u_i \quad (2)$$

Where  $Y_{it}$ , includes vector of mentioned variables in model 1 and  $(L) \Gamma$  is polynomial matrix based on lag function.

In order to examine the collective stationary of the four tests Levin-Lin & Chu, Im-Pesaran & Shin, Fisher-ADF, Fisher-PP, has been used and is shown in Table 2.

The results of the analysis of prediction error variance for the studied variables are listed in Table 3.

**Table 2.** Results of stationary model

Variables	PP – Fisher Chi-square		ADF – Fisher Chi-square		Im, Pesaran and Shin W-stat		Levin, Lin & Chut	
	Probability level	Test Statistics	Probability level	Test Statistics	Probability level	Test Statistics	Probability level	Test Statistics
<b>FDI</b> ( <i>first difference</i> )	0,0000	455,49	0,0000	82,589	0,0000	-5,982	0,0000	-3,131
<b>LogKOF</b> ( <i>first difference</i> )	0,0000	157,99	0,0000	73,684	0,0000	-5,341	0,0000	-3,,964
<b>logGDP</b> ( <i>first difference</i> )	0,0000	85,004	0,0000	47,723	0,0000	-2,681	0,0000	-5,043
<b>TRADE</b> ( <i>first difference</i> )	0,0000	179,77	0,0000	72,166	0,0000	-5,204	0,0000	-3,156
<b>SCHOOL</b> ( <i>level</i> )	0,0000	70,453	0,0000	39,679	0,0000	-2,349	0,0000	-4,296
<b>POP</b> ( <i>first difference</i> )	0,0000	88,132	0,0000	100,34	0,0000	-8,009	0,0000	-9,752

**Table 3.** Analysis of variance of model variables.

	(FDI)	(GDPpc)	(OPEN)	(TERROR)
(FDI)	0.865	0.119	0.014	0.001
(GDPpc)	0.004	0.986	0.008	0.002
(OPEN)	0.025	0.059	0.912	0.004
(TERROR)	0.001	0.029	0.013	0.957

According to the results of Table 2 and calculated statistical values and the probability of their acceptance, it shows that all variables except human capital with one time difference became stationary. Human capital variable is at stationary level.

Based on Table 3 it can be observed that about 86% of the fluctuations of FDI inflow (as a percentage of GDP) is explained by shocks related to FDI and about 12% of the fluctuations of this variable is explained by shocks caused by gross domestic product per capita. Other shocks in the pattern explain a small part of changes in the FDI. As seen in the table above, in the long term more than 98% of fluctuations of gross domestic product per capita (GDPpc) variable is explained by self-variable shocks and other variables have a very little share in explaining the fluctuations of these variables. The same situation can be observed for variables like trade openness (OPEN) and terrorism (TERROR) in Table 3. Co-integration test results using Pedroni method and Cao test (with the null hypothesis based on the lack of co-integration for the two tests) is shown in Tables 4 and 5.

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**Table 4.** Pedroni co-integration test results.

	Y- Intercept		Y intercept with procedure	
	Test Statistics	P-value	Test Statistics	P-value
Panel v-Statistic	0,65498	0,2562	-46223	1.0000
Panel rho-Statistic	2.4656	0.9932	2.9278	0,9983
Panel PP-Statistic	-7.1789	0.0000	-119533	0.0000
Panel ADF-Statistic	-4.6572	0.0000	-4.1108	0.0000
Group rho-Statistic	3.5887	0.9998	4.2222	1.0000
Group PP-Statistic	-9.4600	0.0000	-16.4804	0.0000
Group ADF-Statistic	-3.7710	0.0003	-2.8113	0.0025

**Table 5.** Cao co-integration test results.

Kao Cointegration	t-Statistic	P-value
ADF	-4,5577	0.0000

#### 4. THE ESTIMATION RESULTS

A major problem in the use of conventional estimation methods, such as least square error and maximum likelihood is that these estimators in high observations and low time period are incompatible for dynamic panel model parameters. It's also possible that some common hypothesis are inconsistent in the regression model such as uncorrelated explanatory variables and error components, then other methods such as instrumental variables are proposed, which generally act based on the differences. Because, in general, in a model, the number of estimators obtained based on these variables are high for a particular parameter, therefore the generalized method of moments (GMM) is presented as an alternative method for estimating dynamic panel linear regression models (Kaji 2005). Therefore in estimating the research model dynamic panel method or generalized method of moments was used. The results of estimator are shown in Table 6.

**Table 6.** Results of the estimation model (GMM).

Variables of the Model	Coefficient	Test Statistics	P-Value
FDI (-1)	0.04242	30.9440	0.0000
LogKOF	0.1121	3.6771	0.0000
LogGDP	0.01192	2.21191	0.0278
logTRADE	0.0024	0.5863	0.5584
LogSCHOOL	0.01999	3.6771	0.0003
LogPOP	-0.0366	-4.6762	0.0000
J-statistics: 5.179    Sargan test: 0,9271 Instrument rank: 12			

As you can see, the null hypothesis based on the lack of correlation tools with disturbing components cannot be rejected, so it can be concluded that the techniques used for estimation have the necessary validity. According to the results of estimation model it can be seen that all model variables except the index of trade are at confidence level of 97% and affect the absorption of foreign direct investment in selected countries. As expected, there is a positive significant relationship between dependent variable and the lag of foreign direct investment (FDI (-1)). This means that an increase in the level of foreign direct investment in the previous period, the entry of foreign direct investment will increase in the current period; This can also be interpreted in such a way that the increase in foreign direct investment activities in the current period increases foreign direct investment in the future or the next period.

Globalization Index (KOF) as the main variable of discussion has a direct and significant effect on attracting foreign direct investment in the selected countries. This means that with increase in the globalization index, the absorption of foreign direct investment will be added. This conclusion is consistent with the theory. According to estimation model Table 6, the coefficient variable of the global index has the greatest effect among introduced explanatory variables on attracting foreign direct investment. The next variable is the variable of market size (logarithm of gross domestic product), which has a significant and direct effect on attracting foreign direct investment. The effect of GDP on attracting foreign direct investment is positive and significant at level of 97%, in other words, by increasing domestic demand for goods and services and the expansion of the market, foreign investors have got higher motivation to invest.

Trade index variable (exports logarithm which is a share of GDP) which represents the importing country's economic openness here is positive but meaningless. According to the theoretical literature, the more the ratio increases, the more volume of international trade increases. Because it will benefit from the efficiency of specialized production. In other words, the more an economy is open, the higher would be its size of the business flow (capital), and if the limits especially in the field of trade policy are reduced, the trade flow will increase. Meaninglessness of this coefficient is may be due to high customs restrictions, or the fact that the selected countries, generally exporters of primary commodities, which have a small share of world trade in the present time which is full of new technology.

Human capital index (logarithm of total gross enrollment in high schools) has a direct and significant effect in attracting FDI. Increase of human capital in the country will increase efficiency and productivity, enhance the ability to perform complex tasks and also increase in the flexibility in the responsibility of the workforce and flexibility of power in taking charge of new jobs are in line with technological developments within the industry. In other words, the variable of this coefficient indicates that an increase in human capital, will increase ratio of foreign direct investment to GDP ratio.

Finally the population index (logarithm of city population) here implies as the market size and economies of scale. So that the population coefficient of the host country is negative and significant. This index for the capital of the host country represents the overcome of the negative effects of economies of scale on positive effect of its market size and causes negative and decreasing effect of the volume of foreign capital.

The effects of positive shock of the variable of gross domestic product per capita (GDPpc); which is often used as an index for the market size of each country, is positive on the FDI inflow and will increase it rapidly. This increase in the second and third years occurs gradually, and then it shows a mild decreasing trend, however, the positive effect of GDPpc shock on FDI remained stable for more than 6 years.

The effect of shock variable of trade openness (OPEN) on FDI is also positive and as expected. In terms of quantity, the effect of trade openness variable shock is less than the shock of gross domestic product per capita in selected countries of the Middle East and North Africa. Also the shock effect of trade openness variable remained stable up to 6 years.

FDI reaction to the shocks of the terrorist events (TERROR) is theoretical as it was expected. The results of the impulse response function indicate that through a positive shock of the terrorist events in the studied sample, the attraction of foreign direct investment decreases. FDI negative reaction to terrorism shocks decreases with a very gentle trend which indicates that the consequences of terrorist incidents in the host countries for a long time can lead to a decrease in foreign investment in that country. In fact, the emergence of terrorist events leads to the risk of terrorism and increases the costs of doing business through spending costs for security and insurance of economic activity, high cost of preventive measures, and high wages for employees who are exposed to the risk. These costs reduce the expected return of investment activities and

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in case the terrorism risk increases to a certain extent, the foreign investors will transfer their capital to a safer country, or they may avoid investing in countries with large terrorist incidents. The amounts of impulse responses of FDI to shocks variable model are presented along with positive and negative bounds in Table 7.

**Table 7.** Amounts of response functions of FDI to shocks of related variables.

Period	Shocks of FDI			Shocks of GDPpc		
	Negative bound (0.05)	Amount of IRF*	Positive bound (0.95)	Negative bound (0.05)	Amount of IRF*	Positive bound (0.95)
<b>0</b>	<b>3.077</b>	<b>3.274</b>	<b>3.454</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>
<b>1</b>	<b>0.338</b>	<b>1.033</b>	<b>1.689</b>	<b>0.133</b>	<b>0.391</b>	<b>0.661</b>
<b>2</b>	<b>- 0.003</b>	<b>0.476</b>	<b>1.100</b>	<b>0.232</b>	<b>0.501</b>	<b>0.825</b>
<b>3</b>	<b>- 0.134</b>	<b>0.183</b>	<b>0.725</b>	<b>0.263</b>	<b>0.513</b>	<b>0.878</b>
<b>4</b>	<b>- 0.141</b>	<b>0.057</b>	<b>0.519</b>	<b>0.225</b>	<b>0.531</b>	<b>0.952</b>
<b>5</b>	<b>-0.155</b>	<b>0.002</b>	<b>0.373</b>	<b>0.157</b>	<b>0.473</b>	<b>0.987</b>
<b>6</b>	<b>-0.190</b>	<b>-0.019</b>	<b>0.309</b>	<b>0.103</b>	<b>0.423</b>	<b>1.008</b>
	Shocks of OPEN			Shocks of TERROR		
	Negative bound (0.05)	Amount of IRF*	Positive bound (0.95)	Negative bound (0.05)	Amount of IRF*	Positive bound (0.95)
<b>0</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>
<b>1</b>	<b>-0.016</b>	<b>0.068</b>	<b>0.156</b>	<b>0.687</b>	<b>0.167</b>	<b>0.374</b>
<b>2</b>	<b>-0.009</b>	<b>0.074</b>	<b>0.186</b>	<b>0.713</b>	<b>0.160</b>	<b>0.468</b>
<b>3</b>	<b>-0.018</b>	<b>0.057</b>	<b>0.195</b>	<b>0.705</b>	<b>0.159</b>	<b>0.517</b>
<b>4</b>	<b>-0.025</b>	<b>0.042</b>	<b>0.203</b>	<b>0.661</b>	<b>0.153</b>	<b>0.550</b>
<b>5</b>	<b>-0.033</b>	<b>0.026</b>	<b>0.212</b>	<b>0.627</b>	<b>0.147</b>	<b>0.518</b>
<b>6</b>	<b>-0.042</b>	<b>0.014</b>	<b>0.214</b>	<b>0.581</b>	<b>0.141</b>	<b>0.501</b>

\* *Impulse response function*

## 5. CONCLUSION

In this research new composite index of economic globalization (KOF) was used as an index of globalization. The results of the model indicate that the index of globalization, market size index and human capital index have a positive and significant effect and population growth index has a significant negative effect on attracting foreign direct investment in selected member countries of MENA.

The present study is conducted specifically to create awareness of the consequences of terrorism on attracting foreign direct investment. Based on the results of the research model estimation and analysis of impulse response function, positive shocks of GDP and trade openness have a positive effect on attracting FDI, in contrast the impact of terrorism shocks has a negative effect on attracting foreign direct investment, so the Middle East countries need to create mechanisms to reduce this phenomenon to overcome the risk of terrorism.

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