Journal of Economic Policy and Management Issues

ISSN: 2958-6313 Volume 3, Issue 2, 2024, pp. 41-51

The determinants of private investment: A review of international literature

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Keywords:

- Private investment
- Economic growth
- Public investment
- Literature review

Abstract

This study reviews the empirical literature on the determinants of private investment. The study evaluated and analysed empirical research on the determinants of private investment in both developed and developing countries. The findings show that the key determinants of private investment and their impacts vary across countries and depend on the methodology used. Overall, the study found that credit to the private sector, interest rates, public investment, inflation, GDP growth, terms of trade, savings, external debt, and exchange rate are some of the key determinants of private investment. The study also found that economic growth, public investment, and credit to the private sector were generally positive determinants, while inflation, the real interest rate, and the exchange rate were mostly negative determinants.

1. Introduction

Several studies have been done in a bid to understand the relationship between private investment and its determinants (Acosta & Loza, 2005; Erden & Holcombe, 2006; Michael & Aikaeli, 2014; Akçay & Karasoy, 2020). The core of these studies has been centered on establishing the determinants of private investment, as it is believed that a boost in private investment is good for the growth of an economy. On the other hand, the empirical literature about the determinants of private investment is inconclusive. These determinants include public investment, economic growth, inflation, interest rates, exchange rates, credit to private sector, and savings among others (see Sakr, 1993; Oshikoya,1994; Ghura & Goodwin, 2000; Mlambo & Oshikoya, 2001; Ribeiro & Teixeira, 2001; Ouattara, 2005; Karagoz, 2010; Magableh & Ajlouni, 2016; Ngoma et al., 2019; and Ayeni, 2020). Although the findings of these various studies have found that the impact of the determinants on private investment can be positive, negative, or inconclusive, most of the findings were in favor of the positive determinants. Although the debate on the determinants of private investment has not been fully settled, the area has been well researched.

Against this backdrop, the aim of this study is to take stock of what is available in the literature on the determinants of private investment. It will also provide a comprehensive review of the literature on the determinants of private investment from the empirical studies. The study aims to explore the argument of whether the determinants have a negative or positive impact on private investment. The study is expected to contribute to the literature on private investment. The methodology used is that of a critical review of the empirical literature on the determinants of private investment. The study uses secondary sources from studies conducted to explore and identify the determinants of private investment over the years. The outcome of this study is expected to have significant policy implications, as it disentangles complicated outcomes into digestible and usable outcomes.

The rest of this article is organized as follows: Section 2 presents a review of the empirical literature and section 3 discusses the findings from the empirical literature. Section 4 presents some concluding remarks and recommendations for future studies.

2 Empirical literature

Several studies in the literature have examined the determinants of private investment. However, the empirical literature also points to inconclusive findings. To achieve the study's objective, the empirical studies on the determinants of private investment were gathered from various journals. Each study was examined, and based on the results, only studies that focused on establishing the determinants or the impact on private investment and used econometric techniques were selected. The available literature on the determinants of private investment has two main elements. The first is the studies that focus on finding the determinants of private investment. The second one is on the studies that have examine the impact of the established determinants on private investment. As a result, the empirical literature was reviewed in line with these categories of studies.

Using the ordinary least squares methodology, Oshikoya (1994) investigated the determinants of private investment from 1970 to 1998 in four middle-income and four low-income African countries. The findings of the study suggest that the determinants that have the most influence on private investment in middle-income countries are lagged debt service ratio, public investment rate, domestic inflation rate and real exchange. The credit to the private sector, GDP growth rate and debt service ratio had the most impact on low-income countries.

Mitiku (1996) investigated the macroeconomic determinants of private investment in Ethiopia from 1975 to 1994 using Ordinary Least Squares (OLS). The results indicate that credit to the private sector, the real exchange rate, policy and external debt are the determinants of private investment. Real interest rate, growth of per capita GDP, public investment and change in terms of trade were found not to have an impact on private investment. In another study for Ethiopia, Ambachew (2010) examined the determinants of private investment for the period from 1950 to 2003. The findings of the study indicate that the domestic market, trade openness, return to capital and liberalization measures, infrastructural facilities and FDI have a positive impact, while government expenditure, political instability and macroeconomic uncertainty have a negative influence on private investment.

In Ghana, Frimpong and Marbuah (2010) used the ARDL approach to examine the determinants of private investment using data from 1970 to 2002. The study findings reveal that the determinants of private investment are public investment, real interest rate, inflation, real exchange rate, openness and a regime of constitutional rule in the short run, while in the long run, the determinants are inflation, real output, openness, real interest rate, external debt and real exchange rate. Using the error correction mode, Naa-Idar et al. (2012) also studied the determinants of private investment with data from 1960 to 2010 for Ghana. The study found that the determinants are GDP, inflation, public investment, exchange rate, trade openness, private sector credit, foreign aid and external debt in the short and long run.

In Brazil, Ribeiro and Teixeira (2001) investigated the determinants of private investment from 1956 to 1996. The findings of the study show that output, public investment and credit have a positive impact, while the exchange rate and inflation have a negative effect on private investment, and the interest rate was found to be insignificant. In Iran, Valadkhani (2004), using annual time series data from 1960 to 2000, found that in the short run, the growth of non-oil GDP is the main determinant of private investment. In Brazil, Acosta and Loza (2005), for the period from 1970 to 2000, found that in the short run, exchange rate and trade liberalization determine private investment, while in the long run, it is determined by both credit markets and well-developed financial. Using the ARDL methodology, Ouattara (2005) examined the determinants of private investment in Senegal using data from 1970 to 2000 and found that public investment, real GDP and foreign aid flows have a positive effect on private investment, while credit to private sector and terms of trade have a negative impact.

Using ARDL, Karagoz (2010) examined the determinants of private investments in Turkey for the period between 1979 and 2005 and found that in the long run, real GDP, private external debt and private sector credit to GDP are the positive determinants, while inflation, real exchange rate and trade openness are the negative determinants of private investment. Public investment and interest rates are found to be insignificant. In another study for Turkey, Akçay and Karasoy (2020) examined the determinants of private investment for the period from 1975 to 2014 using ARDL. The results indicate that democracy, output growth and financial development contribute positively to private investment. However, real interest rates, public investment and macroeconomic instability have a negative impact on private investment.

In Nigeria, using the ARDL approach, Ajide and Lawanson (2012) investigated the determinants of domestic private investment during the period from 1970 to 2010. The study found that real GDP, public investment, real interest rate, credit to the private sector, terms of trade, exchange rate and external debts are the determinants in the long run, while in the short run, real GDP, public investment and terms of trade are the determinants of private investment.

Adugna (2013), using the ordinary least square and data from 1981 to 2010 for Ethiopia, found that public investments, real GDP per capita and external debt have a positive influence on private investment. In the short run, inflation rate was found to have a negative impact. Other variables, such as lending interest rate and exchange rate, had an insignificant long-run effect, which was negative, while it was positive for economic openness and corporate tax. Using the ARDL approach for the period from 1992 to 2010, also for Ethiopia, Ambaye et al. (2013) found that domestic saving, exchange rate and domestic credit have a negative significant influence, while government expenditure and external debt are found to have a significant positive effect on domestic private investment. In Tanzania, Michael and Aikaeli (2014) examined the determinants of private investment using an error correction model for the period from 1975 to 2010. The study found that the variables that have an influence on the growth of private investment are GDP growth, public investment and credit to the private sector, while there was no evidence to suggest that exchange rate, degree of openness of the economy and interest rate have an impact on the growth of private investment.

Suhendra and Anwar (2014) examined the determinants of private investment in Indonesia from 1990 to 2011 and found that the positive determinants are government investment, credit availability for private investment, exchange rate and economic growth. Interest rates and inflation were found to be the negative determinants. Magableh and Ajlouni (2016) examined the determinants of private investment using data from 1976 to 2012 in Jordan using ARDL methodology. The study found that private investment is positively related to real GDP growth and negatively related to real public investment and real interest rates. For the period from 2000 to 2017, Ngoma et al. (2019) investigated the macroeconomic determinants of private investment for 35 sub-Saharan African (SSA) countries. The findings of the study reveal that public investment, GDP growth rate, inflation rate and interest rate are the determinants of private investment in the 35 SSA countries.

Using the ARDL methodology in Gambia, Ayeni (2020) examined the determinants of private investment with data from 1980 to 2019. The study found that government investment, credit to the private sector and interest rate have a positive influence, while real GDP and exchange rate have a negative impact and inflation and external debt are insignificant in the long run. In the short run, external debt, credit to the private sector and government investment are the positive determinants, while interest rate, inflation and exchange rate are the negative determinants, and real GDP is found to be insignificant.

In Kenya, Rwanda and Burundi for the period from 2009 to 2018, Mose et al. (2020) examined the macroeconomic determinants of domestic private investment and found that credit to the private and real GDP per capita have a positive and significant impact, while public investment has a negative and significant effect on private investment. In Malawi, Maluleke et al. (2023) investigated the determinants of domestic private investment in Malawi using the ARDL bounds testing approach for the period from 1980 to 2018. The study found that inflation and interest rate are the negative determinants of private investment in the long and short run, while trade openness is a positive determinant in the short run.

Mlambo and Oshikoya (2001) examined the relationship between macroeconomic factors and private investment in 40 developing countries in Africa, East Asia, Latin America, and South Asia from 1970 to 1996. The findings indicate that fiscal deficit, domestic credit to the private sector, the real exchange rate, and macroeconomic uncertainty had an impact on private investment. Using data from 1980 to 1997, Erden and Holcombe (2006) investigated in 19 developing countries the impact of public investment on private investment. The findings indicate that in the long run, public investment has a positive impact on private investment and is also positively related to real GDP. Private investment is found to be negatively related to uncertainty, while interest rate is insignificant. In the short run, real GDP, real interest rate and uncertainty are insignificant; however, public investment and the credit availability to the private sector have a significant impact on private investment.

In Malaysia, Ang (2009) examined the relationship between private domestic investment, public investment and foreign direct from 1960 to 2003 and found that in the long run, public investment and foreign direct investment stimulate private domestic investment. In another study for Malaysia, Tan and Tang (2012) examined the dynamic relationship between private domestic investment, the user cost of capital, and economic growth using data from 1970 to 2009. The results reveal that user cost of capital has a negative impact on private domestic investment, while economic growth has a positive effect on private domestic investment in the long run.

Fowowe (2011) examined the effect of financial sector reforms on private investment in selected sub-Saharan African countries from 1980 to 2006 and found that financial sector reforms have had a positive influence on private investment in the selected countries used in the study. In 18 sub-Saharan African countries, Misati and Nyamongo (2011) examined the relationship between financial sector development and private investment from 1991 to 2004. The results reveal that there is a negative relationship between the interest rate on deposits and private investment, while the credit to the private sector has a positive impact, and the turnover ratio on investment is found not to be significant. The study also found that the informal sector has a positive influence on private investment and also that in Africa, institutional variables play an important role in determining the level of private investment. In 91 developing host countries, Al-Sadig (2013) examined the effects of FDI inflows on private investment using data from 1970 to 2000. The results reveal that FDI stimulates private domestic investment. Furthermore, the findings reveal that in low-income countries, the positive effects of FDI on private investment depend on the availability of human capital. Tung (2019) examined the impact of foreign direct investment on private investment in Vietnam for the period from 2003 to 2017. The findings reveal that in the long and short run, foreign direct investment and GDP per capita have a positive influence on private investment, while inflation has a negative effect and net export is insignificant. Table 1 presents the summary of the empirical literature on the determinants of private investment.

Table 1. A summary of the empirical literature on the determinants of private investment

Author (s)	**Region/Country and sample period**	**Methodology**	**Findings**
Oshikoya (1994)	four middle-income and four low-income African countries 1970 to 1988	Ordinary least squares	- Lagged debt service ratio, the domestic inflation rate, the public investment rate and the real exchange have the most impact on private investment rate in middle-income countries. -Credit to the private sector, GDP growth rate and debt service ratio had the most impact on low-income countries
Mitiku (1996)	Ethiopia 1975 to 1994	Ordinary least squares	-Private investment is determined by the availability of finance, the real exchange rate, policy and external debt
Mlambo and Oshikoya (2001)	40 developing countries from Africa, Latin America, East Asia and South Asia 1970 to 1996	Panel data regressions	Domestic credit to the private sector, fiscal deficit, real exchange rate, and macroeconomic uncertainty have an effect on private investment

Ribeiro and Teixeira (2001)	Brazil 1956 to 1996	ARDL approach	In the long and short run: - Output, public investment and financial variables have a positive effect. - Exchange rate has a negative effect
Valadkhani (2004)	Iran 1960 to 2000	Error correction model	The growth of non-oil GDP is the main determinant in the short run.
Acosta and Loza (2005)	Argentina 1970 to 2000	Error correction techniques	-In the short run, exchange rate and trade liberalization -In the long run, well-developed financial and credit markets
Ouattara (2005)	Senegal 1970 to 2000	ARDL approach	- Public investment, real income and foreign aid flows have a positive impact on private investment. - Credit to the private sector and terms of trade have a negative impact
Erden and Holcombe (2006)	19 developing countries 1980 to 1997	Error correction model	In the long run: - Private investment is positively related with public investment and real GDP - Private investment is negatively related to uncertainty. In the short run: -Public investment and the credit availability to the private sector have a significant impact
Kumo (2006)	South Africa 1975:Q1 to 2003:Q3	Error correction model	Macroeconomic uncertainty has negative effects on private fixed investment.
Ambachew (2010)	Ethiopia 1950 to 2003	Multivariate single equation ECM estimation	- Private investment is influenced positively by the domestic market, return to capital, trade openness, liberalization measures, infrastructural facilities and FDI. - Government expenditure, macroeconomic uncertainty and political instability have a negative influence on private investment
Frimpong and Marbuah (2010)	Ghana 1970 to 2002	ARDL approach	- In the short run, the determinants are public investment, inflation, real interest rate, openness, real exchange rate and a regime of constitutional rule.

			- In the long run, the determinants are real output, inflation, external debt, real interest rate, openness and real exchange rate
Karagoz (2010)	Turkey 1979 to 2005	ARDL approach.	In the long run, real GDP, the ratio of private sector credit to GDP, real exchange rate, private external debt, trade openness, and inflation are the main determinants
Fowowe (2011)	sub-Saharan African countries 1980 to 2006	Panel data analysis	Financial sector reforms have a positive effect
Ajide and Lawanson (2012)	Nigeria 1970 to 2010	ARDL approach	- In the long run, public investment, real GDP, real interest rate, exchange rate, credit to the private sector, terms of trade and external debts are the determinants of private investment. - In the short run, the determinants are public investment, real GDP and terms of trade
Naa-Idar, *et al.* (2012)	Ghana 1960 to 2010	Error correction model	- The long- and short-run determinants are inflation, exchange rate, public investment, GDP, trade openness, foreign aid, private sector credit and external debt.
Tan and Tang (2012)	Malaysia 1970 - 2009	Vector error correction model	In the long run: - Economic growth has a positive effect - User cost of capital has a negative effect
Adugna (2013)	Ethiopia 1981 to 2010	Ordinary least square regression	In the long run: - Public investments, external debt and real GDP per capita have a positive effect - Lagged private investment has a negative effect In the short run: - GDP per capita and external debt have a positive influence - Lagged inflation rate has a negative effect
Al-Sadig (2013)	91 developing host countries 1970 to 2000	System generalized method of moments	FDI stimulates private domestic investment
Ambaye *et al.* (2013)	Ethiopia	ARDL approach	- Domestic saving, exchange rate and domestic credit have a negative effect

	1992 to 2010		- Government expenditure and external debt have a significant and positive impact
Michael and Aikaeli (2014)	Tanzania 1975 to 2010	Error correction model	- The determinants of private investment are public investment, GDP growth and credit to the private sector.
Suhendra and Anwar (2014)	Indonesia 1990 to 2011	Multiple regression method	- Positive determinants of private investment are government investment, exchange rate, availability of credit for private investment and economic growth. - Negative determinants of private investment are Inflation and interest rates.
Molapo and Damane (2015)	Lesotho 1982 to 2013	ARDL approach	In the long run: - Economic growth and public investment have a positive influence. - General price level has a negative impact In the short run: -Public investment has a positive effect
Magableh and Ajlouni (2016)	Jordan 1976 to 2012	ARDL approach	In the long and short run: - Private investment is positively related to real GDP growth. - Private investment is negatively related to real public investment and real interest rate
Ngoma *et al.* (2019)	35 Sub-Saharan African countries 2000 to 2017	Pooled regression, fixed effects and random effects models	- The determinants of private investment are GDP growth rate, interest rate, inflation rate, and public investment
Tung (2019)	Vietnam 2003 to 2017	Error correction model	In the long and short run: - Foreign direct investment and GDP per capita have a positive influence. - Inflation has a negative impact.
Akçay and Karasoy (2020)	Turkey 1975 to 2014	ARDL approach	- Democracy, financial development and output growth have a positive impact on private investment. - Macroeconomic instability, real interest rate and public investment have a negative impact on private investment.
Ayeni (2020)	Gambia	ARDL approach	In the long run:

	1980 to 2019		- Government investment, credit to the private sector and interest rate have a positive influence on private investment. - Real GDP and exchange rate are found to have a negative impact on private investment. In the short run: - Credit to the private sector, external debt and government investment are the positive determinants of private investment. - Exchange rate, interest rate and inflation are the negative determinants of private investment.
Mose *et al.* (2020)	Kenya, Rwanda and Burundi 2009 to 2018	Panel data approach	- Credit to the private sector and real GDP per capita are positive determinants of private investment. - Public investment is a negative determinant.
Maluleke *et al.* (2024)	Malawi 1980 to 2018	ARDL approach	In the long- and short-run: - Interest rates and inflation are the negative determinants of private investment. In the short run: - Trade openness is a positive determinant.

Source: Author's own compilation

3. Discussion of the Results

Overall, the empirical studies indicated that economic growth and public investment are mostly positive determinants and are significantly associated with private investment in both the long and short run (see Ribeiro & Teixeira, 2001; Ouattara, 2005; Erden & Holcombe, 2006; Ang, 2009; Tan and Tang, 2012; Adugna, 2013; Michael and Aikaeli, 2014; Suhendra & Anwar, 2014; Magableh & Ajlouni, 2016; Ngoma et al., 2019). The findings are similar, irrespective of whether the countries studied are from high-income, upper-middle-income or low-income countries. The proxies that are widely used for economic growth are GDP growth rate and GDP per capita. However, there are studies where economic growth was found to have an insignificant effect on private investment in the short run (Erden & Holcombe, 2006) and where public investment had an insignificant impact (Mitiku, 1996; Karagoz, 2010).

Some studies have found that public investment has a negative and significant effect on private investment (see Magableh & Ajlouni, 2016; Akçay & Karasoy, 2020; Ngoma et al. (2019). On the other hand, inflation is found to be the most negative and significantly associated with private investment in both the long and short run (see Ribeiro and Teixeira, 2001; Karagoz, 2010; Valadkhani, 2004; Adugna, 2013; Suhendra & Anwar, 2014; Ngoma et al., 2019). The findings are the same regardless of whether the study countries are categorised as high-income, upper-middle income, or low-income countries. However, it was also found to have a negative and significant effect on private investment (see Adugna, 2013; Suhendra & Anwar, 2014).

The determinant that was mostly found to have an insignificant effect on private investment is interest rates (see Mitiku, 1996; Ribeiro & Teixeira, 2001; Erden & Holcombe, 2006; Karagoz, 2010; Adugna, 2013; Michael & Aikaeli, 2014). The results also show that in some studies, interest rate has a significant negative impact on private investment (see Suhendra & Anwar, 2014; Magableh & Ajlouni, 2016). The findings are the

same regardless of whether the study countries belong to the high-income, upper-middle income, or low-income country category.

The availability of funds and credit to the private sector was also found to be a determinant of private investment. Misati and Nyamongo (2011) have found that it has a negative impact, while Karagoz (2010) found that it has a positive influence in the long run. In another study, Erden and Holcombe (2006) found that the credit to the private sector is a positive determinant in the short run, while Ouattara (2005) established a negative relationship in the long run.

The variables that are related to trade, such as terms of trade, trade openness and exchange rates, have been found to determine private investment. However, the literature review revealed mixed findings, where the variables are found to have a positive, negative or insignificant effect on private investment. Although these variables were found to be a positive and significant effect in certain instances (see Ambachew, 2010; Suhendra & Anwar, 2014) they were mostly negative and significant in most studies (see Ribeiro and Teixeira, 2001; Ouattara, 2005; Karagoz, 2010; Ambaye et al., 2013) while other studies have found that the variables have an insignificant effect on private investment (see Mitiku, 1996; Adugna, 2013; Michael & Aikaeli, 2014).

4. Conclusion

This paper has reviewed the empirical literature on the determinants of private investment. From the empirical front, it has been established that the determinants of private investment vary across different countries. The studies have established that credit to the private sector, interest rates, public investment, inflation, GDP growth, terms of trade, savings, external debt, and exchange rate are some of the determinants of private investment. However, the findings are inconclusive, as in some countries, the determinants are found to have a negative effect, in others, a positive effect, and in some, they have no significant impact on private involvement. Despite the inconclusive findings, among the established determinants, economic growth, public investment and credit to the private sector were mostly positive, while inflation, real interest rate and exchange rate were mostly negative determinants. The findings also differ significantly across the countries that are on the same level of development depending on the methodology used and the period of study. Since some macroeconomic variables, such as interest rate and inflation rate, are volatile in nature, and the linear ARDL model used in most studies does not capture the asymmetric relationship between the variables and private investment, future studies may consider using a nonlinear ARDL model to identify the key determinants of private investment and compare their findings with those of the ARDL approach. Additionally, there has been limited focus on the causal relationship between private investment and its macroeconomic determinants. Therefore, it is recommended that future studies place greater emphasis on exploring the causal relationship between private investment and its determinants.

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