



UNIVERSITI PUTRA MALAYSIA

**FOREIGN AID AND FOREIGN DIRECT INVESTMENT, CORRUPTION, AND
ECONOMIC GROWTH IN SUB-SAHARAN AFRICAN COUNTRIES**

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By

MASOUD RASHID MOHAMED

**Thesis submitted to the School of Graduate Studies, Universiti Putra Malaysia, in
Fulfillment of the Requirement for the Degree of Doctor of Philosophy**

January 2014

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DEDICATION

I dedicate this work to my beloved father Rashid Mohamed and mother Biubwa Shaali. I also dedicate this work to my beloved wife Salha, my son Murshid, and my daughter Buthayna.



Abstract of thesis presented to the Senate of the Universiti Putra Malaysia in fulfillment of the requirement for the degree of Doctor of Philosophy

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By

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January 2014

Chair: Shivee Ranjane Kaliappan, PhD

Faculty: Economics and Management

For over forty years, foreign aid has been one of the key development instruments for Sub-Saharan African (SSA) countries, specifically, and the African region as a whole. Foreign aid is largely channeled to assist the growth of the recipient countries by supplementing savings and foreign exchange constraints of the recipient countries. However, despite the huge flow of aid to SSA countries, economic growth is still low. This makes the region underdeveloped with high poverty rates. Besides foreign aid, SSA countries also experience a substantial increase in the flows of foreign direct investment (FDI), although the share is still small compared to the flows of FDI to other developing countries as a whole. Despite having more FDI now compared to previous decades, the region still experiences low economic growth. Another important issue in this respect is that the literature reveals that foreign aid and FDI cannot promote growth if they are associated with a higher level of corruption as corruption itself discourages growth. Against this background, this study intends to a) analyze the long run relationship between foreign aid, FDI and economic growth in Sub-Saharan African countries; (b) explore the empirical nexus between foreign aid and FDI flows in SSA countries; and (c) investigate the impact of foreign aid flows on the level of corruption in SSA countries.

Two methodologies were used to achieve the stated objectives. For the first and second objectives, the Generalized Method of Moments (GMM) approach was used, while for the third objective, a Quantile Regression approach was applied. The analyzed data covered the period of 1996 to 2010 for the first objective (with 41 sample countries); 1990 to 2010 for the second objective (45 countries); and 2000 to 2010 for the third objective (42 countries).

The findings reveal that while foreign aid has a negative effect on growth, the impact of FDI is positive but statistically insignificant. Aid from different bilateral donors was found to have a different impact on growth. The results further indicate that all three

categories of aid (total, bilateral, and multilateral) have a direct positive effect on the flow of FDI. Moreover, the findings indicate that poor institutional quality is associated with the low inflow of FDI into SSA countries. Concerning the link between foreign aid and corruption, the results show that aid has the tendency of increasing the corruption levels of SSA countries. The results further reveal that aid from different bilateral sources has a different impact on corruption. That is, aid from some bilateral donors such as France and US reduce corruption while aid from some other bilateral donors (UK, Canada, and Germany) increases corruption.

Based on the findings, the study suggests that the allocation of aid should be targeted towards the improvement of institutional quality in order to generate the desired outcome of high economic growth. Moreover, it is highly crucial to ensure that the aid fund is allocated to the most productive sectors so that a substantial improvement could be achieved in the economic growth and welfare of SSA countries. This could be achieved if the coordination between the various donors (bilateral and multilateral) is also improved. Since current allocation of aid seem to be associated with increase of corruption, the allocation policy should be revisited to ensure that aid improve the quality of institution and governance of recipient countries in order to reduce the level of corruption. This would eventually ensure more inflows of aid and FDI in the future and will result in a noticeable impact on the economic growth of SSA countries.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi syarat Ijazah Doktor Falsafah

**KESAN BANTUAN ASING, PELABURAN LANGSUNG ASING DAN RASUAH
TERHADAP PERTUMBUHAN EKONOMI DI NEGARA-NEGARA AFRIKA
SUB-SAHARA (SSA)**

Oleh

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Sejak lebih empat dekad yang lepas, bantuan asing merupakan salah satu daripada instrumen pembangunan utama di negara-negara Afrika Sub-Sahara (SSA), khususnya, dan wilayah Afrika, amnya. Bantuan asing kebanyakannya disalurkan untuk membantu pertumbuhan negara-negara penerima dengan menambah tabungan dan kekangan pertukaran asing di negara-negara tersebut. Meskipun terdapat pelbagai bantuan asing yang disalurkan ke negara-negara SSA, pertumbuhan ekonomi di wilayah ini masih berada di tahap yang rendah, dengan kadar kemiskinan yang sangat tinggi. Selain daripada bantuan asing, negara-negara SSA juga mengalami peningkatan pelaburan langsung asing (FDI) yang tinggi, walaupun jumlahnya masih kecil berbanding aliran FDI ke negara-negara membangun yang lain. Walaupun jumlah FDI kini lebih tinggi berbanding beberapa dekad lalu, wilayah ini masih mengalami pertumbuhan ekonomi yang rendah. Kajian lepas juga menunjukkan bahawa bantuan asing dan FDI tidak boleh membantu pertumbuhan ekonomi jika ia dikaitkan dengan kadar rasuah yang tinggi kerana rasuah dipercayai menghalang pertumbuhan. Atas dasar ini, kajian ini ingin a) mengkaji hubungan jangka panjang antara bantuan asing, FDI dan pertumbuhan ekonomi di negara-negara Afrika Sub-Sahara; (b) meneroka neksus empirikal antara bantuan asing dan aliran FDI di negara-negara SSA; dan (c) mengkaji kesan aliran bantuan asing terhadap tahap rasuah di negara-negara tersebut.

Dua kaedah digunakan untuk mencapai objektif kajian ini. Kaedah Generalized Method of Moments (GMM) digunakan bagi objektif pertama dan kedua, manakala pendekatan Quantile Regression pula digunakan bagi objektif ketiga. Data analisis meliputi tempoh kajian dari tahun 1996 hingga 2010 bagi objektif yang pertama (41 negara); 1990 hingga 2010 bagi objektif yang kedua (45 negara); dan 2000 hingga 2010 bagi objektif yang ketiga (42 negara).

Hasil kajian mendapati bahawa bantuan asing mempunyai kesan negatif terhadap pertumbuhan ekonomi, sedangkan kesan FDI pula adalah positif tetapi tidak signifikan secara statistik. Bantuan dua hala juga didapati mempunyai kesan yang berbeza terhadap pertumbuhan ekonomi. Hasil kajian seterusnya menunjukkan bahawa ketiga-tiga kategori bantuan (keseluruhan, dua hala, dan pelbagai hala) mempunyai kesan langsung yang positif terhadap aliran FDI. Tambahan lagi, hasil kajian menunjukkan bahawa kualiti institusi yang lemah dikaitkan dengan aliran FDI yang rendah ke negara-negara SSA. Melihat kepada hubungan antara bantuan asing dan rasuah, hasil kajian menunjukkan bahawa bantuan asing cenderung untuk meningkatkan tahap rasuah di negara-negara tersebut. Sementara itu, bantuan daripada sumber dua hala pula mempunyai kesan yang berbeza terhadap rasuah, di mana bantuan dua hala, contohnya daripada Amerika Syarikat dan Perancis dapat mengurangkan rasuah manakala bantuan daripada sesetengah sumber dua hala yang lain boleh meningkatkan rasuah.

Berdasarkan analisis, kajian ini mencadangkan bahawa peruntukan bantuan haruslah menyasarkan kepada penambahbaikan kualiti institusi untuk menjana hasil pertumbuhan ekonomi tinggi seperti yang dikehendaki. Tambahan lagi, adalah penting untuk memastikan bahawa dana diperuntukkan kepada sektor yang paling produktif supaya peningkatan pertumbuhan dan kebajikan ekonomi yang lebih banyak dapat dinikmati di negara-negara SSA. Ini juga boleh dicapai melalui peningkatan koordinasi antara pemberi bantuan (dua hala dan pelbagai hala). Oleh kerana peruntukan bantuan semasa dikaitkan dengan peningkatan rasuah, maka dasar peruntukan perlulah dikaji semula bagi meningkatkan kualiti institusi dan tadbir urus di samping menurunkan tahap rasuah di negara-negara penerima. Ini seterusnya dapat memastikan bahawa aliran bantuan dan FDI terus meningkat di masa hadapan dan dapat memberi kesan yang lebih besar terhadap pertumbuhan ekonomi di negara-negara SSA.

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I certify that a Thesis Examination Committee has met on 28 January 2014 to conduct the final examination of Masoud Rashid Mohamed on his thesis entitled "Foreign Aid and Foreign Direct Investment, Corruption, and Economic Growth in Sub-Saharan African Countries" in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Doctor of Philosophy.

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DECLARATION

Declaration by the student

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