

# Economic globalization, institutions and development

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Summary of the PhD Dissertation

## **Economic Globalization, Institutions and Development: Essays on Aid, Foreign Direct Investment and Trade**

By: HASSEN ABDA WAKO

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This dissertation is an empirical investigation into the interaction between institutions, economic globalization (aid, foreign direct investment (FDI) and trade) and economic development. It looks beyond the growth effect of aid (Chapter 2) and FDI (Chapter 3) in the context of Sub-Saharan Africa (SSA), and the role of institutions in explaining comparative advantage (Chapter 4). It consists of five chapters, including the general introduction in Chapter I that sets the stage and highlights the main contents of the dissertation.

The second chapter examines the institutional and growth effects of development aid. It contributes to the aid-effectiveness debate in the following ways. Firstly, it considers aid from each donor (a total of twenty-two donors including China) to be (potentially) unique and empirically tests for the effectiveness of each. In a similar manner, it allows for the possibility that each recipient responds to aid inflows in a unique way, which is made possible with the state-of-the-art long-panel data techniques – the (Pooled) Mean Group, (P)MG, estimators. In its application of the PMG estimator, this chapter has also taken note of a methodological issue – related to the order of integration of variables – which the few works on aid-growth regression that applied the technique fell short of. In addition to the donor and recipient heterogeneity (and the related methodological issue), the paper has another novel contribution. Instead of taking institutional quality as an ‘environmental variable’ that just conditions the effectiveness of aid, it allows for institutional quality itself to be affected by aid inflows. The findings indicate the danger involved in categorically judging macro aid as either effective or ineffective. Aid from certain donors has a clear positive effect on growth and/or institutional quality; aid from some others has a clear negative effect; and aid from certain donors has no or indeterminate effects. On the other hand, despite differences in their short-run (growth and institutional) responses to aid inflows, recipients in the region share common long-run parameters. The heterogeneity in the effectiveness of aid from different donors points to some interesting policy lessons. First, it reinforces the call for a shift of focus from ‘scaling-up’ aid to giving a ‘better-quality’ aid. Furthermore, some unexpected results point to the primacy of *specialization* and *harmonization* over other facets of quality.

Chapter 3 deals with the empirical association between FDI and some macroeconomic variables in the context of Sub-Saharan Africa. In addition to the widely studied growth-effect of FDI, the chapter examines the influences of FDI on institutional quality and structural change. It contributes to the literature on FDI-development nexus in the following ways. Firstly, instead of taking institutional quality as an exogenous variable that conditions the amount of FDI a country can attract, it allows for institutional quality itself to be affected by FDI inflows. Secondly, it assesses the effect of FDI inflow on structural change – i.e., on the share of manufacturing value added both relative to total value added (GDP) and relative to value added in the non-manufacturing industrial sub-sector. Finally, it allows for host-specific effect of FDI. The findings indicate that the growth-effect of FDI to the region is positive. Secondly, both economic growth and institutional quality records of a country do help in attracting more FDI inflows. On the other hand, FDI has undesirable effects on some institutional quality aspects, namely, rule of law, corruption, and voice and accountability. In addition, FDI to the region preferentially flows to resource-rich

countries, and thereby enhances extensive form of economic growth and contributes to the 'pre-mature' deindustrialization of countries in the region. Thus, the chapter concludes that FDI as a medicine for developmental bottlenecks comes with some side-effects.

Chapter 4 assesses the influence of institutions on comparative advantage. Its novelty lies in decomposing the effect into the extensive and intensive margins, and examining regional disparities. Using data from (almost) all countries pairs in the world, it shows that institutions robustly explain comparative advantage, but are still outplayed by factor endowments, especially by human capital. The benefits to institutional quality improvements accrue through both the intensive and extensive margins (the larger share being through intensive) in the full dataset as well as in the developed world. On the other hand, benefits to developing regions come from the extensive margin. For SSA in particular the benefits come from the extensive margin and mainly from the within-region trade.

Chapter 5 concludes the dissertation, presents some policy implications and suggests areas for further research.