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The effects of international financial inflows on economic complexity in Africa: does institutional quality play a moderation role?

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ABSTRACT

We investigated the effects of international financial inflows (remittances, foreign direct investment and foreign aid) on economic complexity in Africa and the moderation role of institutional quality. We used the dynamic system GMM framework for a panel of 31 African countries over the period 2010–2020. We find that these international financial inflows are significant drivers of economic complexity in Africa, and that institutional quality is significantly moderating and enhancing their effects on economic complexity. Among other recommendations, we encourage policymakers in Africa to continually create an enabling environment to attract these financial inflows in order to promote sustainable investment and economic growth.

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1. Introduction

One of the challenges facing African economies is low domestic savings, which is making it difficult for these economies to finance capital investments. For instance, statistical evidence from the United Nations Conference on Trade and Development (UNCTAD 2020) shows that Sub-Saharan Africa (SSA) has domestic savings consisting of 17.5% of gross domestic product (GDP) compared to other regions of the world, such as East Asia (45%), Pacific (45%) and South Asia (35%). Thus, international financial inflows are needed in Africa to bridge the savings-investment gap in order to achieve sustainable investment and economic growth (Ikpesu 2019). International financial inflows can be in the form of remittances, foreign direct investment (FDI), foreign aid, foreign portfolio investment or sovereign debt (Iheonu, Ihedimma, and Omenihu 2017). Indeed, it has been postulated that through financial inflows, sectoral growth can be fostered by engendering diversification and expansion of the productive capacities of recipient countries, thereby increasing the volume and quality of exports (World Bank 2019).

Interestingly, following the works of Hausmann, Hwang, and Rodrik (2007) and Hidalgo and Hausmann (2009), the concept of economic complexity has rekindled the interests of economic researchers and policymakers globally in the competitiveness and

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productive structures of economies around the world. Two sub-concepts underlie the subject of economic complexity, namely: diversity and ubiquity. While diversity refers to the percentage of products that are exported abroad by a given country, a product's ubiquity is measured by the number of countries to which the exports are destined. Hence, economic complexity is a concept used to describe the diversity of a country's exports in terms of products and export destinations. Some empirical studies have highlighted the economic benefits of economic complexity at regional and national levels (Zhu and Li 2017; Sweet and Eterovic 2019; Shahzad et al. 2021; Vu 2022; Ajide 2022). Unfortunately, when compared to other regions of the world, most of the countries in Africa are placed at the bottom of the economic complexity ranking as shown in Table 1. This low ranking of African economies in the atlas of economic complexity index motivated this study to investigate the macroeconomic factors influencing economic complexity on the continent from the perspective of international financial inflows and the moderating role of institutional quality.

An emerging literature has generally highlighted the important roles of factors such as FDI, remittances, financial development, research and development spending, and trade, as determinants of economic sophistication (Hartmann et al. 2017; Canh, Schinckus, and Thanh 2020; Mealy and Teytelboym 2022; Njangang et al. 2021). For instance, inflow of remittances constitutes a major source of income and accounts for over 20% share of GDP in many developing economies (Qamruzzaman and Jianguo 2020). Global remittances were approximately US$625 billion in 2017, and developing countries received over US$468 billion, which is nearly three times the amount of official development assistance (ODA) in the same period (World Bank 2020). Indeed, international remittances have become one of the most visible benefits of the growing migration to developing countries. Remittances to SSA have been on the increase since 1990. It rose

Table 1. Ranking of countries in the 2020 atlas of economic complexity index (ECI).

Top 20 Countries in 2020 ECI Ranking				Top 20 African Countries in 2020 ECI			
S/No.	Country	Ranking	2020 ECI	S/No.	Country	Ranking	2020 ECI
1	Japan	1	2.19	1	South Africa	54	0.09
2	Switzerland	2	1.99	2	Tunisia	55	0.07
3	Chinese Taipei	3	1.97	3	Egypt	68	−0.17
4	Germany	4	1.88	4	Kenya	80	−0.47
5	South Korea	5	1.88	5	Morocco	81	−0.50
6	Singapore	6	1.84	6	Botswana	85	−0.58
7	Sweden	7	1.59	7	Tanzania	86	−0.65
8	Czechia	8	1.57	8	Namibia	87	−0.66
9	United States	9	1.56	9	Senegal	91	−0.70
10	Austria	10	1.52	10	Zambia	92	−0.71
11	Finland	11	1.47	11	Niger	95	−0.72
12	Slovenia	12	1.46	12	Togo	96	−0.87
13	United Kingdom	13	1.42	13	Ethiopia	97	−0.88
14	Hungary	14	1.40	14	Zimbabwe	98	−0.91
15	France	15	1.34	15	Uganda	99	−0.97
16	Ireland	16	1.34	16	Mali	103	−1.05
17	Belgium	17	1.33	17	Rep. of the Congo	106	−1.09
18	Slovakia	18	1.31	18	Cote d'Ivoire	108	−1.17
19	Italy	19	1.30	19	Algeria	112	−1.19
20	Israel	20	1.16	20	Mozambique	114	−1.24

Source: Authors, with data from Massachusetts Institute of Technology's Observatory of Economic Complexity (http://atlas.media.mit.edu).

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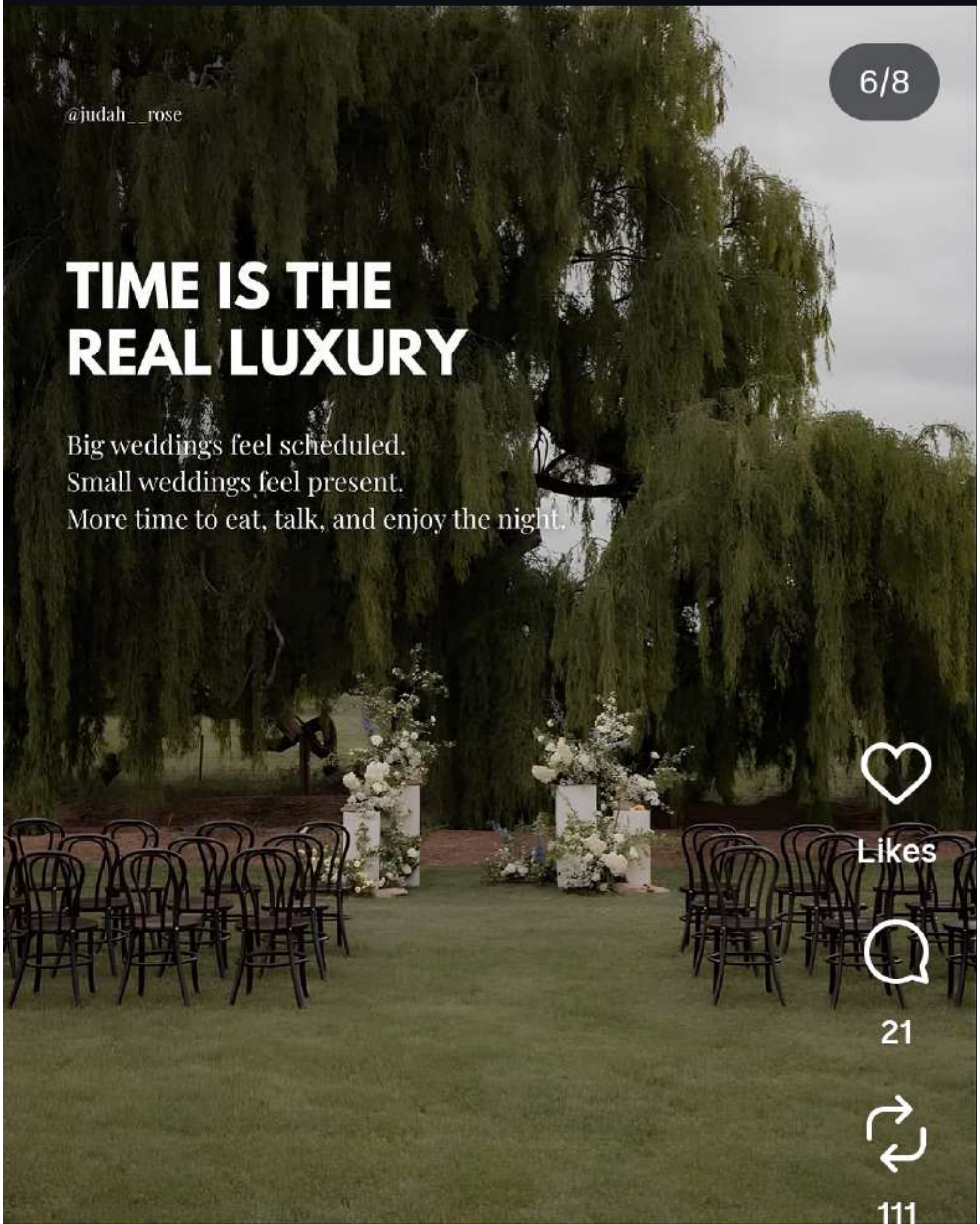
small weddings



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