

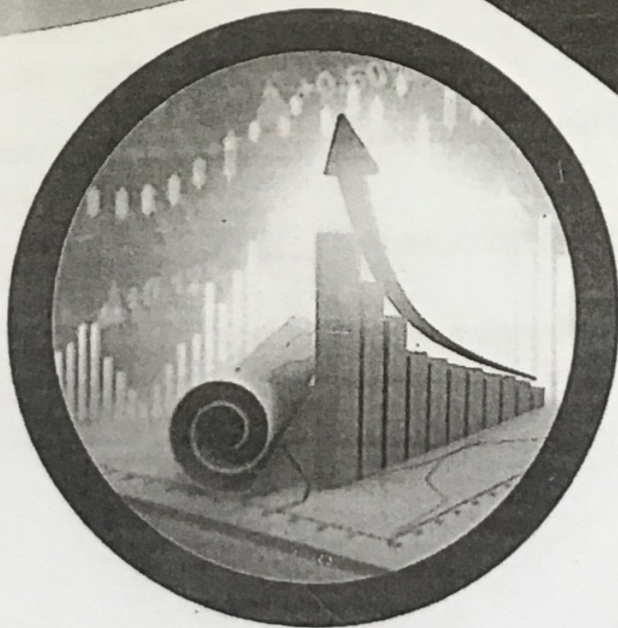
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THE MODERATING EFFECT OF INSTITUTIONAL FACTORS IN THE CHINESE FDI-ECONOMIC GROWTH NEXUS FOR SUB-SAHARAN AFRICA

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ABSTRACT

This study examines the impact of Chinese Foreign Direct Investment (FDI) on economic growth in Sub-Saharan Africa (SSA), highlighting the critical role of institutional quality. The study used System Generalized Method of Moments (SGMM) and Driscoll and Kraay regression techniques to analyze panel data of 48 SSA countries spanning over a period of 2003 – 2022. The results revealed that institutional quality significantly reduces the positive effects of Chinese FDI on economic growth. These findings emphasized that institutional factors such as Control of Corruption, Government Effectiveness, and Political Stability are fundamental in maximizing the benefits of FDI. The need for policymakers to prioritize institutional improvements and sound financial management is important to optimize the benefits of Chinese FDI. This involves strengthening anticorruption measures to reduce corruption, enhancing government effectiveness, and ensuring political stability.

JEL Classifications: F2, K4, O43

Keywords: Chinese Foreign Direct Investment (FDI), Economic Growth, Institutions, GMM, Africa

1. Introduction

In recent years, the economic relationship between China and Sub-Saharan Africa (SSA) has expanded significantly, with China emerging as a leading player in foreign direct investment (FDI) among developing nations. This trend is evident in China's substantial investments across 48 SSA countries, particularly in Southern and Western Africa, where FDI inflows have markedly increased.

As of 2010, China's total outward FDI to SSA reached an impressive \$32.08 billion, reflecting a 23-fold increase since 2003. For instance, in Zambia and Niger, Chinese FDI surpassed 5% of GDP by 2010. This surge in Chinese FDI is anticipated to yield numerous benefits for SSA economies. Directly, FDI enhances the host country's productive capacity by augmenting capital stock, stimulating

domestic savings, and encouraging additional investments (Bosworth & Collins, 1999; Henry, 2003; Mody & Murshid, 2005). Indirectly, it serves as a conduit for technology transfer and business expertise, facilitating local economic growth by improving workforce skills, reducing production costs, and creating a competitive market environment (Borensztein et al., 1998; Findlay, 1978; Görg & Greenaway, 2004).

However, the FDI-economic growth link is complex and significantly affected by different factors, particularly the quality of institutions in host countries. Institutional quality refers to the effectiveness and efficiency of institutions in enforcing laws, maintaining political stability, and fostering economic development. Therefore, the mediation effect of institutional quality on the relationship between FDI and economic growth is essential to understand, especially in SSA, where institutional systems vary widely. This leads to the central research question of this study: How does institutional quality influence the effect of Chinese FDI on economic growth in Sub-Saharan Africa?

Strong institutions facilitate the positive spillovers of FDI through several transmission channels. First, they ensure the efficient allocation of resources by directing investments toward productive sectors of the economy. Institutions that uphold property rights and enforce contracts reduce investment risks, stabilize capital flows, and encourage long-term investments, ultimately improving the host economy's productive capacity (Anyanwu & Yameogo, 2015; Mendoza & Serrano, 2022). Second, effective institutions lower transaction costs by minimizing bureaucratic inefficiencies and corruption, creating a more favourable business environment that boosts profitability and competitiveness. Third, strong institutions support human capital formation by promoting education and skills development, which are critical for technology transfer and the

adoption of new practices introduced by foreign investors. Moreover, political stability and the rule of law foster a predictable and secure environment for business operations, enhancing investor confidence and sustaining economic activities (Bello & Adeniyi, 2020).

Despite these potential benefits, the moderating role of institutional quality in the relationship between Chinese FDI and economic growth remains underexplored. Existing literature has often overlooked how varying institutional frameworks influence investment outcomes. For instance, while some studies argue that a 1% rise in China's FDI stock can significantly enhance Africa's GDP growth by 0.607% (Kaplinsky & Morris, 2009), others express concerns about governance and sustainability implications (Ado & Su, 2016; Tang, 2016). Furthermore, the specific impact of Chinese FDI, given the institutional conditions, warrant attention, as they can yield distinct economic growth effects. In addressing these gaps, this study explicitly analyses the role of institutional quality in shaping the relation between Chinese FDI and economic growth in SSA. The research investigates how institutional quality influences the effect of Chinese FDI on economic performance while exploring the complex factors driving growth in the region. Additionally, it highlights how improvements in governance and regulatory frameworks can improve the direct effects of FDI, promoting sustainable economic development.

To achieve these objectives, this study analyzes panel data from 48 SSA countries covering the years 2003-2022, using a two-step System Generalized Method of Moments (SGMM) approach for growth model estimation and address the cross-sectional dependence that may influence the panel structure. The empirical results demonstrated that institutional quality plays an important role in stimulating economic growth, with its impact varying across different institutional

frameworks. By focusing on the intersection of Chinese FDI, economic growth, and institutional quality, this study contributes new insight to the understanding of these dynamics in SSA, ultimately filling a critical gap in existing research.

2. Literature Review

2.1 Review of theoretical literature

This study depends on the comprehensive theoretical framework by integrating Romer's Endogenous Growth Theory (Romer, 1990), Institutional Theory, and the concept of Institutional FDI Fitness (Wilhelms & Witter, 1998) to examine the role of institutions in the relationship between Foreign Direct Investment (FDI) and economic growth in Sub-Saharan Africa (SSA). Romer's Endogenous Growth Theory posits that endogenous factors drive economic growth, notably human capital, innovation, and knowledge spillovers (Romer, 1990). This theory underscores the critical role of economic agents individuals and firms in generating and disseminating new ideas and technologies. Unlike exogenous growth models that treat technological progress as external, Romer's theory emphasizes that investment in knowledge and innovation is essential for sustained economic growth. Foreign Direct Investment (FDI) can significantly facilitate technological advancement and economic development by providing capital, advanced technologies, and managerial expertise to host countries. Through technology transfer, foreign firms enhance the productivity of local industries, contributing to overall economic growth. Additionally, FDI fosters human capital development by offering training and skill development opportunities for the local workforce, which is crucial for the technological advancement needed in Sub-Saharan Africa (SSA). Institutional Theory complements Romer's framework by highlighting the role of institutions in shaping the investment frameworks and economic

outcomes. North (1990) defines institutions as the rules, norms, and organizations structuring human interaction. Strong institutions are crucial for creating an environment conducive to investment, providing governance structures, regulatory frameworks, and property rights protections that influence investor behavior. In SSA, the quality of institutions significantly affects the effectiveness of FDI. Countries with robust institutions are better positioned to manage foreign investments, maximizing benefits and mitigating potential negative externalities (Acemoglu, Johnson, & Robinson, 2001). In contrast, weak institutions can deter investment by fostering an unpredictable business environment characterized by corruption and political instability (Knack & Keefer, 1995).

Moreover, the link between FDI and institutional quality is bidirectional: strong institutions enhance FDI effectiveness, while the inflow of FDI can incentivize institutional reforms. The presence of foreign investors often drives improvements in governance and regulatory practices, as governments aim to create favourable business environment to attract and retain foreign capital. This interaction emphasizes the significance of institutional quality in analyzing the effect of FDI on economic growth. The concept of Institutional FDI Fitness further enriches the theoretical framework by examining the compatibility between foreign investment and the institutional environment of host countries. Wilhelms and Witter (1998) propose that the effectiveness of FDI is contingent upon the alignment between the investment strategies of multinational corporations and the institutional context of the receiving country. This concept emphasizes that not all types of FDI are equally beneficial, and the effect of FDI on economic growth can vary significantly depending on the institutional framework in place. In SSA, the diversity of institutional settings across countries presents both challenges and opportunities for FDI.

Multinational corporations may adopt different strategies based on the institutional context which can influence the overall impact of their investments on local economies. For example, FDI aimed at resource extraction may have limited spillover effects on local economies in countries with weak institutional frameworks (Jenkins & Thomas, 2002). In contrast, FDI focused on manufacturing and services may be more conducive to technology transfer and human capital development in countries with stronger institutions (Asiedu, 2002).

2.2 Empirical Review

2.2.1 FDI and Institutions

Anyanwu and Yameogo (2015) analyzed the impact of regional integration and institutional quality on FDI in Africa, utilizing both cross-sectional and panel data techniques. They demonstrated that if institutional quality improves, particularly governance and regulatory frameworks, it is associated with significant increases in FDI inflows across African countries. Their findings underscore the importance of regional cooperation in enhancing institutional standards to attract more investment. Bello and Adeniyi (2020) investigate the role of corruption control in FDI attraction using data from several developing countries. They find that countries with better corruption control tend to receive higher levels of FDI, emphasizing that transparent and accountable governance systems are crucial for fostering investor confidence. This supports the broader understanding that institutional integrity plays a pivotal role in attracting international capital. Adusei (2021) investigated the effect of political stability on FDI in Africa, finding a robust correlation between stable political environments and increased FDI inflows. This study highlights that investors are particularly sensitive to political risks and prefer investing in countries with predictable and stable governance.

Sangaré (2020) investigates the relationship between economic freedom and FDI, using data from various African nations. The study observed that higher levels of economic freedom, characterized by open markets and minimal government intervention, are positively associated with FDI inflows. This aligns with the notion that free-market policies can create an attractive environment for foreign investors. Quazi, Vemuri, and Soliman (2019) identify corruption as a significant barrier to FDI in Africa, underscoring the need for anti-corruption measures and governance reforms. This is echoed by Samimi and Ariani (2010), who highlight the positive influence of economic freedom and strong institutions on FDI inflows in developing countries. Tiba and Frikha (2019) find that better institutional frameworks enhance FDI inflows in the MENA region, reflecting trends observed in SSA. Du, Lu, and Tao (2018) highlight the importance of political stability and institutional quality. Their research indicates that Chinese investors prioritize countries with stable political environments and effective governance structures. Similarly, Khayat (2021) found that property rights protection and bureaucratic efficiency are crucial factors that determine FDI attractiveness in African countries, reinforcing the notion that institutional quality significantly moderates the impact of FDI on economic growth. Bellos and Subasat (2017) study 38 developing countries from 1996 to 2013, employing a system GMM estimator to analyze the role of institutions in attracting FDI. They find that regulatory quality and rule of law are crucial determinants of FDI, suggesting that institutional reforms can enhance investment attractiveness. Ajide and Eregha (2015) found that improvements in institutional quality, such as government effectiveness, regulatory quality, and the rule of law, positively influence FDI inflows in West African countries. This suggests that strengthening institutional frameworks is essential for enhancing the region's

attractiveness to foreign investors, including those from China. Asiedu and Lien (2011) emphasize the conditional effects of democracy on FDI, noting that democratic institutions can boost FDI when accompanied by effective control of corruption, a factor particularly relevant for Chinese investors seeking stable environments.

2.2.2 Institutions and Economic Growth

Institutions and economic growth have been extensively studied in recent years. Veiga (2021) uses a System-GMM estimator to analyze data from 180 countries from 1970 to 2015. The results showed that political instability has a significant negative impact on GDP per capita growth. Instability affects economic growth primarily by reducing productivity growth and, to a lesser extent, by hindering human and physical capital accumulation. Similarly, Mendoza and Serrano (2022) apply a panel data approach with fixed effects to 55 countries from 2000 to 2019. Their study confirms that strong institutional frameworks positively affect economic growth by enhancing market efficiency and reducing corruption. Devarajan et al. (2020) utilize dynamic panel data models to examine 140 countries over a 30-year period. They find that when governance indicators improve, such as the rule of law and regulatory quality, it significantly contributes to higher economic growth rates. Likewise, Haug et al. (2019) use a cross-sectional dataset from 82 countries. Through Ordinary Least Squares (OLS) and Instrumental Variables (IV) approaches, they demonstrated increased higher economic freedom is strongly associated with higher GDP per capita, especially in developing countries.

Fosu (2021) employs a panel data approach focused on 54 African countries from 1995 to 2019. The study shows that institutional quality, including political stability and regulatory quality, plays an important role in

enhancing economic growth, with significant implications for policy-making in the region.

La Porta et al. (2020) use a large cross-country dataset to assess the effect of legal institutions on economic growth. The results highlighted that better legal institutions especially property rights and contract enforcement, are positively correlated with economic growth. Galiani and Schargrodsky (2020) analyze data from 120 countries using a difference-in-differences approach. They find that improvements in governance structures lead to significant increases in GDP per capita, supporting the view that effective institutions drive economic performance. Similarly, Zhu and Yang (2021) employ System-GMM estimation to study the effect of institutional quality on economic growth in 60 nations from 2000 to 2020. Their results indicate that improvements in regulatory quality and political stability have a substantial positive effect on economic growth. Romer and Williams (2022) use a panel data approach with fixed effects to analyze 75 countries from 1995 to 2015. Their study confirms that higher levels of economic freedom and effective governance structures are associated with increased GDP growth. Finally, Ghosh and Ghosh (2022) analyze data from 110 countries using System-GMM. They find that improvements in institutional quality, particularly in terms of political stability and legal frameworks, leads to higher economic growth.

2.2.3 Institutions, FDI and Economic Growth

The question of whether institutions play a moderating role in the impact of FDI on economic growth has been explored in numerous studies. Alguacil et al. (2011) investigate whether nations with stronger institutional frameworks and macroeconomic conditions can utilize FDI more effectively, or whether these local factors serve as the pathways that drive growth. They use inflation rates and the external debt-to-export ratio as

indicators of the macroeconomic environment, and the Fraser Institute's Economic Freedom of the World Index to represent institutional quality. Their results highlight the importance of accounting for these environments when analyzing the relationship between FDI and economic growth in emerging market economies. It was observed that FDI has a sustained positive impact on growth in low-income nations, but this effect diminishes in more developed economies. Similarly, Kose, Prasad, and Taylor (2011) identify specific thresholds in financial depth and institutional quality that are crucial in the stages of financial integration. They suggest that the benefits of financial openness significantly increase when the thresholds are reached. Additionally, they observe that the threshold for equity-related flows, such as FDI and portfolio investments, is lower compared to that of debt flows.

Fang et al. (2021) employ a dynamic panel GMM estimator to study the effect of institutional quality on FDI efficiency in 65 developing countries from 2000 to 2020. Findings suggest that improvements in institutional quality, particularly in terms of the rule of law and regulatory quality, significantly boost the positive impact of FDI on economic growth. Gao et al. (2022) use a cross-sectional dataset of 110 countries and apply OLS and IV techniques to explore the role of institutional quality in enhancing FDI benefits. Their results indicate that better institutions are important for maximizing the growth benefits of FDI, especially in low-income countries. Hassan and Ali (2021) analyze data from 40 African countries using a panel fixed-effects model. They demonstrate that institutional quality, along with macroeconomic stability indicators such as inflation and external debt levels, significantly influences the effectiveness of FDI in promoting economic growth. Jiang et al. (2021) utilize a System GMM method to assess the linkage between macroeconomic stability and institutional quality in 75 countries from 2005 to 2019. They find that

countries with stable macroeconomic environments and high-quality institutions are more successful in translating FDI into economic growth.

Khan and Rizvi (2022) conduct a meta-regression analysis on studies involving over 100 nations and assessed the impact of institutional quality on FDI. Their study finds that strong legal institutions and effective governance are critical for enhancing the growth impact of FDI. Lee and Kim (2023) analyze 50 emerging economies using panel data techniques. They find that institutional quality and macroeconomic stability jointly determine the efficiency of FDI in boosting economic growth, suggesting that both factors are necessary for maximizing FDI benefits. Siddiqui et al. (2023) employ cross-sectional and panel data methods to analyze 120 countries. They show that better institutional environments and macroeconomic conditions significantly improves FDI efficiency in fostering economic growth. Umar and Bibi (2023) use a meta-analysis of studies involving over 100 countries. Their findings suggested that effective institutions and stable macroeconomic environments are critical for improving the impact of FDI on economic growth. Vargas and Pinto (2022) analyze 55 countries using a panel data approach with fixed effects. They demonstrate that while macroeconomic stability is important, high-quality institutions play a more substantial role in ensuring that FDI contributes to economic growth. Rao and Rajan (2022) use a difference-in-differences approach with data from 80 countries. Their findings reveal that countries with higher institutional quality experience more significant growth benefits from FDI compared to those with weaker institutions.

3. Data and Methodology

3.1 Model Specification

In order to capture the influence of institutional factors in the FDI and economic growth relationship, we adopted the standard growth

model commonly utilized in empirical growth studies (Brautigam, 2009; Buckley et al. 2019; Rodrik et al. 2004; Kaufmann et al. 2010; Barro, 1991) as shown in equation (1):

$$GDP_{it} = \alpha_0 + \alpha_1 CHNFDI_{it} + \alpha_2 INSTQ_{it} + \alpha_3 (CHNFDI_{it} \times INSTQ_{it}) + \alpha_4 X_{it} + D_t + \varepsilon_{it} \quad (1)$$

where: GDP_{it} represents the annual GDP growth rate in country i at year t , $CHNFDI_{it}$ denotes China's outward Foreign Direct Investment (FDI) as a percentage of host country's GDP, measuring the influence of Chinese investments. $INSTQ_{it}$ is an institutional quality indicator reflecting governance effectiveness, control of corruption, regulatory quality, voice and Accountability, political stability and rule of law in country i at year t . X_{it} encompasses exogenous variables like gross national savings, terms of trade, money supply deviation, and current account balance, influencing economic stability and growth. The selection of the control variables is inferred from the previous empirical studies (Alfaro et al. 2004; Ajide & Eregha, 2015; Alguacil et al. 2011).

D_t represents year dummies to capture time-specific effects. ε_{it} is the error term accounting for unobserved factors affecting Growth GDP_{it} . Coefficient α_1 captures the direct effect of Chinese FDI on economic growth. This variable assesses how increases in FDI from China impact economic growth in SSA countries. Brautigam (2009) discusses the significant rise of Chinese FDI in Africa and

its implications for economic growth and development. Coefficient α_2 measures the effect of institutional quality on economic growth. Higher institutional quality, including effective governance and strong regulatory frameworks, is expected to enhance economic growth and economic efficiency. Rodrik et al. (2004) argue that institutions play a pivotal role in economic performance, emphasizing the importance of governance and regulatory environments. The coefficient α_3 in the interaction term ($CHNFDI_{it} \times INSTQ_{it}$) assesses how institutional quality moderates the impact of Chinese FDI on economic growth. This interaction helps determine whether countries with stronger institutions experience amplified benefits from FDI. Kaufmann et al. (2010) provide understanding into how governance indicators interact with economic outcomes, illustrating the conditional effects of institutional quality on FDI impacts. Exogenous variable α_4 covers exogenous factors such as national savings, terms of trade, money supply deviation, and current account balance. These factors influence economic stability and growth dynamics. Romer (1990) and Blanchard and Fischer (1989) provide foundational discussions on exogenous factors in growth models and the effect they have on the performance of the economy.

TABLE 1:
Description of variables

Variable	Description	Measurement	Sources of Data
Chinese Foreign Direct Investment (CFDI)	Foreign direct investment from China into SSA	Annual inflows in USD	China Ministry of Commerce (MOFCOM) (2014)
Economic Growth (GDP)	Annual percentage growth rate of GDP at market prices based on constant local currency.	Annual GDP growth (%)	WDI, World Bank
Gross Savings (GS)	Gross savings as a percentage of GDP.	% of GDP	WDI, World Bank
Government Effectiveness (GE)	Assesses the quality of public services, policy formulation, and implementation	Evaluated based on surveys of governance and service delivery	WDI, World Bank
Regulatory Quality (REQ)	Measures the ability of the government to formulate and implement sound policies and regulations.	Derived from assessments of regulatory practices and quality.	WDI, World Bank
Political Stability and Absence of Violence (POS)	Reflects the likelihood of political instability and/or violent conflict.	Measured through expert assessments and surveys.	World Bank Governance Indicators (WGI)
Control of Corruption (COC)	Measures the extent to which public power is exercised for private gain.	Assessed through expert surveys and assessments	World Bank Governance Indicators (WGI)
Rule of Law (ROL)	Reflects the extent to which laws are transparently and impartially enforced.	Evaluated through surveys on judicial independence and legal frameworks.	World Bank Governance Indicators (WGI)
Voice and Accountability (VOA)	Gauges the degree to which citizens can engage in choosing their government and enjoy freedom of expression.	Assessed through surveys of democratic processes and freedom of expression	World Bank Governance Indicators (WGI)
Aggregate Institutional Index (INS)	This is the average score of the six institutional indicators	Overall institutional factors	Computed by authors based on WGI data
Broad Money (M2) (BMONEY)	Represents the total money supply, including cash, checking deposits, and easily convertible near money.	Measured as a percentage of GDP or in absolute terms	World Bank Governance Indicators (WGI)

Source: Author's compilation, 2024.

3.2 Nature, Source of Data and Variables Description

This study examines how institutional quality influences Chinese Foreign Direct Investment (CFDI) in Sub-Saharan Africa (SSA), focusing on governance frameworks, regulatory environments, and institutional stability to attract and leverage CFDI for economic development. Institutional quality indicators are sourced from the World Governance Indicators (WGI) provided by the World Bank. These indicators assess various dimensions of governance, such as political stability, government effectiveness, regulatory quality, control of corruption, voice and Accountability and the rule of law, which are crucial for analyzing the role of institutional quality in the nexus between Chinese FDI and economic growth. For control variables such as, gross savings, terms of trade, and current account balances, data is also drawn from the World Bank's WDI. This ensures consistency and comparability across all variables used in the analysis. Data for a total of 48 countries in Sub Saharan Africa spanning 2003 – 2022 was used. The list of countries is contained in Appendix (Table A) to the paper. The brief description of each of the variables along with the sources of data is presented in Table 1:

3.3 Estimation Techniques

The System Generalized Method of Moments (SGMM), based on the Blundell-Bond approach is the method of estimation and it's used to address potential endogeneity issues and dynamic panel bias. This method is particularly well-suited for dynamic panel data analysis, as it uses lagged variables as instruments to control for unobserved heterogeneity and simultaneity bias. Having endogenous explanatory variables in this study necessitates the use of System GMM, which provides more reliable estimates by mitigating biases associated with endogeneity and omitted variable problems. This approach offers a good explanation of the diverse

relationships between Chinese FDI, institutional quality, and economic growth. It enhances the validity and robustness of this study's results (Blundell & Bond, 1998). In addition, the study employs Driscoll-Kraay standard error based regression to address the issue of endogeneity in the model.

4. Empirical results and discussion

4.1 Descriptive Statistics and Correlation Coefficients

A preliminary step to the analysis is descriptive analysis presented in table 2 for all the variables used in the model. Table 2: analysis reveals the level of Control of Corruption (COC), the average level of corruption control is relatively low at -0.6553, indicating widespread corruption. The values range from a high of 1.69815 (indicating excellent control) to a low of -1.93671 (indicating severe corruption), suggesting substantial variation in corruption levels across the dataset. Government Effectiveness (GE), the mean government effectiveness score is -0.8161, indicating generally low performance. There's a considerable range, with a best score of 1.15049 and a worst of -2.43996, highlighting significant differences in government efficiency. Political Stability and Absence of Violence (POS), the mean political stability is -0.5812, suggesting moderate instability. The data spans from high stability (1.20101) to significant violence (-2.41295), indicating a wide spectrum of political conditions. Regulatory Quality (REQ), the mean regulatory quality is -0.7379, implying suboptimal regulations. The range extends from a very business-friendly environment (1.19695) to a highly restrictive one (-2.44773), showcasing diverse regulatory landscapes. Rule of Law (ROL), the average rule of law index is -0.7316, indicating weaknesses in legal systems. The data varies from countries with strong rule of law (1.02396) to those with very weak legal frameworks (-2.39088). Voice and Accountability (VOA), the mean voice and

accountability score is -0.5950, suggesting limited citizen participation. The range, from -2.22605 to 0.9751, reveals disparities in democratic processes and civil liberties. Broad Money Supply (BMONEY), the mean broad money supply is 32.39, suggesting moderate levels of money in circulation. The values range from a very low supply of 0.023039 to a high of 176.789, indicating significant differences in monetary policy. Current Account Balance (CAB), the average current account balance is -6.1608, suggesting a general trade deficit. The balance ranges from a surplus of 28.8266 to a deficit of -65.2567, indicating diverse trade positions. GDP Growth (GDP), the mean GDP growth rate is 1.4567, suggesting moderate economic expansion. Growth rates vary considerably,

from a contraction of -48.3925 to a robust expansion of 31.8743. Gross Saving (GS), the average gross saving rate is 17.838, indicating moderate saving levels. The range extends from negative savings (-19.903) to high saving rates of 57.8502. Terms of Trade (TOT), the mean terms of trade is 70.077, suggesting relatively favourable trading condition. The values range from 2.69883 to 222.178, indicating significant fluctuations in export and import prices. Chinese Foreign Direct Investment (CFDI), the average Chinese FDI is 50.237, with substantial variation evident in the data. Investment levels range from -814.91 to 4807.86, indicating significant differences in Chinese FDI attraction.

Table 2:
Descriptive Statistic

Variables	Observation	Mean	Std. Dev.	Minimum	Maximum
BMONEY	878	32.39005	24.56441	0.023039	176.789
COC	953	-0.6553	0.6570016	-1.93671	1.69815
CAB	795	-6.16078	10.12935	-65.2567	28.8266
GDP	936	1.456742	5.004516	-48.3925	31.8743
GE	952	-0.8160677	0.648355	-2.43996	1.15049
GS	686	17.83805	11.67664	-19.903	57.8502
POS	952	-0.5811536	0.9208081	-2.41295	1.20101
REQ	952	-0.7378516	0.6442472	-2.44773	1.19695
ROL	952	-0.7315825	0.6577158	-2.39088	1.02396
TOT	833	70.07673	33.74291	2.69883	222.178
VOA	952	-0.5949581	0.7564172	-2.22605	0.9751
CFDI	960	50.23739	199.4505	-814.91	4807.86
INS	960	-6805501	6438894	-2.409535	870319

Source: Author's computation, 2024.

In Table 2, we present the variance inflation factor (VIF) and the toleration rate to assess the influence of collinearity among the variables in the model. The results show that there is no evidence of multicollinearity since all the VIF of the variables are below 5 point.

Table 3
Test of multicollinearity

Variables	VIF	1/VIF
CFDI	1.02	0.978665
INS	2.18	0.459523
CFDI INS	1.11	0.897043
BMONEY	2.09	0.479386
CAB	1.18	0.846479
GS	1.28	0.782991
TOT	1.33	0.752009
Mean VIF	1.46	

Source: Author's computation, 2024

In addition, Table B and C (see appendix) reveal the correlation coefficients between various economic and institutional variables, such as GDP, Chinese Foreign Direct Investment (CFDI), Broad Money Supply (BMONEY), Control of Corruption (COC), Current Account Balance (CAB), and Government Effectiveness (GE). In table B, GDP shows a very weak positive correlation with CFDI (0.0024), suggesting that the direct impact of Chinese CFDI on GDP is minimal. This aligns with Azman-Saini et al. (2010), who found that the effects of FDI on economic growth can depend heavily on the host country's institutional framework. GDP's correlation with BMONEY is slightly negative (-0.0121), indicating little direct relationship, which reflects Levine's (1997) findings that monetary indicators often influence growth through indirect channels. CFDI has a weak positive correlation with BMONEY (0.0897), suggesting some association with financial liquidity. The very weak negative correlation with COC (-0.0198) and a weak positive correlation with GE (0.0410) highlight the multifaceted interaction between foreign investment and institutional quality, as noted by

La Porta et al. (1997), who discussed how legal and institutional frameworks can impact financial flows.

BMONEY is strongly correlated with **COC** (0.6136) and **GE** (0.6889), suggesting that a sound financial system is closely linked with better governance and reduced corruption. This supports the view of La Porta et al. (1997) that robust financial systems are crucial for maintaining institutional quality. **COC** exhibits a very strong positive correlation with **GE** (0.8447), reflecting the interdependence of governance indicators. This supports the findings of Kaufmann et al. (1999), who showed that improvements in one aspect of governance are often related to improvements in others. **CAB** has very weak correlations with **GDP** (0.0059) and **BMONEY** (-0.0738), suggesting minimal direct interaction, which aligns with Milesi-Ferretti and Razin's (1996) work on the complex links between trade balances and economic growth. **GE** shows modest positive correlations with **GDP** (0.1365), indicating that more effective governance is associated with higher economic performance. Knack and Keefer (1995) found similar results, emphasizing how good governance can foster growth.

Table C (see appendix) provides the correlation coefficient between Gross Saving (GS), Political Stability and Absence of violence (POS), Regulatory Quality (REG), Rule of Law (ROL), Terms of Trade (TOT), and Voice and Accountability (VOA). **Gross Saving (GS)** shows a weak positive correlation with **POS** (0.2115), **REG** (0.1298), **ROL** (0.1944), and **TOT** (0.1630), meaning that a rise in savings levels are modestly associated with better political stability, regulatory quality, rule of law, and terms of trade. These findings support the idea that strong institutional frameworks and stable political environments encourage saving, as discussed by Acemoglu et al. (2001), who highlighted how good governance and political stability can foster economic

environments conducive to saving. **Political Stability and Absence of Violence (POS)** is strongly correlated with REG (0.6644) and ROL (0.7467), indicating that stable political environments are closely linked to better regulatory quality and stronger rule of law. Similar to this is Kaufmann et al. (1999), who found that political stability is crucial for maintaining and improving institutional quality. **Regulatory Quality (REG)** has a very strong positive correlation with ROL (0.9003), suggesting that effective regulation is highly associated with the rule of law. This supports the findings of La Porta et al. (1997), who emphasized the importance of legal and regulatory frameworks in shaping economic and institutional outcomes.

Rule of Law (ROL) shows strong correlations with VOA (0.7899) and moderate positive correlations with TOT (0.3539), indicating that obeying the law is associated with greater voice and accountability and better terms of trade. This aligns with the work of Rodrik et al. (2004), who found that strong legal systems contribute to more effective governance and economic interactions. **Terms of Trade (TOT)** has a weak positive correlation with VOA (0.2864), suggesting that favourable terms of trade are somewhat associated with greater voice and accountability. This is in line with studies by Dollar and Kraay (2003), who discuss how trade openness and favourable terms can enhance governance by promoting transparency and accountability. **Voice and Accountability (VOA)** has a strong positive correlation with POS (0.6865) and REG (0.7406), indicating that greater participation and accountability are linked with political stability and regulatory quality. These results echo the findings of Kaufmann et al. (1999), who demonstrated the interconnectedness of governance indicators.

4.2 Regression Results

In table 4, **Lagged GDP (LGDP)**, the positive and statistically significant coefficients across all models indicate that past GDP growth positively influences current economic growth. The significance at the 1% level across all models emphasizes the robustness of this association. This finding is consistent with the work of Barro and Sala-i-Martin (1992), who demonstrated that economic growth tends to follow historical trends due to factors like capital accumulation and technological progress. **Chinese Foreign Direct Investment (CFDI)**, the coefficient for CFDI is positive and significant in most models, indicating that CFDI has a favourable impact on economic growth in SSA. The significance of the coefficient at the 5% level (indicated by **) in model 1 and at the 1% level in models 2, 4, and 6 suggests that CFDI consistently contributes to economic expansion, although the magnitude and significance vary across different institutional framework.

Table 4:
Blundell-Bond Estimation: Institutional Quality, Chinese FDI and Economic Growth Dynamic

VARIABLES	model 1	model 2	model 3	model 4	model 5	model 6
L.GDP	0.0752*** (0.0173)	0.0865*** (0.0211)	0.0691*** (0.0216)	0.0940*** (0.0183)	0.0669*** (0.0161)	0.0816*** (0.0144)
CFDI	0.000397** (0.000196)	0.000715*** (0.000244)	0.000419 (0.000278)	0.000936*** (0.000290)	0.000475* (0.000244)	0.000889*** (0.000210)
COC	0.795** (0.394)					
CFDI_COC	-0.000820** (0.000357)					
GE		2.130*** (0.592)				
CFDI_GE		-0.000835** (0.000415)				
POS			0.763** (0.362)			
CFDI_POS			-0.000663*** (0.000222)			
REQ				2.213*** (0.832)		
CFDI_REQ				-0.00110*** (0.000345)		
ROL					0.148 (0.608)	
CFDI_ROL					-0.000493 (0.000394)	
VOA						1.976*** (0.651)
CFDI_VOA						-0.00114*** (0.000200)
BMONEY	-0.0533*** (0.00504)	-0.0679*** (0.00516)	-0.0518*** (0.00848)	-0.0639*** (0.00736)	-0.0515*** (0.00901)	-0.0669*** (0.00677)
CAB	0.156*** (0.0176)	0.165*** (0.0150)	0.156*** (0.0166)	0.159*** (0.0171)	0.161*** (0.0117)	0.155*** (0.0150)
GS	0.0840*** (0.0177)	0.0701*** (0.0187)	0.0849*** (0.0182)	0.0723*** (0.0186)	0.0856*** (0.0173)	0.0744*** (0.0151)
TOT	0.105*** (0.00639)	0.0979*** (0.00826)	0.106*** (0.00828)	0.0994*** (0.00738)	0.109*** (0.00690)	0.105*** (0.00647)
Constant	-4.316*** (0.716)	-2.103** (0.866)	-4.574*** (0.707)	-2.667*** (1.024)	-4.860*** (0.755)	-3.305*** (0.695)
Observations	627	627	627	627	627	627
Number of c_id	38	38	38	38	38	38
AR(1)z:	-3.69	-3.73	-3.68	-3.79	-3.62	-3.69
(p value)	0.00	0.00	0.00	0.00	0.00	0.00
AR(2) z:	-1.58	-1.42	-1.54	-1.38	-1.64	-1.43
(P value)	0.11	0.16	0.12	0.17	0.10	0.15
Sargan test: χ^2	34.06	34.80	34.81	34.71	32.70	34.82
(P value)	0.51	0.48	0.48	0.48	0.58	0.48

Source: Author's computation, 2024. Note: (***), (**) and (*) imply statistically significant at 1%, 5% and 10% significant level respectively. Standard errors in parentheses.

In table 4, model 1, the positive and significant coefficient for Control of Corruption (COC) suggests that reducing corruption positively impacts on economic growth. This aligns with the findings of Mauro (1995), who argued that corruption hampers economic development by distorting market mechanisms and increasing transaction costs. For CFDI and Control of Corruption Interaction (CFDI_COC), the negative and significant coefficient for the interaction term reveals that the effect of CFDI on growth diminishes when corruption is better controlled. This could suggest that while reducing corruption generally fosters a conducive environment for growth, it might also impose regulatory adjustments that affect FDI influence. This notion is supported by Habib and Zurawicki (2002), who found that the link between FDI and corruption is affected by numerous factors. Government Effectiveness (GE) and CFDI Interaction (CFDI_GE), the positive coefficient for GE in model 2 suggests that effective governance positively impacts growth, while the negative interaction term indicates that improved governance can moderate the benefits of CFDI. Kaufmann, Kraay, and Zoido-Lobaton (1999) also found out that governance quality influences the effectiveness of foreign investments.

On Political Stability (POS) and CFDI Interaction (CFDI_POS), the positive coefficient for (POS) in model 3 indicates that political stability supports growth, whereas the negative interaction term suggests that stability can alter the effect of CFDI on growth. Alesina et al. (1996) highlighted that political stability is crucial for economic development but can also affect investor behavior. For Regulatory Quality (REQ) and CFDI Interaction (CFDI_REQ), the positive coefficient for REQ in model 4 implies that better regulatory quality enhances growth, while the negative interaction term indicates that regulatory improvements can reduce the

direct benefits of CFDI. Djankov et al. (2002) similarly found that regulatory quality affects the efficiency of investment flows. With regards to Voice and Accountability (VOA) and CFDI Interaction (VOA), the positive and significant coefficient for VOA in model 6 indicates that greater voice and accountability positively impact growth, though the negative interaction term shows that these factors might change the nature of how CFDI influences growth. Acemoglu, Johnson, and Robinson (2001) also emphasized the role of institutional frameworks in shaping economic outcomes.

For Broad Money (BMONEY), the negative and significant coefficients across all models indicate that an increase in broad money supply is associated with reduced economic growth, suggesting potential inflationary pressures. Similar conclusions were drawn by De Gregorio and Guidotti (1995), who highlighted the risks of excessive liquidity in emerging economies. As for Current Account Balance (CAB), the positive and significant coefficients suggest that a favourable current account balance contributes to economic growth. Lane and Milesi-Ferretti (2002) also emphasized the importance of a stable external financial position for sustained economic performance. On Gross Savings (GS), the positive and significant coefficients indicate that increased gross savings rates lead to increased economic growth, underscoring the role of domestic savings in financing investment. This finding is consistent with Solow (1956), who identified savings as a key determinant of economic growth in his growth model. For Term of trade (TOT), the positive and significant coefficients across all models suggest that greater trade openness contributes to economic growth. Frankel and Romer (1999) similarly concluded that open economies tend to experience higher growth rates due to increased access to international markets and technology. These results underscore the significance of institutional

quality in moderating the effect of CFDI on economic growth in SSA. While CFDI generally supports growth, its effectiveness depends upon the institutional conditions, highlighting the need for strong governance frameworks to maximize the benefits of foreign direct investment

4.3 Robustness Checks

To examine the robustness of the results, we take the average of the six institutional factors (INS) (such as Control of Corruption, Government Effectiveness, Political Stability, Regulatory Quality, and Voice and Accountability) and re-estimate our model using SGMM and Driscoll-Kraay estimator. The latter controls for cross-sectional dependence and the results are presented in table 5. It can be seen that the interaction terms between CFDI and institutional quality variables are negative and significant revealing that the positive impact of Chinese FDI on Economic growth (GDP) is less pronounced in countries with weak institutional quality. This pattern can be explained by the efficiency of resource allocation and governance in such countries. Countries with robust institutional frameworks, characterized by low corruption, a highly effective government, political stability, robust regulatory quality, and strong voice and accountability, typically have efficient systems for resource allocation and governance. These efficient systems ensure that resources are used optimally and that economic activities are well-regulated. This optimal resource allocation aligns with findings by Rodrik, Subramanian, and Trebbi (2004), who argue that institutions are the fundamental cause of long-term economic growth by providing the structure needed for effective economic activities.

Table 5:
Institutional Quality, Chinese FDI and
Economic Growth

Variables	SGMM	Driscoll-Kraay estimator
L.GDP	0.08945*** (0.000)	n/a
CFDI	0.0006145*** (0.000)	0.0003498*** (0.266)
INS	2.437249*** (0.000)	3.514555*** (0.000)
CFDI_INS	-0.0008777*** (0.002)	-0.000780* (0.054)
BMONEY	-0.070047*** (0.000)	-0.077031*** (0.075)
CAB	0.1590506*** (0.000)	0.0414116 (0.269)
GS	0.0711035*** (0.000)	0.0629225*** (0.005)
TOT	0.0987002*** (0.000)	0.0788309*** (0.001)
Constant	-2.29837*** (0.006)	-0.5043267 (0.585)
Observations	627	654
R-square	n/a	0.1241
Wald test	2939.96 (0.000)	20.51 (0.000)
AR(1)z: (p value)	3.787 (0.0002)	n/a
AR(2) z: (P value)	1.4019 (0.1609)	n/a
Sargan test: χ^2 (P value)	35.52603 (0.4434)	n/a

Source: Author's computation, 2024. Note: (***), (**) and (*) imply statistically significant at 1%, 5% and 10% significant level respectively. Standard errors in parentheses.

Based on this, when these countries receive CFDI, the incremental benefits to GDP growth may be smaller because their economies are already operating at a high level of efficiency. Alfaro et al. (2004), corroborates this when he suggests that in economies where financial and institutional frameworks are well-developed, the marginal gains from additional investment, such as FDI, are often reduced. This implies that the more developed and efficient a country's institutions are, the less room there is for FDI to introduce significant changes or improvements in economic performance.

5. Conclusion and Policy Implications

This study examined the effect of Chinese Foreign Direct Investment (FDI) on economic growth in Sub-Saharan Africa (SSA), with a particular focus on the role of institutional quality. Using a comprehensive theoretical framework that integrates Romer's Endogenous Growth Theory, Institutional Theory, and Institutional FDI Fitness Theory. The dynamic relationship between Chinese FDI, institutional quality, and economic growth was investigated. The empirical analysis applied System Generalized Method of Moments (GMM) technique of estimation, specifically Blundell-Bond approach to analyze data from 48 SSA countries. This approach allows for a detailed understanding of how institutional quality influences both economic growth and the effectiveness of Chinese FDI.

The findings reveal that institutional quality is important in raising the gains from Chinese FDI for SSA countries. While Chinese FDI can positively impact economic growth, its effectiveness is significantly influenced by the quality of institutions. Key institutional variables, such as Control of Corruption (COC), Government Effectiveness (GE), and Political Stability (POS), play pivotal roles in the effect of Chinese FDI on economic growth. The significant impact of COC across

various models underscores the importance of reducing corruption to create transparent and efficient business environments, thereby facilitating better economic outcomes. Similarly, the positive influence of GE highlights the necessity of effective governance and public service in fostering productive investment and economic stability. Macroeconomic variables also play a critical role in shaping growth impact. The consistent negative linkage between Broad Money (BMONEY) and economic growth suggests that excessive money supply may lead to inflationary pressures, hindering growth. However, the positive effect of the Current Account Balance (CAB) and Gross Savings (GS) emphasize the importance of sound financial management and promoting domestic savings to support investment. Moreover, favourable Terms of Trade (TOT) highlight the benefits of open trade policies and competitive market access in driving economic performance. These findings have several policy implications.

Policymakers in SSA should prioritize improving institutional quality and governance to create an environment where Chinese FDI can be most effective. This involves strengthening anti-corruption measures to reduce corruption, enhancing government effectiveness and ensuring political stability. Additionally, improving financial systems to ensure efficient resource allocation and mitigating the inflationary risks associated with broad money expansion are critical. Encouraging savings and maintaining a stable current account balance can further support sustainable growth.

Future research could explore regional differences within SSA to identify specific local factors that influence the effectiveness of Chinese FDI. Longitudinal studies might provide deeper understanding into the long-term impact of Chinese FDI and associated variables on economic growth, helping to refine strategies that will optimize foreign investment benefits and drive sustainable

development. By focusing on these areas, SSA countries can better leverage Chinese FDI to achieve substantial and lasting economic growth.

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