ISTANBUL COMMERCE UNIVERSITY

GRADUATE SCHOOL OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

ECONOMICS M.A. PROGRAM

FOREIGN CAPITAL INFLOWS AND REGIONAL ECONOMIC GROWTH IN SELECTED EAST AFRICAN COUNTRIES

M.A. Thesis

Mohamed Isse IBRAHIM

200009342

Istanbul, 2020

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Istanbul, 2020

T.C. İSTANBUL TİCARET ÜNİVERSİTESİ

T.C.
İSTANBUL TİCARET ÜNİVERSİTESİ
SOSYAL BİLİMLER ENSTİTÜSÜ

YÜKSEK LİSANS TEZİ ONAY FORMU

İktisat İngilizce Yüksek Lisans programı öğrencisi Mohamed Isse Ibrahim'in "Foreign Capital Inflows and Regional Economic Growth in Selected East African Countries" başlıklı tez çalışması, Enstitümüz Yönetim Kurulu 23.06.2020 tarih ve 2020/510/02 sayılı kararıyla oluşturulan jüri tarafından oybirliği/~~oyçokluğu~~ ile Yüksek Lisans Tezi olarak kabul edilmiştir.

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ÖZET

Yabancı sermaye ekonomik büyüme için fon temininin tamamlanması için önemli olarak tanımlanmıştır; yabancı sermaye girişinin önemi kalkınmakta olan ülkeler başta olmak üzere ticaretin serbestleştirilmesinden sonra artmıştır. Ancak, bu çalışmanın amacı değişkenler ve kısa vadeli dinamikler arasında bir eşbütünleşme ilişkisi bulmak için Autoregressive Distributed Lag (ARDL) modeli uygulayarak 2004 – 2017 dönemi boyunca seçilmiş Doğu Afrika ülkelerinde ekonomik büyüme üzerinde yabancı sermaye girişinin etkisinin araştırılmasıdır. Sonuçlar yabancı doğrudan yatırımların, para havalesi ve dış yardımın ekonomik büyüme üzerinde olumlu ilişkisi olduğunu gösterirken dış borcun uzun vadede ekonomik büyüme üzerinde olumsuz etkisi olduğunu göstermiştir. Kısa vadede, dış borcun ülkenin özelliklerine ve dış borcun nihai tahsisine dayalı olan ekonomik büyüme üzerinde anlamlı olumlu ilişkisi varken doğrudan yabancı yatırımların (FDI) ekonomik büyüme üzerinde olumsuz etkisi vardır. Çalışmamız Doğu Afrika ülkelerinin iyi bir makroekonomik ve mikroekonomik ortamı destekleyen ve yaratan politikalar geliştirmesi ve ayrıca ülkelerin yerel koşulları iyileştirmek isteyenlere nazaran doğrudan yabancı yatırım çekmeye yönelik politikaların maliyetini dengelemesi gerektiğini tavsiye eder. Son olarak, dış borca ve yardıma bağımlılık akıllıca değildir, bu nedenle Doğu Afrika devletleri dış borcun ve yardım kaynaklarının tahsisi üzerinde yeniden düşünmeye başlamalı ve karar vericiler geçmişte işe yaramış olan yardıma ve borca yüksek bağımlılığı azaltacak bir strateji ve politikayı desteklemelidir.

Anahtar Kelimeler: Doğu Afrika Ekonomileri, Yabancı Sermaye Girişleri, ARDL Modeli

ABSTRACT

Foreign capital has been identified as important for supplementing the supply fund for economic growth; the importance of inflow foreign capital have increased after trade liberalization particularly developing countries, However, the purpose of this study is to investigate the effect of foreign capital inflow on economic growth in selected East African countries over the period 2004-2017 by applying Autoregressive Distributed Lag (ARDL) model to find a cointegration relationship between variables and short-run dynamics. The results show that foreign direct investment, remittance and foreign aid have a positive relationship with economic growth, whilst the external debt has a negative relationship with economic growth in long-run. In the short run, foreign debt has a positive significant relationship with economic growth which is depending on the characteristics of the country and the final allocation of external debt while FDI negative effect on economic growth. The study recommends that East African countries should promote policies that encourage and create a good macroeconomic and microeconomic environment, as well as countries, should balance the cost of policies to attract foreign direct investment over those seeking to improve local conditions. Finally, foreign debt and aid dependence are not bright, so the East African governments should start rethinking on the allocation of foreign debt and aid resources and policymakers should promote a strategy and policy to reduce high dependence on aid and debt that have worked in the past.

Keywords: East African Economies, Foreign Capital Inflows, ARDL Model

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Mohamed Isse IBRAHIM

TABLE OF CONTENTS

ÖZET ..... **ii**

ABSTRACT ..... **iii**

ACKNOWLEDGEMENT ..... **iv**

TABLE OF CONTENTS ..... **v**

LISTS OF TABLES ..... **vii**

LIST OF FIGURES ..... **viii**

LIST OF ABBREVIATIONS ..... **ix**

1. INTRODUCTION **1**

2. OVERVIEW OF EAST AFRICAN ECONOMIC PERFORMANCE **5**

2.1 Ethiopian Economic Outlook 6

2.2 Overview Macroeconomic Performance in Kenya 10

2.3 Tanzania Economic Outlook 13

2.4 Economic Outlook of Uganda 15

2.5 Rwanda Economic Review 18

2.6 Burundi Economic Outlook 21

2.7 Comoros Economic Review 24

3. LITERATURE REVIEW **26**

4. FOREIGN CAPITAL INFLOWS IN EAST AFRICA **44**

4.1 Foreign Direct Investment 45

4.2 Foreign Debt 46

4.3 Foreign Aid 47

4.4 Remittances 48

5. RESEARCH METHODOLOGY **50**

3.1 Theoretical Framework of the Study 50

3.2 Data 51
3.3 Model Specification 53
3.4 Method of Estimation 56
3.4.1 Descriptive statistics 56
3.4.2 Unit Root Test 56
3.4.3 Testing Correlations 56
3.4.4 Autoregressive Distributed Lag (ARDL) Method 56
3.4.5 Granger Casuality Test 57
3.4.6 Diagnostic Test 57
6. EMPIRICAL RESULT AND DISCUSSION 58
6.1 Descriptive Statistics 58
6.2 Correlation 59
6.3 Unit Root Test 60
6.4 Empirical results from Autoregressive Distributed Lag (ARDL) bound test 61
6.5 Granger Causality Test 65
7. CONCLUSION AND POLICY RECOMMENDATION 66
REFERENCE 68
APPENDIX 77

LIST OF TABLES

Table 1: Remittances as Percentage of GDP in East Africa 49

Table 2: Main Variables 52

Table 3: Descriptive Statistics 58

Table 4: Correlation Matrix 59

Table 5: Unit Root Test 60

Table 6: Long-Run and Short-run Estimation Results 62

Table 7: Granger Causality Test 65

LIST OF FIGURES

Figure 1: Gross Domestic Product Growth in East Africa, by Country, (2014-2020) 2

Figure 2: GDP growth rate in Africa, by region, 2008–2020 6

Figure 3: Contribution to GDP growth by sectoral value added in Ethiopia (1980-2017) 8

Figure 4: GDP growth rate in Kenya (1960-2017) 11

Figure 5: Gross Domestic Product in Tanzania (1990-2017) 14

Figure 6: Gross Domestic Product in Uganda (1960-2017) 16

Figure 7: GDP growth rate in Rwanda (1960-2017) 18

Figure 8: Gross Domestic Product in Burundi (1960-2017) 23

Figure 9: GDP growth rate in Comoros (1990-2017) 25

Figure 9: Foreign Direct Investment to East Africa 45

Figure 10: Foreign Debt to East Africa 47

Figure 11: Foreign Aid Received to East Africa 48

Figure 12: Foreign Capital Inflows and Economic Growth in the Host Country 51

LIST OF ABBREVIATIONS

ADF: Augmented-Dickey-Fuller

AFDB: African Development Bank

ARDL: Autoregressive Distributed Lag

CEE: Central and Eastern European Countries

DMO: Debt Management Bureau

ERS: Economic Recovery Strategy

FCF: Flows of Foreign Capital

FDI: Foreign Direct Investment

GMM: Generalized Method of Moments

HIPC: Heavily Indebted Poor Countries

IMF: International Monetary Fund

MNES: Multinational enterprises

ODA: Official Development Assistance

OECD: Organization for Economic Co-operation and Development

PMG: Pooled Mean Group

PP: Phillips-Perron

RMO: Remittance Outflow

SSA: Sub-Saharan Africa

UN: United Nations

UNCTAD: United Nations Conference on Trade and Development

1. INTRODUCTION

Foreign capital has been identified as important for supplementing the supply fund for economic growth, particularly developing countries. Most developing economies and other emerging economies need substantial external debt and foreign aid to achieve sustainable economic growth Jawaid and Saleem (2017). Inadequate domestic resources, chronic budget deficit low saving and wide saving- investment gaps are pushed African countries to need external capital which is epitomized in Africa, in a situation where there is hardly enough money for consumption (Klobodu & Adams, 2016). The impact of foreign capital on economic growth depends on capital flows type and economy system (Aizenman, Jinjarak, & Park, 2013). How the different foreign capital inflows impact on productivity growth has drawn significant attention in the literature. Because foreign capital could boost domestic saving, some scholars believe inflows foreign capital would boost GDP growth in developing economies.

Theoretically, capital inflows would raise domestic capital. In neo-classical theory, such foreign capital inflows spur GDP growth. The literature explains how different types of foreign capital contribute differently to economic growth. For example, FDI contributes to growth by increasing investment and spillover effects, while remittance contributes positively to growth through financial development as well as improved credit constraints of the poor. Foreign debt changes the economy's macroeconomic environment (Arellano, Bulíř, Lane, & Lipschitz, 2009). The main advantages of external financial resources expressed by their externalities are not only developments and adoption of new technologies, but also their complementarity with domestic finance sources that affect major macroeconomic variables such as, export competitiveness of exports in developing economies, job creation, and domestic investment as well business development.

There are many types of foreign capital inflows, most of which are foreign aid, foreign debt and foreign direct investment, and most analytical literature studies examine their effects on growth separately. The study's main issue is whether the drastic increase in capital flows has resulted in the desired impact on developing countries' economic development. Developing economies, especially East Africa has been struggling to achieve impressive

and sustained economic growth since the advent of political independence for more than five decades. According to the World Development Indicators noted that foreign capital flows in the form of foreign debt, foreign aid, remittance and foreign direct investment have been increased in East Africa over the last three decades. FDI has increased by 50% over the last decade, $ 4.49 billion in 2007 to $ 8.49 billion in 2017. The external debt reached $102.25 billion in East Africa, by the end of 2017. Debt situations have become untenable in some countries in the region, requiring urgent actions whose scope and modalities depend on the precise diagnosis of the source of debt distress. The average debt to GDP ratio in East African economies is 35 to 45 %. A fast loan build-up brought East African economies close to a debt crisis, putting at risk the long-term economic stability of the region. Foreign aid inflows to East African economies continued to grow, reaching $ 17.79 billion in 2017. In some East African economies, including Somalia, Djibouti and South Sudan, the foreign aid in education budget in more than 25 percent. Meanwhile, remittances growing as a form of private capital flows to East African economies which have steadily increased from around the early 1980s East Africa, the rising sharply about 2 times $2.58 billion in 2007 to 5.21 billion in 2017.

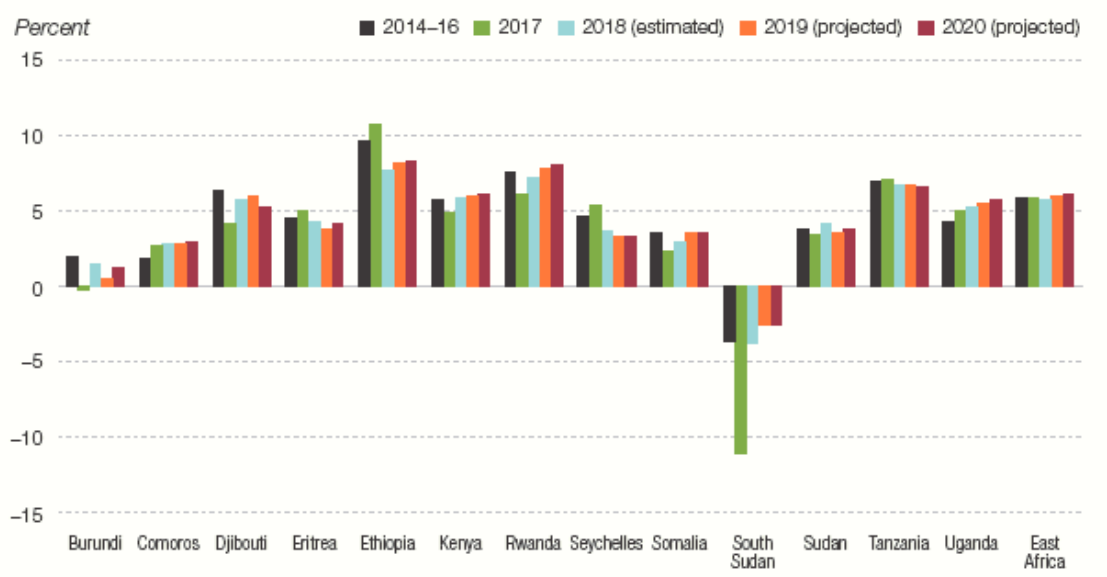


Figure 1: Gross domestic Product growth in East Africa, by country, (2014-2020)

Source: (African Development Bank, 2019)

As of 2017, East African's economic growth was $253 billion. Over the past 10 years, the value for this metric has fluctuated from $112 billion over 2008 to $253 billion in 2017. Gross domestic product in East Africa grew by approximately 5.7% in 2018, slightly below 5.9 % in 2017, and the highest in Africa. The growth rate is projected to remain strong, 5.9% in 2019 and 6.1% in 2020. The highest-growth countries are Rwanda, Ethiopian, Kenya and Tanzania. The growth drive-by service and industry followed by agriculture, the main supply-side growth driver. On the demand side, consumption was the main driver of growth across East Africa.

This highlights the problem of foreign capital flows volatility in the presence of economic changes. The report gives a thudding reminder that the East African economy becoming more dependent on foreign capital. Meanwhile, the poor economic growth experienced in the past and the recent surge in the growth of many East African countries deserve research attention. More specifically, the big question is could the foreign capital inflows be partly responsible for the region's growth pattern? This is the question the study seeks to address. The main objective of this study is to examine and determine the empirical impact of foreign capital inflow on productivity growth in Eastern African countries, in order to recommend policies to help boost sustainable economic growth in the region. In existing empirical literature on foreign capital spillovers, there are different capacities mentioned that the host countries need to improve in order to benefit from foreign capital inflows which are: the local financial system, the level of human capital, institutional development and infrastructure. Relevant research objectives are described below:

The specific objectives of this study are listed below:

- To identify the relationship and direction of causality between inflows of foreign capital and regional economic development in the selected East African Economies.
- The relative contribution of inflows foreign capital to sustainable growth in selected East African Economies.
- To present policy recommendations on the best foreign capital inflows and draw for sustainable economic development

The study proposes valuable approaches in several areas. Theoretically, this research helps to understand the impact on the economic growth of foreign capital inflows in developing countries. Practical implications, it's necessary to understand the role of foreign capital flows in economic growth. This research will be functional in developing policies in East African countries. Finally, the result of the study will give an overview of how foreign aid, external debt, remittance inflows and foreign direct investment effect on regional economic growth. This research wills also benefit developing countries to get more detail about the effect of foreign capital flows on sustainable economic growth. This study will study also benefits academics in referencing this study for further researches on their interest.

To achieve the above objectives, the thesis contains five chapters. Following the introduction, Chapter two is focusing economic performance on Ethiopia, Kenya, Tanzania, Uganda, Rwanda, Burundi and Comoros respectively; first, this chapter presents the inspiration for each selected country and provides a general overview of each country's history in terms of economic growth. Chapter three is a literature review. This chapter analyses, the relationship between foreign capital flows and economic growth to establish the importance of the research questions. Chapter four summarizes foreign capital inflow performance as well as discussion comparing between countries of the selected East African countries. Chapter five is the theoretical framework of the study which is consists of the model specification based on the theory adopted, data and method of estimation. The theoretical framework employed in this study is explored to ensure the thesis hypothesis by reviewing the past empirical studies on the role of foreign capital inflows in sustainable economic growth. Then, Chapter six presents empirical investigation and interpretation. In the last chapter, Chapter six summarizes all findings and draws policy recommendations for the East Africa region and makes suggestions for further studies.

2. OVERVIEW OF EAST AFRICAN ECONOMIC PERFORMANCE

Africa's economy is consisting of agriculture, industry, trade, and human resources. By 2019, about 1.3 billion people lived in 54 African countries. Recent growth was due to revenue growth in services, goods, and manufacturing. East Africa, West Africa South Africa and Central Africa in particular are predicted to cross $29 trillion of GDP by 2050. However, in 2013, Africa was the fastest-growing continent in the world at 5.6% per GDP growth rate and GDP is projected to rise by an average of over 6 % per annum between 2013 and 2023. In 2017, the AfDB reported that Africa is the second-fastest economic growth in the world and estimates that average growth will recover to 3.4 % in 2017, while growth is expected to rise by 4%. International trade has driven much growth in the early 21st century Africa's economy. Increasingly, India and China are trade partners. Africa's economic growth is forecast at 3.4% in 2019, around the same as in 2018. Although stable, this is below the region's decadal average of a 5% rise. The slow growth is estimated partly due to the limited expansion of five big African countries Nigeria, Egypt, South Africa, Algeria, and Morocco. Jointly rising at an average rate of 3.1% relative to the continent's average of 4.0%. Growth is forecast to pick up 3.9% in 2020 and 4.1% in 2021. Africa's estimated growth masks major cross-regional and cross-country variations. East Africa leads as the fastest-growing region on the continent, with growth projected at 5.0% in 2019. West Africa's growth grew to 3.7%, from 3.4% the year before. North Africa's second-fastest, 4.1%. Southern Africa's growth slowed from 1.2% to 0.7%. Central Africa is estimated to have grown 3.2% in 2019, from 2.7% the year before (AfDB, 2020).

East Africa has 13 countries according to the African development bank report. In 2017, East African's economic growth was $253 billion. Over the past 10 years, the value for this metric has fluctuated from $112 billion over 2008 to $253 billion in 2017. Gross domestic product in East Africa grew by approximately 5.7% in 2018, slightly below 5.9 % in 2017, and the highest in Africa. The GDP growth rate is projected to remain strong, 5.9% in 2019 and 6.1% in 2020. The highest-growth countries are Rwanda, Ethiopian, Kenya and Tanzania. The growth drive-by service and industry followed by agriculture, the main supply-side growth driver. On the demand side, consumption was the main driver of growth across East Africa (AfDB, 2019).

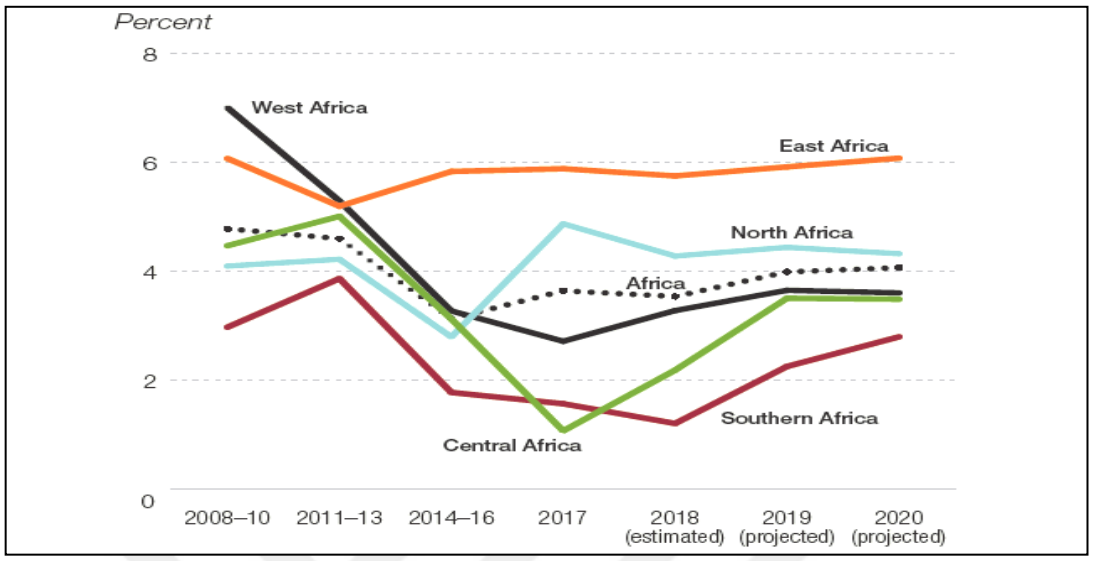


Figure 2: GDP growth rate in Africa, by region, 2008–2020

Source*:* African Development Bank Report

East Africa is still facing various threats that could undermine economic and development prospects. Agriculture's vulnerability to nature vagaries, Heavy reliance on exports in agricultural commodities and rising oil prices in importing countries are major risks. The Strong economic growth of the region is underpinned by significant sustained investment in infrastructure and increases in agricultural productivity. Prospects for East African growth have also been fostered by resolving the long-standing political dispute between Ethiopia and Eritrea, a remarkable development that promises to fuel growth in the Horn of Africa. Populations range from less than 1 million in Djibouti to over 100 million in Ethiopia, Ethiopia's second most populated region.

2.1 Ethiopian Economic Outlook

Ethiopia’s location gives it strategic supremacy in East Africa, bordering Kenya, Somalia, South Sudan, Eritrea and Sudan. Ethiopia is a landlocked country using the main port of neighboring Djibouti for the last 20 years. Ethiopia is one of the fastest-growing economic growth and the second-most populated nation after Nigeria in Africa and East Africa's fastest-growing economy. Many government-owned properties have now been privatized. Nonetheless, other sectors such as financial, insurance, telecommunications, services, land transportation and air services are remaining under government control for the near future. Nearly 50% of Ethiopia's population is under 18 (Theodora.com, 2020).

Ethiopia's economic performance varies depending on the government and policies implemented. During the imperial regime, Ethiopia followed a liberalized economy, while in the military regime, politics were transformed into a command or centralized economic system, and the present government also adopted different economic systems. Those are ongoing liberalized, pro-poor, and state-developing economy. Following the 1974 revolution, the colonial dictatorship was overthrown, put with military rule. The economic system in this regime was a centralized command economy, where the government-administered the market. Under the military regime, the government received revenue from both domestic and foreign grant sources. Sources of tax revenue were a direct tax, indirect tax, import tariff, and export tax. General government spending declined, results in a ten-year tighter fiscal policy. Total spending fell from 24.7% of GDP in 2003/04 to 16.8% in 2011/12 and fell by around 17.8% in 2012/13 and 2013/14. Nominally, overall general government spending increased more than nine-fold between 2003/04 and 2013/14. In real terms, the increase was less than double over the same era. Recent years have seen a substantial rise in spending due to increasing spending on pro-poor sectors. However, public investment has risen as a share of total spending, demonstrating the government's commitment to expanding Ethiopia's social and economic infrastructure and building public capital stock (World Bank, 2017).

In 2019, GDP growth decreased to an estimated 7.4% from 7.7% in 2018, caused by fiscal contraction to offset public debt and social unrest. Service and industry grew in 2019. This high economic growth was driven by investment in government infrastructure and sustained development in the service and agricultural sectors. Structural transition is ongoing but accelerated. While agriculture's share of GDP has fallen, the agricultural sector employs over 70% of Ethiopia's labor force. The country is one of the poorest with a $790 per capita GDP. Ethiopia will hit lower-middle-income by 2025. Ethiopia's economy is highly dependent on service and agriculture, though its share is now decreasing. In 2017, value-added services constitute 36% of GDP, while agriculture and industry account for 33% and 23% respectively (World Bank.org, 2020).

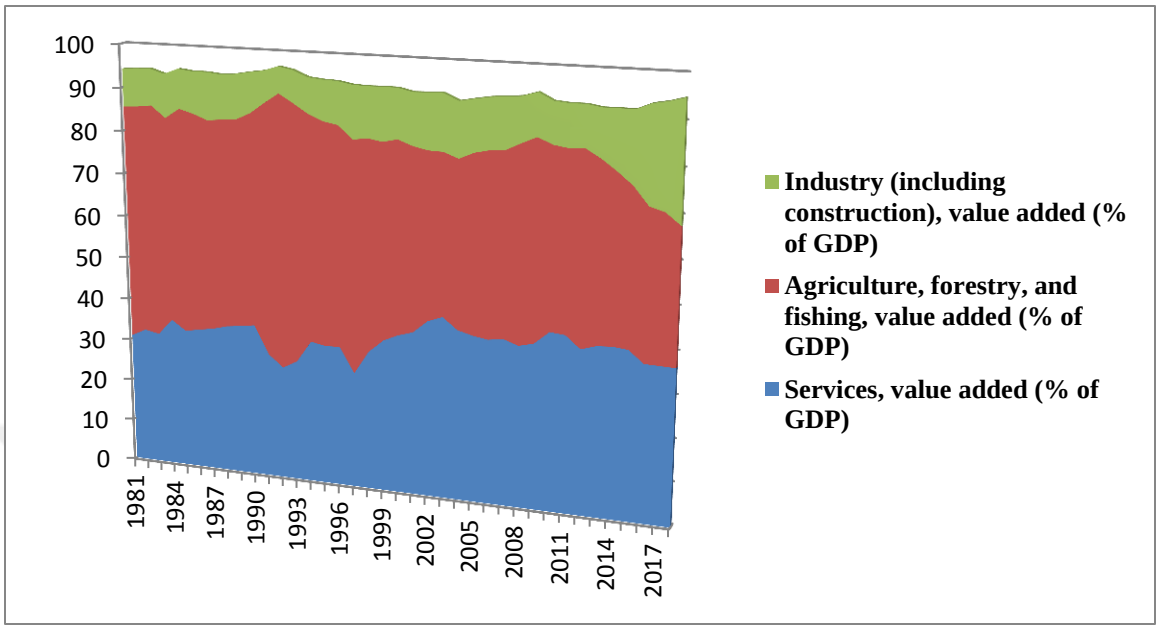


Figure 3: Contribution to GDP growth by sectoral value added in Ethiopia (1980-2017)
Source: Author's analysis data from World Bank.

Ethiopia is one of the lowest income inequalities in the region and world. Despite progress towards reducing extreme poverty, Ethiopia considered one of the world's poorest nations due to its low starting base and rapid population growth. Changes in rainfall from climate change patterns resulted in the worst food shortage for millions of Ethiopians in 30 years from 2015 to 2016. Higher productivity growth brought promising trends in rising rural and urban poverty. The government has launched the second phase of its 2020 Growth and Transformation Plan to continue to develop physical infrastructure through public investment, turning the country into a development hub. GTP II targets average annual GDP growth of 11% and, in line with the industrial sector is set to grow by 20% on average, jobs creating and the manufacturing strategy (Theodora.com, 2020).

Ethiopia's public-private partnership arrangement would diversify the nation's development financing streams, enhance the rising export. According to the trend in World Bank data, Ethiopian export performance was highly volatile last decade. Ethiopia's exports reached an unprecedented level of $2 billion in the fiscal year. Ethiopia's exports in 2016 were $6.23 billion, an impressive 7.6 percent increase from the previous year's $430 million exports. Ethiopia primarily exported traditional products.

Over the past two decades, merchandise exports have grown at an average rate of 9.09% per annum. The trend also reveals that few primary commodities dominate the export sector in Ethiopia, with manufacturing exports accounting for less than 12.5% of merchandise exports in 2016.

In 2017, Ethiopia's average inflation rate was around 10.68% relative to the previous year. Unemployment in Ethiopia rose from 16.90% in 2016 to 19.10% in 2018. The average was 86 % rural and 58 % urban. Unemployment youth is high, especially in urban areas at 25%, requiring changes in quality of education to increase employability. The country's unemployment rate stood at 6%, the proportion of underemployed Ethiopians in both rural and urban areas. In the past decade, Ethiopia has implemented various fiscal-policy reforms. Most of these reforms focus on indirect taxes and poor spending patterns. Ethiopia's current government has undertaken various fiscal policy reforms, including decentralized budget administration, and tax policy changes such as export taxes, the introduction of value-added tax, capital goods tariff exemption for huge investments, and other incentives. Ethiopia's monetary policy remains focused on maintaining exchange-rate and price stability while sustaining a growth-friendly macroeconomic environment. 2003 Drought led to a 15.1% increase in inflation. Inflation decreased to 8.6% in 2004 and 6.8% in 2005, as favorable environmental conditions minimized food price pressures. In line with the inflation reduction target, the large money supply was allowed to rise at 19.6% in 2004/05, resulting in liquidity growth of 14.7% (Mengistu, 2013).

Ethiopia's National Bank control currency, managed credit and monetary policy, handled foreign-exchange reserves and foreign-currency transactions. Many banking services were concentrated in major urban areas, despite efforts to create more branches across the country (OCED, 2006).

The monetary policy of the country strong meanwhile inflation stayed double-digit in 2019, owing to central bank advances to fund the fiscal deficit beyond the 8 percent central bank goal. Nevertheless, high inflation has led to overvaluing the Ethiopian birr following the 15% devaluation in 2017, prompting a steady transition to a more sustainable exchange rate. Fiscal reform maintained small and manageable fiscal deficits amid a weak tax-to -GDP ratio, average 11% in 2016–19. Tax measures are ongoing to improve tax collection,

but deficit funding has fueled inflation by central bank developments and diminished monetary effectiveness. In a broader revenue generation context, it is also important to note that relatively untaxed activities in the agricultural subsistence sector continue to make up a large part of the economy (AfDB, 2020).

2.2 Overview Macroeconomic Performance in Kenya

The Kenyan economy is market-based with a liberalized international trade system and some state-owned enterprises. Significant industries include oil, Agriculture, fishing, forestry, mines, finance and tourism. Kenya's policy is generally investor-friendly and has introduced many administrative changes to ease international and domestic investors, including establishing an export-processing zone. 1963 Kenya regained independence. Under President Jomo Kenyatta, the Kenyan administration encouraged Kenyan economy Africanization, generating rapid GDP growth through promoting public and private investment as well as mostly FDI and smallholder agricultural production. An important session paper by Mwai Kibaki and Tom Mboya in 1965 emphasized Kenya's need to combat both the Western capitalist economy and Eastern communism. Kenya's economic growth grew at an average annual rate of 6.6% from 1963 to 1973 and it grew 7.2% on average in the 1970s. Nevertheless, GDP growth rate decreased in the 1980s to 4.2% per year, and in the 1990s to 2.2% per year (Theodora.com, 2020).

The growth rate of the Kenyan economy has steadily declined in 1997, the GDP growth rate dropping to -0.5% in 2000, similar to 1.9% in 1999. So many factors that account for continued decline. Such factors included weak economic management in 2000; public sector inefficiency, 1997 removal of donor funding and adverse weather conditions. GDP growth was to remain low at 2.0% in 2001 and 1.2% in 2002. As the government undertakes renewed growth-enhancing initiatives, including renewed efforts to meet donor requirements to sustain international aid flow. The 2000 economic recession was expressed in all major economic sectors. Growth in the agricultural sector decreased from 1.2% in 1999 to -2.4% in 2000. Bad weather, low foreign agricultural product prices, and weak infrastructure led to the decline. For the second consecutive year, maize production in the crops sector decreased by 14% from 233 500 tons in 1999 to 201 200 tons in 2000,

resulting in imports of about 409 000 tons of maize for commercial and relief purposes. Insufficient seed supply, Drought, high farm input costs and weak crop husbandry were among the factors leading to the decline in maize production (AfDB, 2002).

Kenya is East Africa's economic, financial and transport hub. Over the last decade, Kenyan GDP growth averaged over 5 percent. Kenya has been listed as a lower middle-income country since 2014 since its GDP per capita exceeded a World Bank classification by income. While Kenya has growing middle-class entrepreneurship and steady growth, weak governance and corruption have impaired its economic development. In 2019, real GDP increased by an estimated 5.9%, led by demand-side household consumption and spending and supply-side services. GDP fell from 6.5% in 2018, mainly due to unfavorable weather and lower government investment. At 5.2%, inflation remains within the target band of 5 ± 2.5% of the central bank. Currency reserves increased from $9 billion in 2018 to $9.4 billion at the end of 2019, equal to 6 months of imports or more than the 4.5-month convergence criterion of the East African Group (AfDB, 2020).

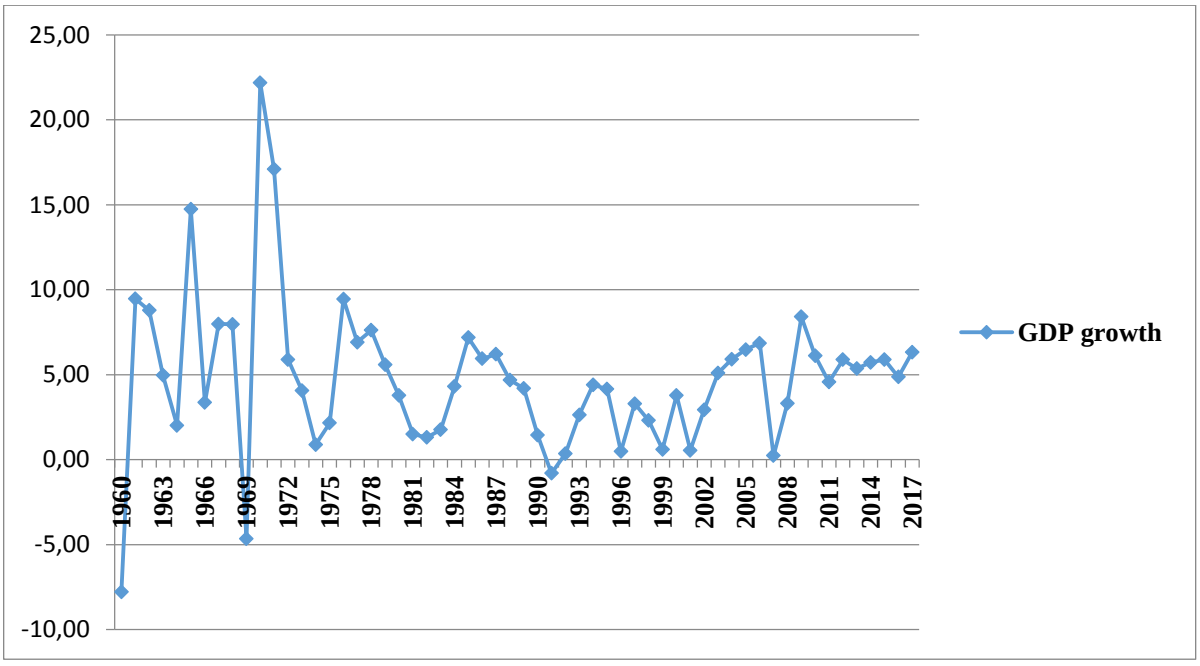


Figure 4: GDP growth rate in Kenya (1960-2017)

Source: World Bank (2019)

Kenya vision 2030 is 2008-2030's long-term growth strategy. It aims to turn Kenya into a highly prosperous, "middle-income economy supplying its entire population with high-quality life by 2030." The vision was created by an all-inclusive consultative process including Kenyans from around the world. The Vision was developed to provide continuity to the growth trajectory achieved by successfully implementing the "Economic Recovery Strategy for Wealth and Employment Creation".

On three pillars it is anchored: the political social and economic pillars. The economic pillar aims to provide prosperity for all Kenyans through an economic development program aimed at achieving a 10 % annual sustained average GDP growth rate. The social pillar aims to build "a just and cohesive society with social equity in a clean, safe environment." The constitutional foundation seeks to establish a stable political structure focused on issues-oriented policies that respect the rule of law and safeguards the freedoms and rights of every person in Kenyan society kenyarep-jp.com (2020).

Kenya is primarily open to international trade, accounting for approximately 36.2% of GDP Kenya imports nearly three times more than exports, which translates into a negative trade balance. This condition continues with a downward trajectory due to infrastructure development and oil production based imports. Currency deficit was $10.2 billion WTO in 2017. Total product exports hit $6.05 billion in 2018, while total goods imports were $17.37 billion. The service import bill was $3.39 billion, while service exports were $4.33 billion. Export growth, primarily from agricultural products, is projected to continue, reducing the goods deficit.

Foreign direct investment in Kenya remains relatively low despite its scale and pace of growth. Nevertheless, Kenya is one of Africa's largest FDI recipients, with FDI inflows significantly increasing since 2010. UNCTAD noted that Kenya's FDI flows rose 27% to $1.6 billion. This rise relates FDI mainly from China, in the hydrocarbon and mining industries. According to UNCTAD's 2019 World Investment report, Kenya's FDI intake rose dramatically from $1.2 billion in 2017 to $1.6 billion. FDI's overall balance was $14.4 billion in 2018. FDI's other sectors are tourism, banking, transport and extractive industries Public policies have kept inflation 5.2% within the target range and are predicted to continue stable over the next two years according to World Bank.

2.3 Tanzania Economic Outlook

Tanzania's market-driven economy attracts international and domestic investment. Beginning in 1986, Tanzania's government embarked on reform program to remove socialist economic controls and promote more active private-sector involvement in the economy. Tanzania experienced fast growth rates based on large natural resource and tourism, with GDP growth rate in 2009-17 averaging 6%-7% per year. Tanzania largely completed its market economy transition, although the government has a presence in such sectors as energy, banking, telecommunications and mining.

Despite the ongoing acute power crisis, Tanzania's economy has remained to perform strongly. Preliminary figures for 2011 indicate that the economy expanded by 6.4%, led primarily by services sector results, estimated growth of 7.6%; manufacturing and development estimated growth of 8.1%; and agriculture, forestry and hunting expected growth of 4.3%. The GDP growth rate was forecast at 6.8% in 2019, down from 7% in 2018.

Optimistic outlook was underpinned by a vastly diversified economy, characterized by vigorous private consumption, large public expenditure, high investment growth, and export production. Mining, tourism, manufacturing, construction, services are important sectors. GDP growth is estimated to be broadly stable at 6.4% in 2020 and 6.6% in 2021, subject to prudent fiscal management, favorable weather, financial sector vulnerability mitigation, and business environment reforms (AfDB, 2020).

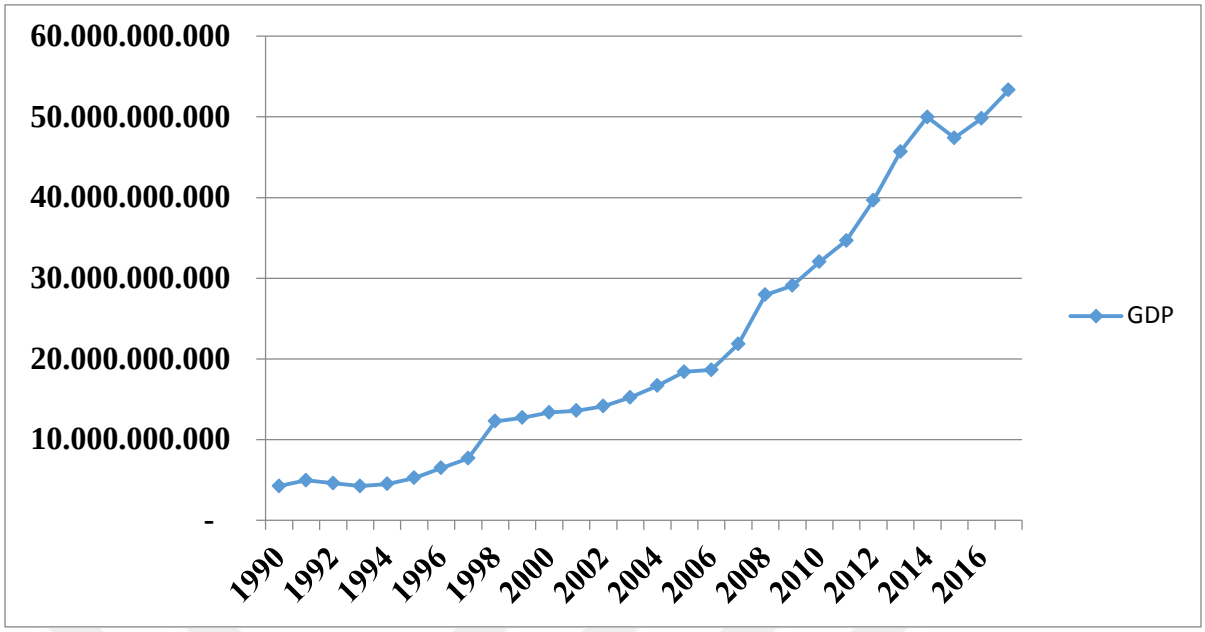


Figure 5: Gross Domestic Product in Tanzania (1990-2017)

Source: World Bank (2020)

The fiscal deficit, financed mainly by concessional foreign debt, peaked at 1.3 percent in 2018 to 2.0 percent of GDP in 2019 and is expect to steady until 2021 at 2.2%. In 2019, 63% of concessional foreign debt constituted 70.4% of total public debt. The current account deficit grew 3.3% in 2018 to 3.4% in 2019. Youth unemployment, Inequality and poverty continue amid recent vigorous growth. Poverty rate fell, however between 2012 and 2018, at a 6.4% slower level than 18.0% between 2007 and 2012. Youth unemployment increased 7.3% in 2016 from 5.7% in 2012. Additionally, secondary school for 15-24-year-olds dropped 30% to 24.7%, undermining the standard of labor market skills (AfDB, 2020).

Tanzania's financial sector has expanded over the years, and financial institutions account for about 48 percent of the total assets of the banking industry. Trade policy aims to create more competitive local industries and diversify their export sector to stimulate economic growth. Tanzania mainly exports household goods (3.1%), lime (3.3%), furniture (4.7%), vehicles (2.7%), toys (2.6%), machine tool accessories (2.7%), etc. The major imports are palm oil (2.6%), petroleum oils (19.1%), ferrous derivatives (2.3%), transport vehicles (2.3%), tractors (2.1%), drugs (2.4%) and motor vehicles (2.1%).

According to World Investment Report in 2019, Tanzania's FDI inflow reached USD 1.10 billion in 2018, showing a significant increase over the previous year $938 million. UNCTAD estimates the existing FDI stock at $20.7 billion, representing 35.8% of GDP.

The budget for 2010 was expansionary, with actual deficit-after grants being 7.1% GDP respectively. The approved 2011 budget has a projected deficit 7.6% larger, updated to 6.6% of GDP after international aid. Medium-term target is to reduce it to 5.5% of GDP. Ratio GDP of revenue in 2012 is estimated at 18 % of GDP. Total expected non-concessional borrowing is 3.2% of GDP. In recent years, policy revenues have generally performed well, rising by 22% annually. Total revenue of government collections were 93 percent of fiscal 2011 target. Total expenditure of government fell by 10 percent below target, partly due to income mismatch with budget spending commitments. The central bank of the country began pursuing monetary policy to support the government's macroeconomic goal of achieving one-digit inflation. Specifically, the bank of Tanzania pursued to achieve intermediate goals in 2011, widespread money supply (M2) as well as money supply (M3) of no more than 20.7% and 21% respectively. Central bank of the country implemented a mix of instruments pursuing monetary policy objectives, including foreign exchange transactions, government securities, stand-by facilities and repurchase agreements (AfDB, 2012).

2.4 Economic Outlook of Uganda

Over the past decade, Uganda's economic growth remained strong despite its recent slowdown. Uganda has substantial natural resources including, oil reserves, daily rains, gold, copper rich soils and other minerals deposits. Uganda's limited manufacturing sector relies on imported inputs such as heavy machinery and refined oil. Since 2016, Uganda's economic growth slowed as public debt and government spending grew. Road and Energy infrastructure spending dominates Uganda's budget, while Uganda relies on donor support for long-term growth drivers, including health, education and agriculture. Over the next three to five years, the attract FDI planning to invest $9 billion in production facility projects, $4 billion in export pipelines and $2-3 billion in domestic and EAC petroleum products (Theodora.com, 2020).

Uganda is open to international trade, contributing 48.2% of GDP according to World Bank. The country is a member of various international organizations such as WTO and EAC and COMESA. The country primarily exports coffee (14.1%), gold (16.7%), oil

(4.2%), fish (3.3%) and beet or cane sugar (3.4%). Its main imports are gold (5%), oil (18.9%), palm oil (3.5%), drugs (3.5%), motor vehicles (2.5%), ferrous goods (2.6%), wheat and meslin (2.3%). Uganda is one of East Africa's most attracting FDIs. FDI flows to Uganda represented $1.3 billion in 2018, up from $803 million in 2017. According to the 2019 World Investment Report, FDI stock also grew to $13,333 billion, valued at 47.4 %t of GDP.

Uganda's economic performance varies depending on the government and policies implemented. The GDP has been increasing over last two decades. In 2015, The Ugandan economy reported strong growth 5.1 percent.

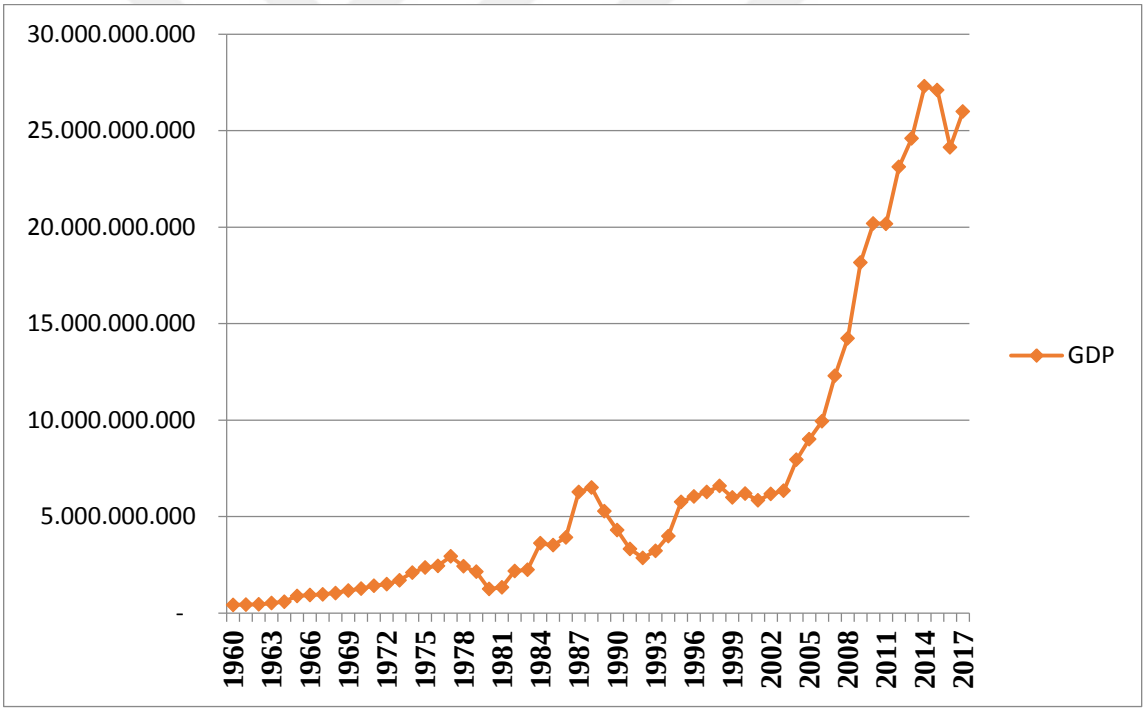


Figure 6: Gross Domestic Product in Uganda (1960-2017)

Source: World Bank (2020)

The revision of the 2010-2017 base years and the inclusion of previously missing activities meant that the economy was 21% larger over the last 10 years and fiscal 18/19, with an industry share of 30 % of GDP, much larger than the previous 20% estimate.

This growth was largely driven by mining, where the share doubled from around 8% to over 16% of GDP. Service share decreased from 58% to 46% of GDP, while agriculture increased from 22% to 24% of GDP. An average of one million youth is expected to reach working age between 2030-2040. Uganda is among Africa's fastest-growing population and remains on track to exceed 60 million by 2030.

In 2019, Ugandan economy reported fast growth, predicted at 6.3%, driven largely by service expansion. In 2019, industrial growth 6.2% and service growth averaged 7.6 driven by mining and construction. Agriculture rose just 3.8%. Construction, retail and telecom were main economic factors. Inflation is forecast to stay below 5%, strengthening domestic production. Fiscal deficit is forecast to grow to 5.3 percent as a share of GDP in 2018, as public spending is projected to stay low or even increase due to increasing strains and falling revs. Moreover, the trade deficit is projected to increase due to higher imports of private-sector associated with economic activity growth and increasing oil prices. In 2018, the government's macroeconomic policy will remain focused on stabilizing the exchange rate, controlling inflation and mobilizing domestic capital (AfDB, 2020).

Government expenditure continues to rise, supported by domestic investments and public infrastructure for the nascent gas and oil industry. Expenditure rose faster than domestic income, expanding fiscal deficit in 2019. The shortfall is funded by foreign investment, offset by domestic securities. Given rising deficit, Uganda is listed at low risk of debt distress. However, in 2019, debt reached an estimated 43.6% of GDP, up from 25% in 2012, going to raise medium-term concerns. Foreign debts continue to rise 43.6% of GDP in 2019, rising to 47% of GDP in 2020. Moreover, China's non-concessional loans are rising. Despite under-performing international donor-funded projects, the budget deficit is widening. In 2019/2020, the budget debt hit -7.2% which will grow to -7.4% in 2020/2021 which -6% in 2021/2022 (AfDB, 2020).

2.5 Rwanda Economic Review

Rwanda's economy stayed on a fast growth path with GDP growth grew from 7.6% in 2011 to 8.8% higher than the original 7.0% forecast. Growth was driven by agriculture, mining and industry. Agricultural sector was 8.2%, exports increased largely attributed to increasing commodities price and domestic demand supported by expanding private-sector credit. Industry recorded the highest growth rate, 15.1 percent, due to a 15.5 percent and 22.3 percent turnaround in mining and construction. Government expansion and tourism recovery also contributed to growth. Service growth was 7.2% lower than the 9.6% reported in 2010, due to slower growth in communications, transport and financial services. GDP growth was decline to 7.6% in 2012 as planned fiscal consolidation helps to reduce aggregate demand, as well as global economic uncertainty. Inflation remains one-digit but rose, from 0.2 percent at end-2010 to 8.3 percent year-on-year in 2011, contributing to a increase in annual headline inflation from 2.3 percent in 2010 to 5.6 percent in 2011(World Bank, 2019).

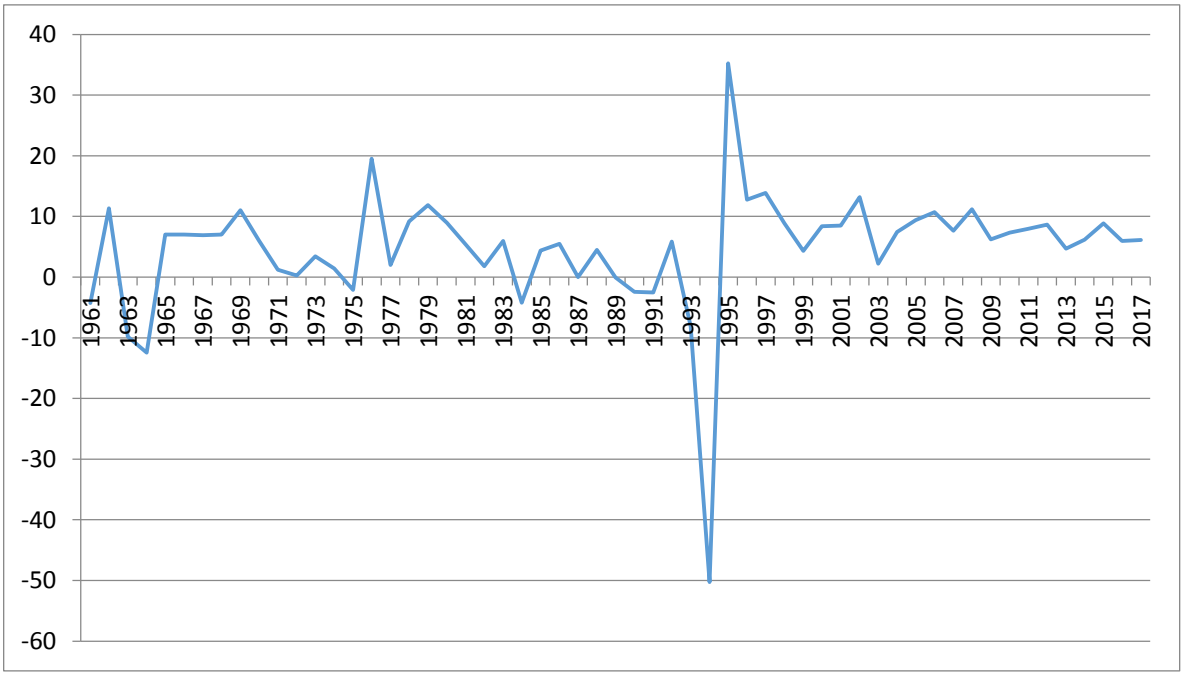


Figure 7: GDP growth rate in Rwanda (1960-2017)

Source: World Bank (2020)

The 1994 genocide destroyed the fragile economic base of Rwanda, severely impoverished people, especially women, and briefly hindered the country's attractiveness private and foreign investment. The government has introduced fiscal policy to reduce poverty through improved infrastructure, education and domestic and foreign investment. Rwanda consistently ranks well for transparency and business. In 2018, the average GDP growth rate was 7.5%, while GDP per capita increased at 5 % annually. GDP growth rate increased at 8.7% in 2019, above the East Africa average. Growth was mainly in industry (18.1%) and services (7.6%). per capita GDP rose 6.1% in 2019. Investment fueled growth, guided by public investment in infrastructure and social services.

Economic growth in Rwanda is expected at 8.0 percent in 2020 and 8.2 percent in 2021, backed by ongoing large-scale projects such as electricity, Hakan Peat plant and Bugesera airport. Inflation rate is predicted to remain approximately 5% target. As fiscal policy shifts between market support and stabilization of public debt, the fiscal deficit is expected to grow to 6.8% of GDP in 2020. The current account balance is expected to decline to 9.1% of GDP in 2020 due to pick-up in export markets. Inflation rate target was 5% in 2019. Inflation increased slightly in 2019, driven by higher domestic demand (AfDB, 2020).

The agricultural sector grew by 5% in 2015 and slightly decelerates to 5.1% in 2016 due to expected export contraction due to falling international commodity prices. Coffee prices have fallen by 20.3% reflecting increased improved supply conditions for Brazil's Arabica coffee and Vietnam's Robusta coffee. The prices of tea have risen substantially in recent years, but have begun to slow as supply is likely to improve. Tea prices narrowly dropped by 0.4 percent in 2015 as prices increased sharply in Mombasa auction by 34.1 percent, offsetting a 16.4 percent decline in tea prices in Colombo. Prices dropped % for abundant production capacity-driven fertilizers.

The strong economic growth in Rwanda was accompanied by substantial improvement in education as well as reduced poverty and child mortality. Strong emphasis on domestic programs and projects has helped greatly increase access to resources and community development metrics. Measured by the national poverty line, poverty fell from 59% to 39%

between 2001 and 2014, but nearly stagnated between 2014 and 2017. The official Gini inequality measure declined from 0.52 in 2006 to 0.43 in 2017 (World Bank.org, 2020)

Imports rose rapidly than exports, trade deficit increased by 3.5% points to 11.3% of GDP in 2019, raising current account deficit by 1.5% point to 9.2% of gross domestic product. Rwanda's trade policy is open to international trade, 51.5% of GDP in 2018 according to World Bank. Additionally, benefit from the bilateral investment U.S.-Rwanda as well as EAC, COMESA and WTO. Rwanda exports are led by gold, petroleum oils, coffee and tea while imports mainly export cement, pharmaceutical product and other equipments. Rwanda's structural trade deficit, due to its strong demand and growth for manufactured goods. The deficit increased significantly in 2018, to $907 million from $829 million according World Bank data. Rwandan retail imports hit $2.58 billion, while exports accounted to $1.1 billion. The country exported $798 million in services and imported $931 million.

Foreign Direct Investment stocks have risen in recent years due to improving the business environment and Rwanda's political stability, foreign direct investment inflows remain relatively weak at $356 million in 2017 and $398 million in 2018 according UNCTAD`s world investment report. At the end of 2018, FDI stock was $2.2 billion, approximately 23.8% of the country's GDP. FDI mainly target real estate and construction, mining, information and communication technologies.

The fiscal policy of the government in 2011 and 2012 focused on achieving monetary stabilization and phased removal of fiscal stimulus while promoting economic growth. The fiscal restructuring program focuses on reducing and prioritizing public expenditures, removing domestic funding, and introducing additional reforms in tax-administration capacity and PFM programs. The main objective of government fiscal policy stimulates the economy. Capital spending as a share of GDP rose from 11.0 percent in 2010 to 11.5 percent in 2011, with recurrent spending rising from 14.2 percent to 15.3 percent in this period. The increase in government grants and revenue between 2010 and 2011 was insufficient to offset the increase in total spending and net lending, resulting in deteriorating overall balance (ECA, 2016).

Tax policy and administration measures initiatives including the implementation of value added tax in electronic and reduce the expected revenue loss. Budget share for these sectors rose to average 70% between 2012 and 2014 from 63.5% in 20010 to 69.9% in 2011. Monetary policy of the Rwanda's National Bank is primarily aimed at contributing to sustained macroeconomic stability as well as ensuring exchange rate and price stability. Under the monetary policy target framework, the national bank managed to keep inflation low and stable by providing the amount of money in the economy broad money aggregate in line with inflation and economic growth goals (ECA, 2016).

2.6 Burundi Economic Outlook

Burundi is landlocked country; Burundi's economy is heavily dependent on agriculture, representing average 42.9% of GDP in last three decades. Burundi is resource poor nation with underdeveloped manufacturing. Agriculture employs over 70% of workers, most of whom are peasant farmers. While Burundi is theoretically self-sufficient in food production, continuing civil unrest, soil degradation and overpopulation have contributed 25% in recent years to the contraction of the subsistence economy. Significant numbers of internally displaced people were unable to produce their own food, relying mostly on international humanitarian aid.

Burundi's post-conflict situation remains a handicap, preventing it from enjoying a favorable external environment. However, the economy made strides with steady growth at 4% in 2011, about the same as 3.9% in 2010. Preliminary government statistics indicate that crisis cost about Burundi $2 billion or around 1% of GDP in 2011. Agriculture is the core of Burundi's economy, accounting for over 36.4% of GDP, mainly through tea and coffee crops. Coffee exports constitute 70% of the state's international trade. Tea production is believed to have grown 9,000 tons in 2011 from 8,016 tons in 2010. Moreover, more evident growth was recorded in stock-increasing due to distribution of cattle to poor people (AfDB, 2020).

Government has initiated an economic reform program based on prudence of budgetary and monetary policy to hold inflation and deficit of budget down. The government's aim is to maintain the budget deficit at about 4.1% of GDP in 2011. This goal was not achieved due

to increase public spending aimed at reducing the impact of rising oil and food prices on the poor. The rate of inflation brought relatively under control with a price increase of 5.6% in 2015, but food prices rose by about 10%. Foreign exchange reserves plummeted by about 41% in 2015. Credit access remains very restrictive at an average borrowing rate of 16.9%. In inflation, the fall from 16.1% in 2017 in 2018 continued in 2019, with a rate of –3.1%. The GDP growth is estimated to grow 3.7% in 2020 and 4.3% in 2021 (World Bank.org, 2020)

The central bank of Burundi has initiated significant exchange rate regulatory reforms that could relieve pressure on the country's foreign reserves. The central Bank of Burundi developed new exchange rules, which came into effect in 2010. These rules relax currency control operations while codifying existing currency exchange rules. The decline of public finances in 2014 continued in 2015. Capital decreased by 16%, especially due to the cessation of budget funding and declining income, while spending decreased by just 6%; the most extreme effects on investment -43%. The 2015 budget deficit was 5.7% of GDP. Burundi's public debt fell slightly 47% in 2011 from 48% of GDP in 2010 and predicted to fall to 37% in 2012. Burundi still favors concessionary loans. It is worth remembering that in 2011, domestic public debt along with state-guaranteed external debt and private debt constituted 14% of GDP.

According World Bank data that international trade represented approximately 38% of Burundi's GDP in 2017. This share has decreased in recent years. Foreign trade, for example, amounted to 42 percent of GDP in 2014. Coffee and gold are the main export goods 24.2% and 30%, followed by tea 15.4%, while primary imports are pharmaceutical 5.2%, petroleum19.4% and fertilizers. Burundi's balance of trade is structurally negative -$496 million in 2017. Foreign direct investment inflows to Burundi are quite small, $1 million to $0.3 between 2017 and 2018. In 2018, total FDI stock stood at $243 million, or 7.1% of GDP.

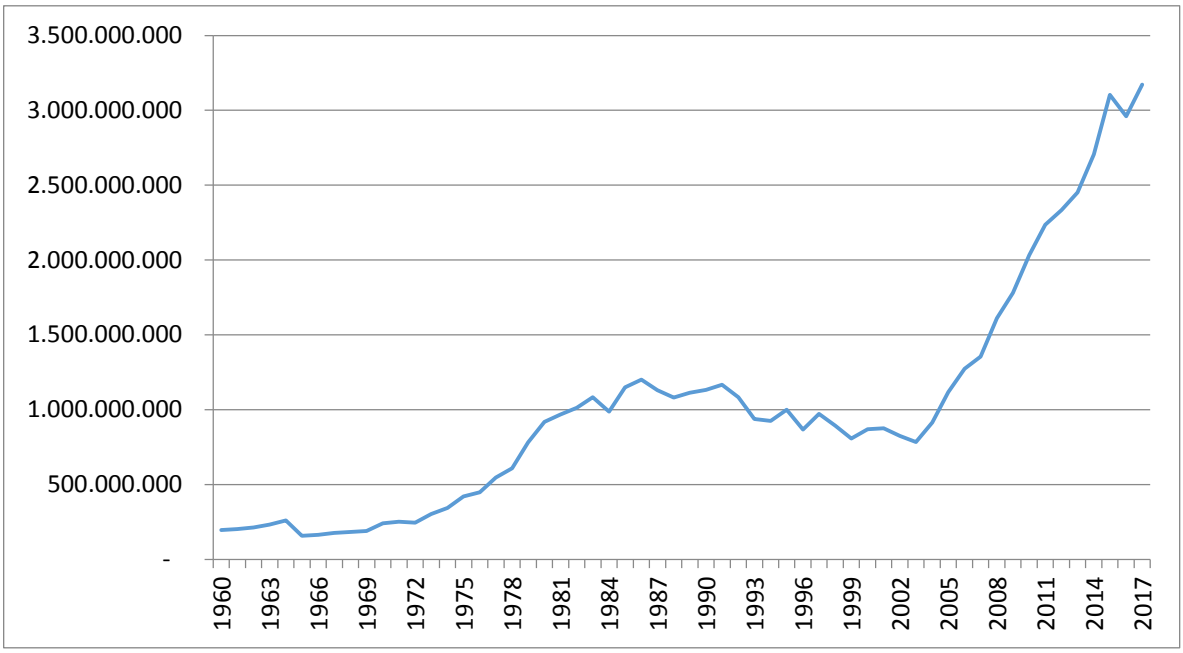


Figure 8: Gross Domestic Product in Burundi (1960-2017)

Source: World Bank (2020)

Burundi's GDP decreased 3.9% in 2015 due to the country's socio-political crisis. The recession ended a decade of economic prosperity with an average annual growth of 4.5%. Recovery is sluggish in a still difficult setting in 2016, with growth projected at 0.7% of GDP. In 2015, the sectors with the greatest decline were agriculture (-3.9%), electricity (-10%), construction (-35%), hotels and catering (-6%) and trade (-9%). Burundi's gross domestic product decreased 3.9% in 2015 due to the country's socio-political crisis. This recession ended a decades of economic stability with an average annual rise of 4.5%. Recovery is sluggish in already tough setting in 2016, with recovery projected at 0.7% of GDP. In 2015, the sectors with the largest downturn were electricity -10%, construction -35%, commerce -9%, and agriculture -3.9% and hotels and catering -6%. GDP growth increased from 0.5% in 2017 to 1.6% in 2018, driven by good industry and rainfall -led agriculture that benefited from more reliable electricity (ECA, 2016). The economy faces challenges related to rising foreign reserves, increasing fiscal, lack of fiscal capacity and external imbalances. Following the 2015 recession, poverty is expected to increase to 84.3% in 2021 due to negative GDP per capita growth. The agricultural sector is predominant employing around 80% of labor and accounting for 28.5% of GDP in 2017.

The economic recovery reinforced 3.3% GDP growth rate, backed by slight increase in public investment, higher coffee exports especially, agricultural production. The fiscal deficit rose to 4.2% in 2019, after 3.3% in 2018. The deficit was financed through accumulation of domestic payment arrears and increased central bank advances. Debt distress risk continues to increase 63.5% of GDP in 2019 compared to 58.4% in 2018 due to higher domestic debt (AfDB, 2020).

2.7 Comoros Economic Review

Comoros is a small African archipelago country comprising three Indian Ocean islands. The country is small with an area of approximately 1,660 km2 and a 427 km coastline, the national economy mainly depending on biodiversity and natural resource. The country has been marked by poverty extreme political instability, poor governance, since France's independence in 1975. Political instability has hampered economic growth and development, preventing implementation of macroeconomic policies. The economic system of the country is private ownership. Comoros' economy is based on subsistence fishing and agriculture. Comoros has insufficient transport connections, fast-growing population and little natural resources. The country is among the world’s poorest East Africa nations; the average GDP per capita estimated $700, real 2007 salaries are about $3–4 a day (Theodora.com, 2020). Post-independence, the GDP growth rate of Comoros pattern was initially associated with high volatility, a situation that stabilized low after 2001. Repeated socio-political problems, including unconstitutional changes in government, followed Comoros' declaration of independence in 1975. Political instability periods have been associated with growth contraction. Followed the adoption of the new constitution in the early 2000s, the number of political crises decreased, which tempered growth pattern instability but, consistent with growth experiences in other politically fragile countries, stabilized low-level development. For decades, economic growth of Comoros has been narrow and weak, reflecting the country's inherent disadvantages, including high transport costs, small size of the local market and poor domestic investment. Economic activity consists largely of subsistence export crops, import-related trade, and agriculture and government services. Tourism and Fishing are far below expectations, with near-inexistent development.

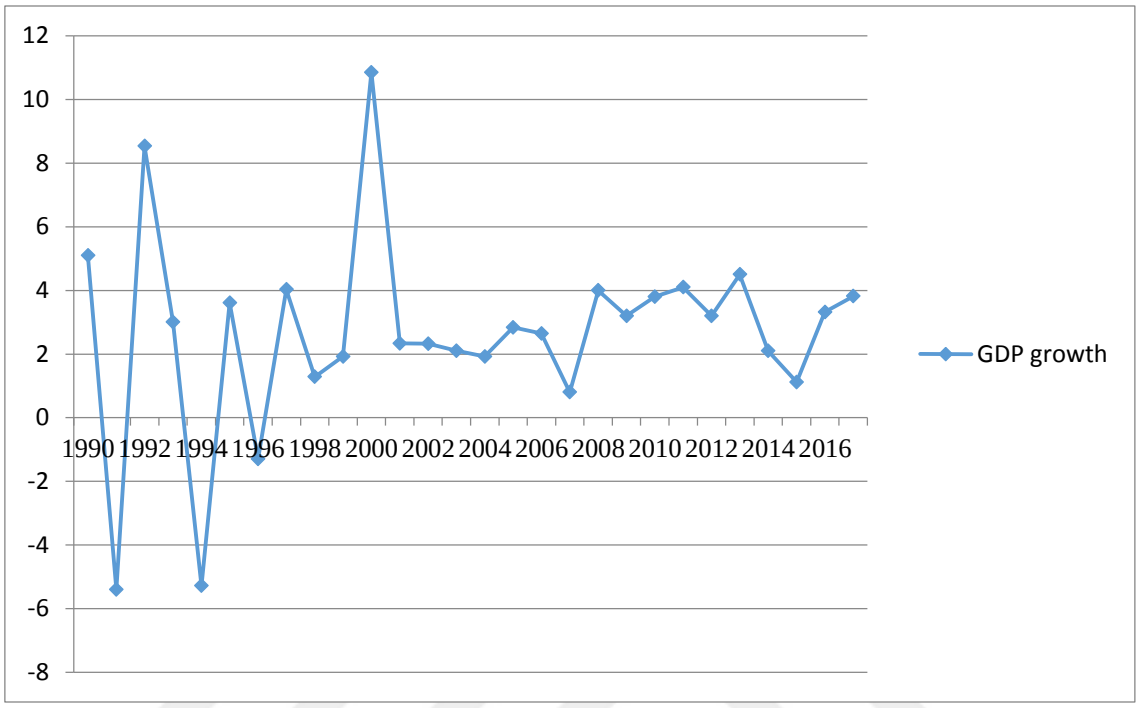


Figure 9: GDP growth rate in Comoros (1990-2017)

Source: World Bank (2020)

The growth rate of the Comoros economy has steadily declined in 1998, the GDP growth rate dropping to 1.28% in 1998, similar to 1.28% in 1999. Over the period 2001 to 2017, the average real GDP growth rate was 2.8%, also highlighting that the economy's growth pace could not significantly outstrip population growth. GDP growth in 2019 was 1.5%; the growth was driven by supply-side transport and electricity, and demand-side public investment. Inflation is estimated at 2% for 2019, current account deficit at 8.9% of GDP, fiscal deficit at 2.6% of GDP and foreign debt at 32.4% in 2018 up slightly from 29.3%.2017. Inflation is estimated at 1.9% for 2020 and 2.1% for 2021, current account deficit at 8.8% of GDP 2018, fiscal deficit at 2.8% of GDP in 2018 (AfDB, 2020).

GDP growth will hit an average of 3.2 % between 2019 and 2021. Telecommunications and tourism sectors will also boost growth, with a very high-speed submarine cable arriving in Moroni. Diaspora remittances will remain the main private-consumer support. Comoros is open to international trade, representing 43% of GDP. The country primarily exports

vanilla 32.3%, cloves 45%, grading machines 2%, essential oils 12.3% and motor vehicles 1.7%. Its main imports include electrical or visual signals 11.6%, motor vehicles 11.9%, rice 9.3%, and meat 5% and cement 7.1%. Comoros has a structural trade deficit due to underdeveloped manufacturing, commercial agriculture, basic consumer goods and dependence on fuel imports. According to the latest data of World Bank, the country exported $127 million and imported $303 million in 2018. In 2018, the trade deficit was $175 million. Current foreign direct investment inflows to Comoros remain negligible given the government's tax cuts and incentives, which are determinedly striving to boost the economic environment and institutional stability. These inflows in 2018 amounted to only $6 million according World data, which is consistent with historical trends but well below 2011 's exceptional peak $ 23 million.

The Comoros' fiscal policy fits into an IMF economic program, supported by the Expanded Credit Facility (ECF) financing of $20 million. Comoros' monetary policy is focused on modest economic growth rate development. Money supply in the broad sense would need to rise by an average of 5.75% in 2011 and 2012, slightly less than nominal GDP growth, compared to 19.4 percent in 2010. The state must take a prudent approach to the level of its debt to the banking system to allow the private sector to expand lending.

3. LITERATURE REVIEW

This chapter reviews the main established impact of inflows foreign capital on economic growth in selected East Africa economies. Several literates have been conducted on the relationship between foreign capital and sustainable economic growth in the literature. Over recent years, an increase in academic interest has been seen to foreign capital and economic growth, especially economic development in developing economies. The effect of capital flows on an economy is explained through two theoretical perspectives: structuralist views and neoclassical. The theory of neoclassical economy shows that open capital-scare countries attract foreign capital from rich resource countries, to boost economic growth and domestic investment (Klobodu & Adams, 2016). The discussion on foreign capital inflows and their potential effect on host countries' productivity growth remains an open topic in literature. These capital inflows are different types, such as FDI inflows, remittances, aid, and debt. Tahir, Estrada and Afridi (2019) have provided sound evidence to support the hypothesis that FDI and foreign aid are positivity related to economic growth while the impact of trade flows and foreign debt is negative. Nevertheless, for specific countries, remittances have insignificant effects on growth. Recent findings Ehigiamusoe and Lean (2019) show that foreign portfolio investment positively impacts economic development. Furthermore, Nigeria's FDI and foreign assistance have little effect on productivity growth. Remittance inflows are primary revenue sources in developing countries.

Starting from Harrison (1994) the impact of foreign direct investment on sustainable economic growth or their relationship has been discussed both theoretically and empirically, there is no consensus about their relationship because of the unlike dataset and measurement used in the empirical investigation and different theoretical foundation used in the literature. The differences in the results reviewed show the importance of regional specific studies. To have an understanding of the role of absorptive capacities based on previous papers, the next part will discuss the FDI absorptive capacity and the choice of financial functioning as the focus of our study, the relationship between productivity growth financial market development as well as how functioning financial intermediation is vital for promoting investment and eventually an increasing gross domestic product.

This case study in Venezuela and Morocco showed that foreign-equity companies are more productive than domestic companies, and have a higher level of productivity growth. However, the study found that domestic competitive competitiveness was harmed in Venezuela because the intervention of multinational firms reduced their market share. FDI is usually viewed as a channel for technology to spread to developing economies (Balasubramanyam Salisu, & Sapsford, 1996). Moreover facilitate technology transfer as well as improvement marginal capital productivity, thus contributing to productivity growth. The theoretical basis for empirical FDI and growth studies derives from either endogenous growth models or neo-classical growth model. FDI improves productivity and/or output in neoclassical growth models, leading to long-run impacts and medium-term, transitional growth improves. The latest endogenous growth models find long-run growth to be a function of technological progress and provide a structure through which foreign direct investment can steadily increase host economy growth through technology spread and spill effects.

In the macro-empirical test Balasubramanyam et al. (1996) investigated cross- countries for the 1970-85 period the relationships in the context of new growth theory in various trade policy regimes between trade strategy, FDI and GDP in the developing world. The study tested Jagdish Bhagwati's hypothesis that the increasing effects of FDI in countries pursuing an export promotion policy are stronger than following an import substitution policy. The findings showed that FDI has a positive effect on the economic growth of those countries that have followed development strategies inward. To achieve this end, the paper divides the countries in the sample into IS and EP categorizations based on structural stability analysis for import shares. Borensztein, Gregorio and Lee (1998) expanded an endogenous growth model in which foreign direct investment boosts long-term growth due to its impact in the host country on the rate of technological spread from the developed world.

The study used apparently unrelated regression with instrumental variables in 69 developed countries with panel data distributed over two different periods 1970-89 with dependent per capita GDP growth levels in each decade. The study concluded that FDI alone has a favorable yet marginal effect on economic development. Foreign investment is a key

determinant of sustainable productivity growth only when a country has a minimum threshold of human capital, and in that case, it contributes to productivity growth more than domestic investment.

Luiz and Mello (1999) assessed the FDI effect on overall factor productivity (FFP) growth and capital accumulation using the OECD and non-OECD countries from 1970-99. The study found FDI is low, and the degree of substitution and complementarity and substitution between foreign direct investment and domestic investment. Nair-Reichert and Weinhold (2001) conducted a study of 24 developing economies from 1971-1995 to examine the complex relationship between FDI and economic growth using fixed and random models. The contemporary correlation of FDI and productivity growth was investigated and Granger Causality between FDI and productivity growth was performed. The findings revealed that the causal relationship between FDI and productivity growth is highly heterogeneous in developing economies. In the report, the causal relationship between productivity growth and foreign direct investment is found on average and there are some signs that FDI is more successful in more open economies, albeit extremely heterogeneous across nations.. The findings indicated that it is essential for FDI to influence GDP growth beyond domestic investment as well as an open economy.

To identify the importance of country-specific characteristics on FDI led growth, Zhang (2001) the empirical study has been carried out using data for 11 Eastern Asian and Latin American economies. The study found that there was a positive relationship between foreign direct investment and productivity growth, concluding that the strength of this relationship depended in particular on host country conditions for improving education and hence the state of human resources, and preserving macroeconomic stability and implementing a liberalized trade regime. This paper used FDI/GDP ratio to measure FDI inflow in respective countries while Ram and Zhang (2002) suggested that FDI/GDP ratio measurement is the lowest in the least developed countries, but the annual average increase in real net FDI flows is the best for developing countries. Additionally, the study failed to find complementarity between foreign direct investment and the host country's human capital. The reason why they reached a different conclusion is that the different sample sizes and proxies they used to measure their variables. Bengoa and Sanchez-robles (2003)

analyzed and reached the same conclusion panel data from 18 Latin American countries. Although the papers focus on specific country conditions, they are still limited to a small sample size.

Choe (2003) investigated relationships between foreign direct investments; productivity growth and growth of domestic investment with larger samples in 80 countries during 1971–95 were examined by using the VAR panel model. The findings revealed that foreign direct investment Granger causes increase gross domestic product and vice versa; the impact is more obvious from the growth of FDI than from FDI to growth. The result suggested that strong positive correlations between productivity growth and FDI or GDI inflows have not generally contributed to rapid economic growth through high inflows of FDI or GDI levels. The author found that there were more effects from growth to FDI that would lead to more FDI in countries with prosperous economic development. To look at how flows of FDI are driven by host economic growth, the two types of FDI are not distinguished by their motives. Market-seeking FDIs by multinational firms in various countries are driven by domestic market access to hosting countries in more efficient use of resources and by economies of scale or export-oriented FDIs, which are motivated by differential factor prices such as low-cost labor in host countries, together with infrastructure and human capital conditions. The unidirectional result of growth to FDI based on the market that seeks FDI motives may be true, although the paper lacks a theoretical basis.

Alfaro, Chanda, and Kalemli-ozcan (2004) discussed that the advantages of FDI differ across sectors and negative incidences of foreign direct investment in the primary sector and that their effect on service and manufacturing respectively is positive and ambiguous. As a result, FDI targeting the primary sector, particularly in oil exported countries, did not view the host country as being human capital thresholds or even be politically stable as long as multinational companies repatriate more profit, which is happening in many developing countries. To overcome the limitation, Li and Liu (2005) investigated whether FDI effects sustainable productivity growth on a panel of 84 developing countries by using the simultaneous equation and single equation method to detect the endogenous issue. The paper merged and used the UN and World Bank data world investment directories. The

study also used schooling, technology gap and infrastructure as an interaction concept and found that foreign direct investment promotes productivity growth not directly by itself. Johnson (2006) investigated role FDI on GDP cross-sectional data from 90 developing and developed countries, the study concluded that FDI enhanced productivity growth in developing economies through because of technology spillovers, not in developed countries. Ekanayake and Ledgerwood (2010) confirmed that FDI has a positive and significant effect on productivity growth, as requested in the panel data on a community of 85 developing economies covering Africa, Asia, Caribbean and Latin America for the period 1980-2007.

FDI inflows and their effect on economic development are also not a new phenomenon and the last two decades has extensive debated this relationship. Brenner (2014) studied the effect on the national economic growth of foreign direct investments through GMM panel regressions and identified impacts on productivity development, capital and labor inputs as well as innovation activities. Moreover, less and more developing countries are being analyzed separately along with the periods 1974-1991 and 1992-2009. FDI's effects on production capacity for the first time in more developed countries, while impacts on innovation activities for the medium-developed countries in the latter era are established. GMM regressions are very negative in less developed countries for four different dependent variables and six different sub-sets of observations. The findings show clearly that growth is negatively dependent on the degree of growth already achieved and that economic growth is positively dependent on rises in capital production. Pegkas (2015) examined the effect of FDI on productivity in Eurozone economies, the main result of the study indicated that FDI is a significant factor that positively affects productivity growth in Eurozone economies. So FDI plays an important role in economic growth in Eurozone.

Owusu-Nantwi (2018) empirically examined the long and short-run relationship between FDI and GDP in South America used panel data form 1970 to 2013. The empirical result indicates that positive and statistically significant in the long-run relationship between FDI and productivity growth while short-run the findings show bidirectional Granger causality between sustainable economic growth and foreign direct investment. Awad and Ragab

(2018) study highlighted that FDI appears statistically effect on economic growth per capita, the result indicated that increasing 10% in FDI inflow would lead to increase in the growth rate in per capita economic growth by an average 1.3%, the positive impact of FDI, in this case, that not reflect simply in domestic investment. C. Li and Tanna (2019) noted that FDI is commonly seen as a catalyst for productivity growth, especially developing economies, the GDP-enhancing impact of inward FDI while dependent on the capacity of absorptive of developing economies. The study found that there is a weak direct impact of FDI on total productivity growth in developing economies over 1984 -2010. The global inflows of FDI have been re-allocated to other emerging economies as the FDI inflows to developed countries have been decreased in the last ten years. The weak allocation of foreign direct investment gives credence to the African continent's weak financial structure. The continent's financial system is largely bank-based and undeveloped (Acquah & Ibrahim, 2019). Financial development measures financial institution's ability to make financial services available to individuals and to finance n support of the economic drive of the private sector in the financial system.

Most foreign aid has been a channel to developing economies over four decades. Not surprised, from the perspective of aid's effect on sustainable economic development, a large literature looks, especially at aid effectiveness. Arndt and Jones (2015) focused on long-term cumulative effects of aid in developing economies; supports recent evidence of a positive influence of aid on development and expands the reach of evaluation to a variety of outcomes including near-growth sources, indices of social security and economic change. Additionally, Heinrich, Kobayashi, and Bryant (2016) developed an argument that foreign aid cuts occur during economic downturns because voters put a lower emphasis on aid, and politicians respond by reducing aid to demonstrate that economic downturns contribute to a decrease in public support for the poor abroad. The finding of the result has implications for how advocates can avoid reductions in aid during economic recessions. The impact of aid on aggregate economic results has spawned a vast, much of it polemical, literature. Nevertheless, the set of empirical studies recently published about the effect of aid on growth draws broadly similar conclusions has noted by (Jones & Tarp, 2016).

Fact, foreign aid isn't always contributing to higher productivity growth. Harb & Hall (2019) confirmed that foreign aid has a positive effect on productivity growth in lower-middle and least developing countries. Developing countries remained to have insufficient resources and low income to fill the gap between revenue and expenditure; the study must rely on foreign capital, i.e. external debt and foreign aid to address to the budget deficit. Qayyum, Din, and Haider (2014) investigated the impact of external debt, foreign aid and governance on sustainable economic growth, the study found that aid does not directly influence investment but directly affect the gross domestic product. Another study, Chauvet and Ehrhart (2018) examined 4355 firms in 29 developing economies, 11 of them are in Africa, discuss the effect of foreign aid on firm growth. The result of study is robust for many tests, in particular for aid instrumentation and estimates on various sub-samples and an expanded cross-sectional survey of 93 developing economies. The effect of official development assistance on the sustainable productivity growth of the recipient countries has been the subject of intense debate in the literature on international development noted by (Civelli, Horowitz, & Teixeira, 2018).

Aid is a voluntary transfer of resources by private organizations, individuals and government individuals to help the development of the beneficiaries. Bhavan, Xu and Zhong (2011) examined to what extent different categories of foreign aid affect the rate of productivity growth in developing economies, moreover, since the trend of each foreign aid's transfer category appears to be volatile, the paper also examined whether volatility inhibits rates of growth in these countries. The study found a positive relationship between foreign aid and development, while volatility hurts it. Long-impact aid favors development more than short-impact aid. The volatility of short-impact aid hurts development, whereas the volatility of long-impact aid doesn't affect it. Unconditional aid and volatility have no productivity growth impact.

Furthermore, as shown in Jena and Sethi (2020) empirically analyzed the foreign aid effectiveness efficacy in enhancing economic growth opportunities in sub-Saharan Africa from 1993 to 2017, authors find short and long run and relationships between economic development, foreign aid, price stability, financial deepening, investment and trade openness in the SSA economies. The study also found unidirectional causality, from

foreign aid to productivity growth. Despite several foreign aid recipients' failure to bring stability and growth to their economies, the foreign aid effectiveness in fostering development and growth has been thoroughly investigated. This resulted in a series of discussions between policymakers and economists about the role of foreign aid effectiveness in economic development noted by (Husein, 2019). Foreign aid has been described as one way emerging economies can achieve sustainable economic growth. Therefore, various donor countries and organizations implement policies that will increase the amount of aid allocated to developing economies. Adedokun (2017) reviewed the debate on the effectiveness of foreign aid quantitatively by examining the relationship between governance, economic development and foreign aid using more recent data from 1996 to 2012 in SSA and heterogeneity testing in beneficiary countries. Foreign aid in aggregate SSA has an insignificant negative relationship to economic development. In sub-Saharan Africa, however, one cap doesn't cover all, as heterogeneity among foreign aid recipients has implications for the effectiveness of foreign aid.

Moreover, Altaghlibi and Wagener (2019) identified the dynamic effects of unconditional aid on the growth of the recipient country and its direction of growth. The study found that the conditionality of aid is counterproductive if the conditionality restriction is strictly binding and can only have the intended effect in a small window of cases decreasing to zero with the preferred rate of time. In development economics, one of the most controversial issues refers to the effectiveness of foreign aid. In this debate, three distinct camps can be distinguished: First, some believe that official aid is ineffective and has harmed the poor countries over the years noted by (Edwards, 2015).

Several empirical research on aid effects and conditionality of aid effectiveness in various recipient countries can explain our theoretical analyzes. Pham & Thin Kim (2020) presented a tractable model to examine the aid effectiveness in the light of donor rules and, by the way, contributing to the discussion on the aid effectiveness in terms of economic development, including other empirical studies. The study found that foreign aid effectiveness depends heavily on how aid is used and its absorptive potential in the recipient countries, as well as the initial level of development of the recipient economies. Another study, Mahembe and Odhiambo (2019) investigated the causal relationship

between poverty reduction, foreign aid and economic development in 82 developing economies from 1981-2013. The key result is evidence of unidirectional causal relationship from productivity growth to foreign aid.

Successful foreign aid needs effective management during the implementation of aid, including disbursement, acquisition, and distribution of aid. Proposing that inadequate management of foreign aid was one of the major causes of aid failure and waste worldwide, donors increasingly stressed the importance of enhancing foreign aid management by (Kim, 2011). The belief among African scholars is that the poorer Africa became the more developed north cooperated with western countries. The generosity of western has increasingly failed to impress development academics and experts. Moyo and Mafuso (2017) focused on foreign aid effectiveness with particular emphasis on Zimbabwe in developing countries. The paper found that the Zimbabwean government was granted official aid development and made significant contributions to the overall economy, although it was largely linked to some donor stipulations that hurt its purpose, resulting in Zimbabwe's government becoming more dependent on aid. Furthermore, as shown in Minoiu and Reddy (2010) Re-examined the causal relationship between foreign aid and GDP in a broad cross-section of aid beneficiary countries, allowing different types of aid to have distinct growth impacts. The study found that foreign aid has a positive and robust impact on subsequent growth. Advanced OECD countries are primarily responsible for global carbon emissions by providing technological and financial assistance to the fastest-growing economies has noted by (Kretschmer, Hübler, & Nunnenkamp, 2013). Official development aid is believed to play a significant role in fostering sustainable growth in the vast majority of developing countries.

Sothan (2017) examined the sustainable economic growth effects of aid in Cambodia from 1980-2014. The study found that trade openness had positive effects on both short and long productivity growth; domestic investment contributed positively to long-term productivity growth, while aid only had positive effects on short-term productivity growth. It has negative long-term effects on investment and productivity growth. Additional Sethi, Bhujabal, Das and Sucharita (2019) examined the relationship between foreign aid inflows and sustainable growth for Sir lank and India using the 1960–61 to 2014–15 time series

data. The study confirmed that there is a long-run relationship in India between economic growth, foreign aid, financial development and domestic investment. For the same, there is also a unidirectional causality among variables. The study confirmed that foreign aid in Sri Lanka has no significant effect on productivity growth in the short and long run. In recent years, in the wake of a growing threat to international security and peace from the failure of development in many developing economies, foreign aid has received new emphasis has noted (Sharma, 2014). Furukawa (2019) found that foreign aid inflows as a percentage of GDP is 3.5% or higher, up to 9.3%, the concentration of aid has a positive and strong effect. However, the relationship between aid inflows and sustainable economic growth rate slowly becomes an inverted U-curve. The study noted that fragmentation of aid is a situation in which in a recipient country a large number of fragmented and uncoordinated donor projects undertaken with procedures varying from donor to donor, which increases transaction costs.

Furthermore, a separate strand of existing literature looks at foreign aid and domestic investment Dutta, Sobel and Roy (2016) found that foreign aid hampers contribute overall economic growth by degrading domestic investment of countries, aid inflows can lessen domestic wealth creation, foreign direct investment and entrepreneurship. It could be caused by helping to weaken national governments' incentive to look after their own source tax revenues, which in essence lowers the 'tax income costs' of imposing higher rules, but also by aiding domestic political actors to invest in human capital development in rent research and central planning. Another study Simplice (2014) confirmed that foreign aid effectiveness increases in positive the magnitude distribution while the positive link between foreign aid and GDP per capita this reveals nonlinear trends across distributions and parameters, with correlations significantly higher in top quantiles than in bottom quantiles after accounting for heterogeneity not observed.

Moreover, human development aid correlation is negative and almost identical across distributions. The inflow of remittance to developing economies have continued to increase in recent decades, given their impressive development, the development effect of remittance on recipient countries' economies remains a contested subject among policymakers and scholars. Kadozi (2019) examined the effect of remittance inflows on

sustainable productivity growth, the study found that remittance growth is positively influenced by the country's financial development, education and level development, yet adversely affected by the quality of regional institutional variables such as strict regulations and political instability. Furthermore, as shown in Meyer and Shera (2017) aimed to investigate the effect of remittances inflows on productivity growth based on six remittance-receiving countries. Results show that remittances inflows have a positive effect on gross domestic product and that this effect rises at higher remittance rates relative to gross domestic product. ODA, FDI and remittance inflows have been a major source of foreign exchange and external funding in all developing countries noted by Das and Sethi (2019).

Workers' remittances of the workers played a significant role in promoting the gross domestic product. Compared to other foreign capital inflows workers' remittances, aid, foreign direct investment and foreign loans are considered more for rapid growth due to their safe nature. Jawaid and Raza (2012) investigated the relationship between remittances inflows and productivity growth in Korea and China. The study indicated that Korea has a significant positive, long-term relationship between remittances inflows and productivity growth, whereas China has a significant negative relationship between remittances and gross domestic product. Additionally, Azam (2015) supported There is a positive relationship between migrant remittances and productivity growth. It also required policymakers to be directed in formulating the right and appropriate policies to make migrant workers' remittances more competitive and optimize their benefits for both migrants and country of origin. A significant but neglected source of foreign currency and generally overlooked in the past, the private transfers of workers, or the remittances of workers by migrants to their families in the country of residence noted (Kratou & Gazdar, 2016).

One of the developing economies 'primary foreign-exchange sources is their migrants' remittances. Over the past three decades, migrant remittances have risen more than 20 times. Salahuddin and Gow (2015) re-estimated the relationship between the inflow of remittances and productivity growth in cross countries namely, India, Bangladesh, Philippines and Pakistan, the results showed a there is a long-term positive relationship

between inflow of remittance and GDP in these countries. Another study Awad and Sirag (2018) investigated the Dutch disease hypothesis by exploring the inflows of remittance-growth relationships. The results showed that remittances have a negative effect on productivity growth, but this result is not the Dutch disease hypothesis.

Despite migrants' rising vulnerability, remittances remained steady throughout and after the global downturn. Moreover, for developing countries, remittances have proved to be a more reliable source of the foreign currency than other foreign capital such as public debt, FDI and foreign aid. However, the relationship between inflow of remittances and development remained complex noted by (Nepal, Park, & Lee, 2019). Over the past decades, foreign remittance inflows have been increased compared to other flows of financial decreased. Remittances a key flow of resources in developing economies gained popularity among researchers in cultural, financial and migration studies. For some developing countries, remits contribute substantially to household livelihoods and Gross domestic product. Adams, Kwame and Klobodu (2016) examined the effect of remittance and regime stability on productivity growth in 33 Sub-Sahara, the study confirmed that the inflow of remittances has no significant impact on SSA economic development. Additionally, Anupam Das, Mcfarlane and Jung (2019) examined the relationship between GDP and remittances in Jamaica. The main finding was that remittances and GDP are cointegrated, and the study confirmed that have a positive reinforcing influence on each other. Many developing countries are characterized by broad informal sector and are often heavily dependent on foreign remittance inflows. The study designing a general equilibrium system to better understand the complex absorption of remittances in a small open two-sector economy by integrating many of the informal sector's stylized features noted by (Chatterjee & Turnovsky, 2018).

International migration also continues to be one of the most significant problems on the global agenda, because it causes tremendous economic, social and cultural consequences in the countries that send and receive. Abduvaliev and Bustillo (2019) examined the impact of post-Soviet remittances on poverty reduction and economic development and relative to other foreign capital, such as FDI and ODA; the study found that, on average, one percent rise in remittance flows induces 0.25 percent increase in GDP per capita and 2 percent

decrease in intensity of poverty. Remittances seem to have achieved substantial poverty reduction by smoothing consumption rates and rising income. Another study, Batu, (2017) augmented the standard Business Cycle model in the open economy with stochastic remittance shocks. The contribution of remittance to production volatility was considered small. Increasing the share of output inflow remittances has little impact on production volatility. Maintaining macroeconomic stability is critical to facilitating private sector development, which could foster increased productivity growth. Macroeconomic instability makes the domestic macroeconomic less stable, and such unpredictability affects investment, resource allocation and eventually growth decisions noted by Hossain (2020). Global remittance inflows have significantly increased in developing economies in recent decades.

The main source of foreign-exchange earnings, far exceeding FDI, export revenue, aid and other foreign capital flows. Jongwanich and Kohpaiboon (2019) examined the impact inflow of remittances on sustainable economic development, using the Pacific and Asian developing economies as a case study. The result of the study found some degree of sustainability between financial development and remittances greatly contributes to productivity growth. Moreover, Eggoh, Bangake, and Semedo (2019) provided evidence of how remittance inflows boost productivity growth based on data from 49 developing economies for the period 2001-2013. The study identified two major results. First, the inflow of remittance impacts economic growth in developing economies positively and substantially, while FDI and aid a have marginal effect. Second, with regard to the nonlinear relationship, the study recorded two dramatic regimes with a sharp shift characterizing the inflow of remittance- GDP growth relationship in terms of conditional variables, where the remittance effects under the first and negative under the second regime are positive and significant. Ghana's economic growth factors weren't obvious. Several studies contributed to the literature on growth and finance, with little exposure to remittances and the joint impact of the financial sector 's development and remittance Asoman, Ofor, and Ofor (2019).

The Key argument proposed for flexible regimes, among others, is that, in the midst of nominal rigidities, the study noted that the promotion of economic growth by encouraging

changes to specific shocks from a foreign and domestic sources. Lartey (2016) studied the question of whether exchange rate policy impacts the recipient countries' impact of inflow of remittances of productivity growth. The study found that exchange-rate flexible schemes are correlated with GDP following a rise in inflow of remittances, but also positive is the effect of remittances on growth under fixed schemes. Moreover, the findings show that the impact of remittances under a fixed rate of exchange schemes is also positive in less financially developed economies, but do not provide definitive evidence that this impact differs inversely with the theoretical flexibility of exchange rates in those countries; the findings are sensitive to the selection of the financial development indicator. Additionally, as shown in Chitambara (2019) assessed the linkage between the outflow of remittances and productivity growth in the GCC countries. The findings of the study indicated in Granger causality that remittance has effect GDP per capita in Oman, Bahrain and Saudi Arabia. Similarly, GDP-to-RMO causality per capita findings are important for four nations, namely Qatar, Kuwait, Bahrain and Saudi Arabia.

Worldwide remittances are one of the main international financial opportunities, often exceeding foreign direct investment flows. The sources of economic growth in developing economies have been heated for centuries, and why some countries show strong economic growth compared to others has noted by (Meyer & Shera, 2017). In developing countries, migrant worker's remittances from developing economies are becoming very important. Until recently, governments and financial markets had paid little attention to these payments of transfer very small amounts. Pradhan, Upadhyaya and Upadhyaya (2008) examined the effect of remittances on productivity growth in 39 developing economies using panel data from 1980 to 2004 resulted in 195 observations. The results indicate substantial overall fit based on the fixed-effect approach as the random-effect model is rejected in statistical tests. Inflow's remittance positively affects development. Another study Pontarollo and Muñoz (2018) analyzed the permanent and temporary effects of inflow of remittances on Ecuador's productivity growth. Both effects were found to be statistically significant. However, the magnitude of the permanent impact is inverted to the production level. It's not new remittances, but development and economic geographers are currently particularly interested in remittances sent back by workers who migrated from the

poorer countries to the world's rich countries and send money back to the countries they originally came from noted by (Page, 2020).

Migration is a complex phenomenon with many cultural, social, economic and security implications. Cismaș and Vădăsan (2019) have studied the effect of inflows remittance on the country of origin. The study tested the first hypothesis that remittances are more stable in some CEE countries than foreign capital inflows over the business cycle. The second hypothesis was not tested for the Romanian economy. The results showed no long-term or short-term influence or causality to Granger but the hypothesis was validated. Moreover, Shahbaz, Rehman and Mahdzan (2014) dynamic linkages between international remittance, income inequality and productivity growth were explored using time-series data for Pakistan from 1976 to 2006. The results of the study revealed that inflows of remittance and income inequality are boosting gross domestic growth. Causality research based on an advanced accounting methodology demonstrates two-way causal correlations between economic development and income inequality, the same applies to foreign remittances and income inequality. The Inflow of remittances affects GDP, but not otherwise. Literature does not accept that remittances have a long-term effect on GDP. Previous studies confirmed that this could be linked to financial development in the transfer country, but the link direction remained unclear has noted by (Sobiech, 2019).

Furthermore, mentioned in the literature is the relationship between debt and productivity growth Ramzan and Ahmad (2014) reported that foreign debt has a negative effect on productivity growth but in the presence of a sound macrocosmic policy this adverse effect can be reduced. Gmez-Puig and Sosvilla-Rivero (2015) investigated the debt-growth relationship in the European Monetary Union and Economic the period 1980 and 2012. The paper was applied heterogeneity in the bi-directional Granger-causality. Empirical findings of the study indicate that Greece, Belgium, the Netherlands, and Italy have a negative effect on economic output from an endogenously above breakpoint debt level ranging from 56% to 103% depending on economies. China’s debt/GDP ratios were 41.14% in 2014, Chen, Yao, Hu, and Lin (2017) pointed out that the effect optimal levels of public debt and government investment on economic growth in 65 developing and developed countries over 1991-2014. The empirical findings indicate that government investment's impact on

growth decreases as spending rates increase. If government investment / GDP ratio exceeds a certain point, government investment's impact will shift from positive to negative. Public debt's impact on economic growth shows a similar trend.

Eberhardt and Presbitero (2015) have studied debt-growth nexus in 118 countries from a different category of income according to World Bank classification by using linear and non- linear specification, the empirical result presented evidence of systemic variations in the debt to growth relationship in these countries while there is no evidence of systemic non-linearities within the foreign debt to productivity growth across countries. The poor countries' foreign debt grew to a debt crisis during the 1970s and 1980s. The main source of foreign debt was surplus revenues produced by major oil price increased in the 1970s. Many countries have not used foreign debt prudently and wisely. As oil sales revenue began to decline in the 1980s due to low oil prices, heavily indebted developing countries (HIPCs) had trouble servicing debt Siddique and Selvanathan (2016). Another study Panizza and Presbitero (2014) confirmed that public debt has a causal impact on productivity growth in 17 OECD countries, except that negative debt-to-growth associations are often used to justify policies that believe debt has a negative causal effect on economic growth. On the other-hand public debt to GDP levels in developed economies has risen sharply due to the global financial crisis peaking around 2012. Twelve Europe countries averaged 92% by 2012 while Japan showed an impressive ratio of 186% and the United States reached 105% (Gabriel, Matesanz, & Nela, (2017).

Economic growth is stronger in the low debt system, for some African countries ratio of debt to GDP below 30%, the GDP growth rate is 2.78% while countries with medium-low a debt ratio of GDP between 30% and 60% experienced a GDP growth rate of 1.57%, those countries with medium-high a debt ratio of GDP between 60% and 90% experienced a GDP growth rate of 0.87 % (Ndoricimpa, 2017). Moreover, the study confirmed that low debt countries are neutral or growth-enhancing, high debt in all cases is consistently detrimental to GDP growth. Public debt in African economies has become a global issue, African economies' widespread indebtedness has been the vigorous discussion among policymakers, scholars and the general public José s, Da Veiga and Sequeira (2016) investigated the relationship between public debt, inflation and productivity growth in

African countries divided on to three different geographical areas approach the overall study including Northern, Sub-Sahara, southern Africa between 1950 and 2012. The result of the study confirmed that public debt caps are negatively related to productivity growth and show an inverted U behavior on the growth-debt nexus. As well as sated that high public debt levels correlate with lower GDP growth rates and rising inflation. However, African countries achieved the highest performance of average GDP growth rates 6.39 percent while the ratio of public debt to GDP is between 30 to 60 percent with the average inflation rate is 8.17 percent.

More recent studies find growth-debt nexus such as Guei (2019) examined the relationship between foreign debt and sustainable growth in 13 developing countries. The result indicates that foreign debt is significant with negative associated productivity growth in the short-run while in the long-run, foreign debt is also negatively but insignificant associated with GDP growth. Moreover, the finding PMG model indicated that there is no causal relation between foreign debt and economic development. Saungweme and Odhiambo (2019) found that there is a unidirectional relationship from productivity growth to Zambia's public debt in the short and long run. Moreover, the study failed to find causality between debt service payment and Zambia's productivity growth.

The literature review covers empirical results about the relationships between foreign capital inflows and sustainable economic growth. In this chapter, the concept of foreign capital inflows in developing economies was discussed. The discussion about influences in economic growth can be considered as critical to the consideration of foreign debt and foreign aid. As discussed earlier in this chapter, foreign direct investment, as well as researchers, are concerned about how FDI stimuli and remittance influences are transformed into responses within the mind of economic development. These recent studies have provided the different effects of foreign capital inflows on the economic growth of host countries. So this confirms is still an open question in the literature. Therefore, this study investigates the of effect foreign capital inflows on economic development in East Africa.

4. FOREIGN CAPITAL INFLOWS IN EAST AFRICA

Foreign capital inflows to developing countries have increased last decade and remained stable particularly Africa, total foreign inflows financial to Africa remained flat at $205.7bn in 2018, with some shifts in funding sources' relative importance. Remittances, foreign aid, external debt and FDI dominated external funding in 2018 against the backdrop of the global upswing that began mid-2016. Remittances took the lead, hitting $82.8bn, up 7% from 2017. FDI picked up 10.9% in 2018, reaching $45.9 billion, but remaining below $56.9 billion in 2015. Portfolio flows declined 18.9% and foreign aid declined 4% in 2018. inflows remittance to Africa have risen since 2016, hitting new highs as a result of a pick-up in overall economic growth in 2017 and 2018 and increasing migration which nearly doubled last twenty years. Nigeria and Egypt, followed by Ghana, Morocco and Kenya, accounted for 76.2% of 2018 remittances. Foreign debt is high and increasing in most African countries, with the median debt-to - GDP ratio rising over 56% in 2018, up from 38% 10 years earlier. The Africa's foreign debt burden reached almost $500 billion (AfDB, 2020).

According to the World Development Indicators noted that foreign capital flows in the form of foreign debt, foreign aid, remittance and foreign direct investment have been increased in East Africa over the last decade. FDI has increased by 50% over the last decade. Foreign direct investment has increased from $ 4.49 billion in 2007 to $ 8.49 billion in 2017. Meanwhile, remittances growing as a form of private capital flows to East African economies which have steadily increased from around the early 1980s East Africa, the rising sharply about 2 times from $2.58 billion in 2007 to 5.21 billion in 2017. Foreign aid inflows to East African economies continued to grow, reaching $ 17.79 billion in 2017. In some East African economies, including Somalia, Djibouti and South Sudan, the foreign aid in education budget in more than 25 percent. This rise in aid to East Africa is due to the social conflict and high poverty rate which is epitomized the dependency of aid. Foreign debt is the largest of foreign capital inflows in East Africa in 2017. The external debt reached $102.25 billion in East Africa, by the end of 2017. Debt situations have become untenable in some countries in the region, requiring urgent actions whose scope and

modalities depend on the precise diagnosis of the source of debt distress. The average debt to GDP ratio in East African economies is 35 to 45 %. A fast loan build-up brought East African economies close to a debt crisis, putting at risk the long-term economic stability of the region (AfDB, 2019).

4.1 Foreign direct investment

FDI flows remained unchanged, increasing by 2%. Due to the rise and anomalous decline in developed countries, developing countries' share of global foreign direct investment increased to 54%. According to UNCTAD's World Investment Report 2019, Africa has defied the global slowdown in FDI, as flows to the continent rose to US$ 46 billion in 2018 up 11 percent from the previous year. FDI flows to East Africa were largely unchanged, the total FDI inflows into East Africa during 2017 amounted to US$8.49 billion, approximately 4.8% of the total FDI inflows into Africa. Somalia and Djibouti are the biggest recipients of FDI inflows of a percentage of GDP in East Africa during 2017 closely followed by Uganda. FDI was received in diverse, industries, including chemicals, manufacturing, oil & gas and hospitals.

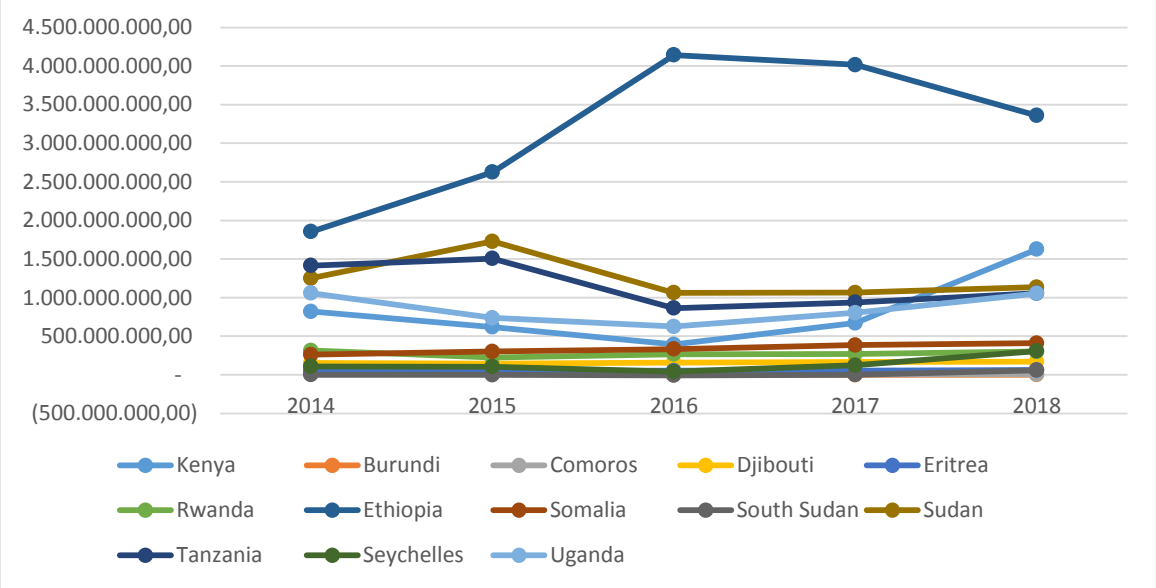


Figure 9: foreign Direct Investment to East Africa (2014-2018)

Source: (World Bank, 2020)

This increase in FDI inflows to East Africa is due to the attractiveness of the regions' diverse sectors despite uncertainty by international companies as to whether to build multi-billion-dollar facilities in East Africa or to undertake more moderate investments. This rise in FDI inflows to East Africa is due to the attractiveness of the various sectors of the regions, amid confusion over whether to develop multi-billion dollar facilities in East Africa or pursue more modest investments. Ethiopia is the largest FDI recipient in East Africa in 2017. Ethiopia received FDI inflows of US$ 4 billion, and increases in FDI inflows to Ethiopia are attributed to the expansion of the textile industry there. However, Ethiopia has a restrictive economic policy against investors and foreign investors are forbidden from investing in the insurance, banking and media sectors. However, the country has implemented various kinds of investment opportunities in industrial development, agriculture and manufacturing.

4.2 Foreign Debt

Long-term foreign debt is high and increasing in most African countries, with the median debt-to GDP ratio growing over 38%. The upward trend in foreign debt ratios is largely driven by the end of the commodity super-cycle, export revenues and slow productivity growth. The East African countries appear to face numerous downside threats that could threaten economic development and growth prospects. Another main factor is large current-account deficits and associated foreign debt rises. East Africa has numerous fragmented states, but mobilizing domestic capital is way below what's required to stimulate investment and development. Small domestic savings and high spending are contributing to sustained fiscal deficits and rising debt (AfDB, 2019). Foreign debt is the largest of foreign capital inflows in East Africa in 2018. The external debt reached $102.25 billion in East Africa, by the end of 2017.

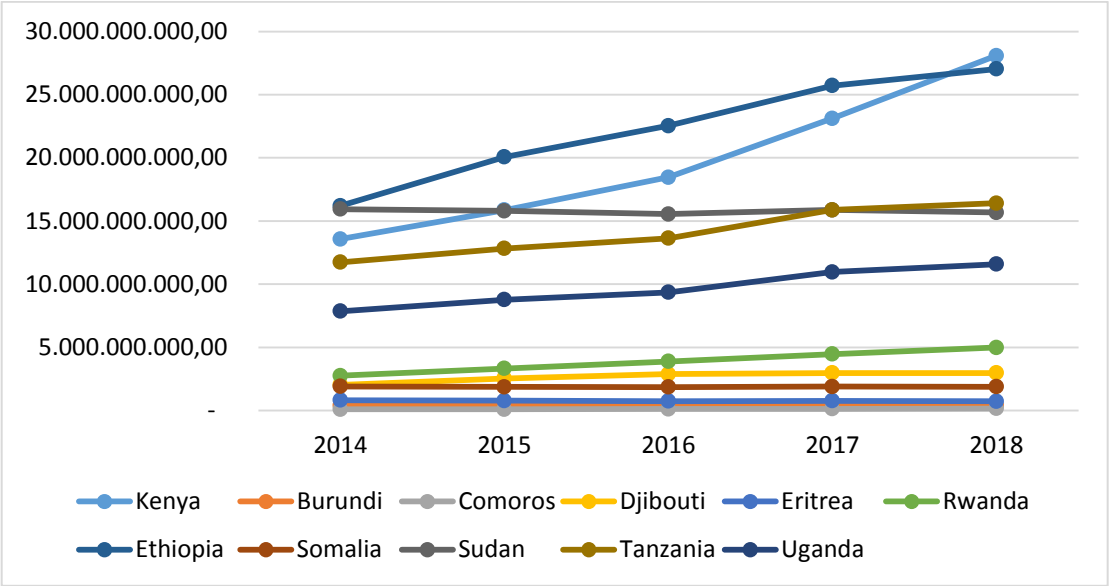


Figure 10: foreign debt to East Africa (2014-2018)

Source: World Bank

Debt-to - GDP levels for Uganda and Tanzania have been raised from 32% to 32% between 2014 and 2018, respectively 29% and 32%. Rwanda's foreign debt figure is $5.4 billion in 2018, rising from $4.8 billion a year ago. According to World Bank statistics, Kenya's foreign debt is valued at $31.5 billion. In Ethiopia, the total external debt is 33% of GDP. Much of China's foreign debt has expensive terms.

4.3 Foreign Aid

Foreign aid inflows are a very important source of capital for developing economies especially the least developing countries. Foreign aid in Africa is used to fund many activities; budget support, debt reduction and macroeconomic reform. African economies have been receiving aid since independence. Foreign aid inflows to sub-Sahara African economies continued to grow, reached $49.54 in 2017. In some sub-Sahara African economies, including Zambia, Burkina Faso and Mali, the foreign aid in education budget in more than 25 percent. This rise in aid to East Africa is due to the social conflict and high poverty rate which is epitomized the dependency of aid. Aid affectivities for low-income countries need to be increased as well as the amount of foreign aid.

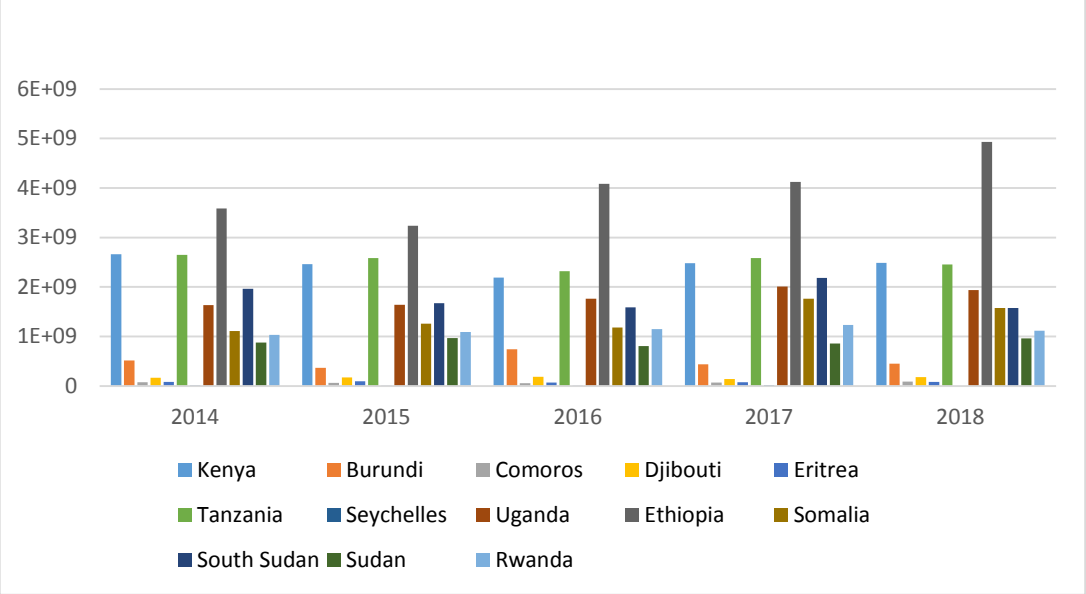


Figure 11: Foreign aid received to east Africa (2014-2018)

Source: (World Bank, 2020)

The average foreign aid to East African continues to exceed private capital flows, although both rising substantially in the last decade. At the end of 2017, foreign aid reached approximately $20.81billion. Foreign aid flows intensity is measured as the aid ratio to GDP Where the ratio reaches 10 percent, countries are rated as highly dependent on foreign aid Using the aid average as a percentage of GDP in 2017, 3 countries in East Africa can be considered highly dependent on foreign aid, namely Rwanda (13%), Burundi (13%) and Somalia (39%). According to World Bank statistics, Tanzania's aid is valued at $ 2.5 billion. In Ethiopia, total foreign aid is $4.12 billion.

4.4 Remittances

Remittances are a significant source of capital for developing economies. Remittances are increasing the international stream of capital for developing countries. Remittances are a new financial phenomenon, and one of the world's major sources of income based on seizure and economic impact. World Bank data show that world remittance is $595,055 billion in 2017 and remittance is 0.748% of global GDP in 2017. The remittance impact on the economic system is deeper developing economies. In 2017, foreign migrants' remittances to Sub-Sahara African economies jumped to $ 48.23 billion. Inflows of remittance to Eastern African economies are small in absolute terms compared to other

African regions. According to World Bank data reveals that East African economies received 178 from their citizens living abroad from 2014 to 2017.

Table 1: Remittances as Percentage of GDP in East Africa

	2014	2015	2016	2017	2018
Kenya	2.34	2.45	2.52	2.49	3.09
Burundi	2.08	1.64	1.06	1.06	1.59
Comoros	13.92	13.66	11.53	12.24	13.81
Djibouti	1.71	1.62	1.54	1.49	2.03
Rwanda	2.29	1.92	2.04	2.36	2.74
Ethiopia	3.23	1.68	1.04	0.48	0.52
Sudan	0.62	0.16	0.16	0.17	1.04
Tanzania	0.78	0.82	0.81	0.76	0.71
Seychelles	1.12	1.34	1.55	1.44	1.43
Uganda	3.25	3.33	4.75	4.48	4.87

Source: (World Bank, 2020)

East Africa is one of Africa's biggest remittance recipients and this income is the region's primary foreign-exchange source. According to the World Bank, Comoros was the region's main receiver of remittances; received a percentage of GDP is 12.24%, followed by Uganda 4.48%, Kenya 2.49%, and Rwanda 2.35%.

5. RESEARCH METHODOLOGY

This chapter described the processes and techniques used in the collection, processing and analysis of data. This is the fifth section of the study, this chapter described the methodology used to conduct the research, and further described the source and type of data, theoretical framework, model specification and the methods and techniques used to analyze the data. It also describes how the appropriate methodology will be constructed, interpreted and analyzed.

5.1 Theoretical framework of the study

Hymer theory, Internalization and Eclectic paradigm are complementary focusing on MNCs perspective and their motivation to invest in a specific country; Hymer explained the movement of FDI in response not to higher interest rates but to financing and supporting the international operations of firms published in 1976. In the mid of 1970s, some economists, for example, in 1979, Swendenborg proposed the application of internalization theory to explain the growth of multinational enterprises based on the theory of transaction costs. The main elements of various explanations of FDI into one framework known as "OLI" in an attempt to overcome the limitations of both industrial organization and internalization theories. The broad photosynthesis model developed by Nguyen, asserts that to assimilate the spillover benefits of FDI, the host country definitely needs to develop its absorptive capacities.

Many developing economies have made efforts to push their development of national to enable their catch up in terms of advanced technology and capital by attracting foreign capital. The important component of the recovery and growth strategy of the developing countries the creation of frameworks for attracting foreign capital inflows to fund investment projects and reform programmes. However, as bank loans and bond issues in the post-debt crisis are closed avenues for most nations, the search for increased foreign resources have turned to alternative sources of funds (Edwards, 2000). This created frustration after empirical studies found that foreign capital has a negative impact on economic growth. A crucial assumption in the framework is that the foreign capital inflows influence growth through the management techniques, technology spread and stimulation

of financial sector development. First, foreign capital affects financial allocation efficiency for investment programs. Thus, foreign capital can contribute to productivity growth through two main channels alongside maintaining and providing a generally accepted exchange. On the one side, it mobilizes savings; this raises the amount of capital available to fund investment, leading to higher economic development.

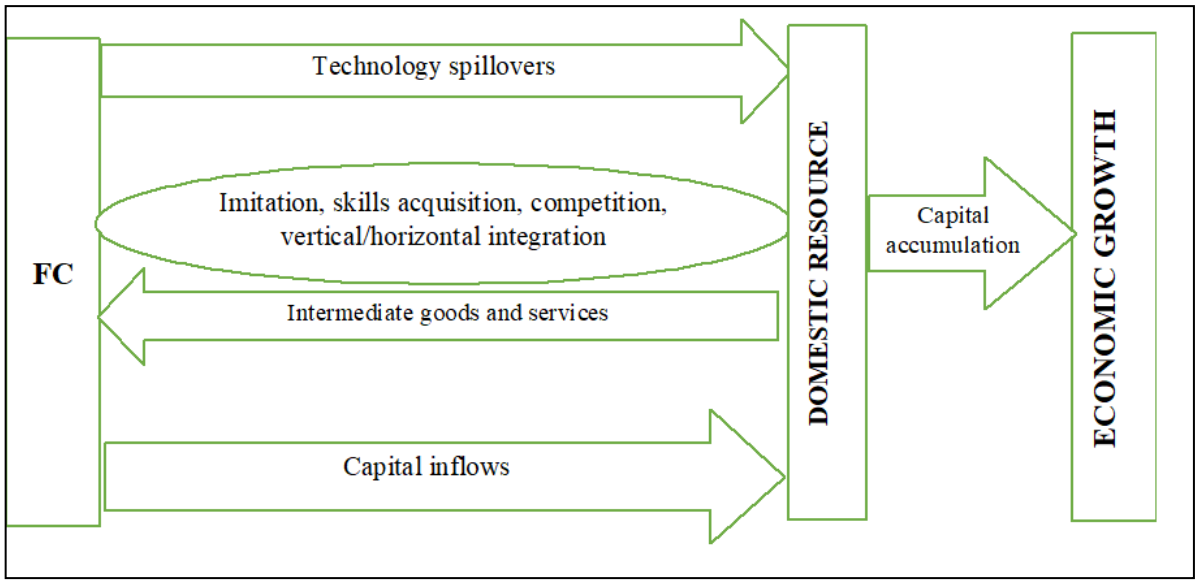


Figure 12: Foreign Capital Inflows and Economic Growth In The Host Country

The relationship between economic development and foreign capital inflows has improved over time. The advantages of inflows capital for productivity through management techniques, technology transfer and boosting stimulating financial sector growth are significant in many countries where developed physical infrastructure, free trade agreements and a good business environment have allowed these flows to be absorbed, not otherwise. The effect of foreign capital inflows on domestic production is uncertain, as a matter of theory (Feldstein, 1994). Inbound capital can increase productivity, but it can also increase imports, thereby dampening domestic investment and production. Therefore, even if access to foreign capital helps one business to raise investment, that company's expansion could cause another to cut investment.

5.2 Data

The study based on the annual data of panel data over the full sample period of 2004-2017 in selected East African countries. The study will apply the Autoregressive Distributed Lag

(ARDL) structural break to test cointegration to examine the long-run and error correction model to determine whether existing short run relationship between the variables. The current data are U.S dollars. Data obtained different sources from World Bank. Panel data estimation is used to capture the parameter dynamic behavior and provide more effective estimates and parameter information. Panel analysis methods are used because of their superiority over time series and cross-section by using all available information that cannot be found in plain time series and cross-sections (Baltagi & Kao, 2012). (Baltagi, 1995) argued, Data panels have several major advantages. Panel data recommend individual heterogeneity to minimize the risk of obtaining skewed findings and include a large number of data points (observations) to increase the degrees of freedom and variation and to research the dynamics of change.

Table 2: Main Variables

Variables	Measurement	Expectation Sign	Source
GDP	Gross domestic product (Current US$)		World Bank
FDI	Foreign direct investment, net inflows (Current US$)	**Positive**	World Bank
REM	Personal remittances, received (Current US$)	**Positive**	World Bank
ED	External debt stocks, total (DOD, current US$)	**Negative**	World Bank
AID	Official aid received and Net official development assistance (current US$)	**Positive**	World Bank

GDP is determined by the amount of the total value added by all resident consumers in the economy plus any commodity taxes and minus any subsidies not included in the product's value. This is estimated to depreciate produced properties or deplete and destroy natural capital without deductions. Current data is U.S. Dollars from 2004 to 2017, the data obtaining from World Bank.

REM is all payments obtained by residents or non-residents in cash or kind from abroad. External remittances cover staff transfers and employee benefits. Financial transfers consist of all existing cash or in-kind transfers made by residents to or from non-resident households. Therefore, personal transfers include all existing transfers between residents and non-residents. Employee pay applies to the wages of border, seasonal, and other short-term workers working in a non-resident economy and non-resident residents. Current Data is U.S. Dollars from 2004 up to 2017, the data obtaining from World Bank.

FDI relates to financial investments in the reporting economy. It's earnings reinvestment, equity capital number and other capital. Direct investment is a form of cross-border investment associated with a resident in one economy having power or a substantial degree of influence on a company's management residing in another. Embarking on foreign direct investment for improved skills by R&D and advanced technology is referred to as information quest. Searching for productivity is the impetus for MNEs to move to areas where, for example, cheaper manpower will reduce production costs. Current Data is U.S. Dollars from 2004 up to 2017, the data obtaining from World Bank.

ED is total external debt is the amount of use of IMF credit, long-term debt and short-term debt that is publicly guaranteed and non-guaranteed. Short-term debt includes all debt with an initial one-year or less maturity and long-term debt arrears. Current Data is U.S. Dollars from 2004 up to 2017, the data obtaining from World Bank.

Foreign aid is measured official aid received and net official development assistance support social and economic development from donors to the territories and the countries. It is a sum of grants, loans for military purposes from export credit agencies and loans. Current Data is U.S. Dollars from 2004 up to 2017, the data obtaining from World Bank.

5.3 Model specification

This research employs and follows the endogenous growth model known as the "AK model" developed by (Pagano, 1993) and its expanded version by (Bailliu, 2000) which implemented to foreign capital inflows in order to capture the relationship between

productivity growth and foreign capital flows. Therefore, the basic specification of the model is presented as:

$$Y_t = AK_t \qquad 1$$

Where Y_t is gross production in time (t), A is marginal capital productivity and K_t capital stock in time (t) combining human and physical capital. There are assumptions: first, the population is constant, second, the economy generates a single commodity that can either be invested or consumed. If invested, it will depreciate at the rate of δ per period. The Investment will be made by.

$$I_t = K_{t+1} - (1-\delta)K_t \qquad 2$$

Transferring savings to the investment needs financial intermediaries, where a saving ratio $(1-\phi)$ is taken as payment for services provided. The remaining share of savings is a closed economy equivalent to investment in capital market equilibrium.

$$\phi S_t = I_t \qquad 3$$

The output growth rate g form equation (1) to (3) without the time indices are given by.

$$\mathrm{g} = \mathrm{A}\left(\tfrac{I}{Y}\right) - \delta = A\phi\mathrm{s} - \delta \qquad 4$$

Where S is the rate of gross saving. Equation (4) is a closed economy's steady-state growth rate. The above-mentioned framework is extended to include the inflow of foreign capital based on the work of (Bailliu, 2000) and (Aziakpono, 2011). Here's the assumption that a closed economy is relaxed to allow movement of capital into and out the domestic market.

Here's the assumption that a closed economy is relaxed to allow free flow of capital out and into the domestic economy. It is possible to modify the above equilibrium condition to adjust the effects of inflows foreign capital as follows.

$$\phi^*(S_t + FCF_t) = I_t^* \qquad 5$$

Where FCF is the flows of foreign capital and $*$ is an open economy. The new steady-state growth rate can be represented as:

$$\mathrm{g}^* = \mathrm{A}^*\frac{I^*}{Y} - \delta = \mathrm{A}^*\phi^*\frac{S+FCF}{Y} - \delta = \mathrm{A}^*\phi^*\mathrm{s}^* - \delta \qquad 6$$

To determine the impact of capital inflows on the gross domestic product in 7 East African countries, Equation (6) can hence be re-expressed as:

$$GDP_{it} = C_0 + \alpha_1 FDI_{it} + \alpha_2 AID_{it} + \alpha_3 ED_{it} + \alpha_4 REM_{it} + \varepsilon_{it} \qquad 7$$

Where: GDP is real gross domestic product, FDI is foreign direct investment, AID is foreign aid, ED is foreign debt and REM is remittances, and ε error term. ARDL methodology includes the bound F-test for conintegration. The ARDL method is a technique involving two steps. To examine the long term cointegration presence, equation (7) is re-arranged in the ARDL framework as an unrestricted error correction model (ECM) as an equation (8):

$$\Delta GDP_{it} = C_0 + \alpha_1 GDP_{i,t-1} + \alpha_2 FDI_{i,t-1} + \alpha_3 AID_{i,t-1} + \alpha_4 ED_{i,t-1} + \alpha_5 REM_{i,t-1} +$$
$$\sum_{i=1}^{n} \alpha_1 \Delta GDP_{it-1} + \sum_{i=1}^{n} \alpha_2 \Delta FDI_{it-1} + \sum_{i=1}^{n} \alpha_3 \Delta AID_{it-1} + \sum_{i=1}^{n} \alpha_4 \Delta ED_{it-1} +$$
$$+ \sum_{i=1}^{n} \alpha_5 \Delta REM_{it-1} + \varepsilon_i \qquad 8$$

Where delta Δ is the operator of the difference and represents the dynamics of the short term. Long term relationships are measured by the parameters attached along with variables. The short-run error correction model is used to determine short-run dynamics and to check the robustness of the long-run coefficient to equation (8). It is stipulated as show in equation (9):

$$\Delta GDP_{it} = C_0 \sum_{i=1}^{n} \alpha_1 \Delta GDP_{it} + C_0 \sum_{i=1}^{n} \alpha_2 \Delta FDI_{it-1} + \sum_{i=1}^{n} \alpha_3 \Delta AID_{it-1} +$$
$$\sum_{i=1}^{n} \alpha_4 \Delta ED_{it-1} + + \sum_{i=1}^{n} \alpha_6 \Delta REM_{it-1} + ECM_{it-1} + \varepsilon_i 9$$

Where GDP is gross domestic product current price; FDI is foreign direct investment inflow; REM is private remittances received; AID is total official aid received; ED represents total external debt as stock.

5.4 Method of Estimation

5.4.1 Descriptive statistics

This study uses descriptive statistics to explain basic data features. It gives a small sample and measure summaries. The form of the basis of virtually any quantitative data analysis with simple graphics analysis is used. Descriptive analysis reveals mean, minimum, stander deviation and maximum of the data.

5.4.2 Unit Root Test

The first step is to check the unit root using Augmented-Dickey-Fuller and Phillips-Perron. To test the data stationary is checked through Phillips-Perron and Augmented Dickey Fuller test are applied to trend and intercept. The Null Hypothesis for PP and ADF are that the series is non-stationary, while the alternative Hypothesis is the series is stationary.

5.4.3 Testing Correlations

Correlation matrix examines the direction of the relationship among variables also indicates mullticollinearity problem. The correlation matrix is based on the correlation coefficient; if there is a perfect positive linear relationship between two variables, the correlation will be 1.0. If the two variables have a perfect negative linear relationship, the correlation coefficient of zero means there is no linear relationship between variables.

5.4.4 Autoregressive Distributed Lag (ARDL) Method

ARDL cointegration technique is used to establish long-run relationships between series and specific integration order (Pesaran, Shin, & Smith, 2001). The parameterized result gives both long-run and short-run dynamics relationship variables considered. While ARDL's cointegration technique does not require pre-testing of unit roots in order to avoid ARDL model crash in the presence of I(2) integrated stochastic pattern, this study will verify that the unit root test should be performed to determine the number of unit roots in the sequence.

5.4.5 Granger Causality Tests

To examine the direction between variable the study a Granger Causality test was performed. The results, which are summarized the relationship between foreign capital inflows and economic growth in selected East African countries.

5.4.6 Diagnostic Test

***Testing the Normality of Data*:** Consistency is a property of the point estimator collapsing around the parameter as the sample size becomes high, it basically tells us nothing about the shape of the sample size. The results of the study need a way of approximating the distribution of the estimators. The hypothesis of the study

H_0 Data is not normally distributed

H_0 Data is normally distributed

6. EMPIRICAL RESULT AND DISCUSSION

In this section, the study presents the findings obtained in the empirical analysis and discussion. First, the analysis presents descriptive statistics to virtualize the quantitative data analysis the analysis also conducts the root check of the device to assess the data in the station. Finally, this analysis explores the empirical foreign capital inflows in East African's economic development. The descriptive statistics are listed in Table 3.

6.1 Descriptive Statistics

Table 3 presents the descriptive statistics show that the average, minimum, stander diversion and maximum.

Table 3: Descriptive Statistics

Variables	N	Mean	Std. Dev.	Min	Max
GDP	98	2.09	2.12	6.33	8.17
FDI	98	5.65	7.64	31593.78	4.02
ED	98	5.98	6.53	1.31	2.66
AID	98	1.53	1.14	23139999	4.12
REM	98	4.04	4.54	11470.97	1.96
No: Countries	7	7	7	7	7

Source: Author's analysis using data from the World Bank. **Note:** GDP represents Gross domestic Product, ED represents External debt, FDI represents foreign direct Investment, AID represent foreign aid and REM represents remittances.

According to World Bank classification most countries of the study sample fall in the category of low-income countries except Kenya. The average GDP growth is 2.09 these statistics show that average economic growth in 7 East African countries. Overall, Economic growth in east African grew by an estimated 5.9% in 2017 and the highest among other African regions. Kenya, Rwanda, Ethiopia, Tanzania and Djibouti are the countries with high GDP growth in east African countries. The region's economic growth has been driven by services and industry, followed by the agricultural sector.

The result indicates that the average of foreign direct investment to East African 5.65 while the highest FDI to East African countries is 4.02. This suggests that FDI has an important source of economic development in the region. The largest recipients of FDI inflow are Ethiopian, Tanzania, Uganda and Kenya respectively. External debt, the average foreign debt growth is 5.98 in East Africa which is regarded as one of the highest foreign debt regions is 2.66, this shows that the foreign debt in the region has been increasing last decades. Regarding foreign aid to 7 East African countries have been increasing more than two decades. The average foreign aid growth is 1.53, it is believed that aid effectiveness contributes to economic development in East Africa, particularly education and poverty reduction. The average of remittance growth is 4.04, the remittances growing as a form of private capital flows to East African countries that have been on the rise steadily from around the early 1980s in East Africa, which depends on the number of revenue and saving of migrant's workers. According to foreign capital inflows, the result of the descriptive analysis shows that external debt growth has the highest number of average while remittance growth has the lowest number of average as well as the standard deviation.

6.2 Correlation

Correlation matrix examines the direction of the relationship among variables also indicates the multicollinearity problem. Table 4 shows the pair matrix for the variables used in the empirical analysis.

Table 4: Correlation Matrix

	GDP	FDI	ED	AID	REM
GDP	1				
FDI	0.75	1			
ED	0.96	0.76	1		
AID	0.84	0.73	0.76	1	
REM	0.76	0.42	0.72	0.54	1

Source: Author's analysis using data from the World Bank.

The result of correlation analysis reveals foreign direct investment and foreign debt have the highest coefficient of the correlation is 0.76, whereas inflows of remittance and foreign direct investment have the lowest coefficient of the correlation is 0.43. Table 4 there is no

general question about multicollinearity problem since not all independent variables have very high correlations.

6.3 Unit Root Test

The study performed unit root testing to evaluate the integration level of each variable using trend and intercept unit root testing both ADF and PP. One of the ARDL's basic assumptions is that the integration order shouldn't exceed one. If the order of integration of any of the variables is greater than one or at least I(2), then Peseran's critical bound provides. It is necessary to test unit root to ensure that all variable meets the underlying assumptions of the ARDL bound testing approach of conintegration procedures before proceeding to the estimation phase. To satisfy the ARDL model's boundary test assumption, each must be either I (0) or I (1). The main idea of the unit root test is to combine P-values form a unit root test applied in the panel data of each group. The Null Hypothesis for PP and ADF is that the series is non-stationary, while the alternative Hypothesis is the series is stationary. The result of unit root tests is reported in table 4.

Table 5: Unit Root Test

			ADF		PP	
	Levels	Model	t-statistics	Prob. *	Adj. S-stat	Prob. *
GDP	At Level	Trend and intercept	13.9543	0.4531	13.8874	0.4581
	1st Difference		32.4631	0.0034***	59.1172	0.0000***
FDI	At Level		5.17519	0.9832	12.2014	0.5901
	1st Difference		22.9635	0.0609**	70.8140	0.0000***
ED	At Level		38.0448	0.0005***	25.5377	0.0296**
	1st Difference		30.5759	0.0064***	32.7603	0.0031***
AID	At Level		10.1283	0.7527	12.2381	0.5872
	1st Difference		26.5595	0.0220**	82.9393	0.0000***
REM	At Level		8.60598	0.8554	7.32286	0.9215
	1st Difference		23.6682	0.0502**	57.5875	0.0000***

Source: Author's analysis using data from the World Bank. **Note:** *, ** and *** indicate statistically significant level at 10%, 5% and 10%, respectfully or a rejection of the null hypothesis of a unit root.

The results reported in the unit root table indicate that external debt is integrated at order zero at 1% significant level, which means ADF and PP tests are stationary at level series, so null hypotheses were rejected at level. But gross domestic product, foreign aid, foreign direct investment and remittance are integrated at the first difference at 1% and 5% significant level, which mean ADF and PPP are stationary at fist difference, so all null hypotheses did not fail to reject for every test at first difference. Since the order of the integration of the variable is a mixture of I(0) and I(1), ARDL is the appropriate technique for examining cointegration among variables.

6.4 Empirical results from Autoregressive Distributed Lag (ARDL) bound test

ARDL bound test is conducted to examine the existence of a short and long-run equilibrium relationship among all variables in the study. This study applied the Autoregressive Distributed Lag (ARDL) structural break to test the cointegration approach to examine the long-run and error correction model to determine whether existing short-run relationships between variables. Pesaran et al., (2001) were introduced a cointegration testing approach ARDL. This method illustrates that provides greater insight into the status of the cointegration and the order of integration of the test variables. (Gmez-Puig & Sosvilla-Rivero, 2015) noted that Autoregressive distributed lag (ARDL) bounds does not require lag-length symmetry; each variable may have different lag-lengths. The key advantage of ARDL lies in defining the cointegrating vectors with several cointegrating vectors. Moreover, this approach is that it is more robust and performs better for the small sample size of the data which appropriate for this study.

Table 6: Long-Run and Short-run estimation results

Long-run results			**Short-run results**		
Variables	**Coefficients**	**Prob. ***	**Variables**	**Coefficients**	**Prob. ***
FDI	7.282050	0.0000***	**Δ (FDI)**	-1.469500	0.0397**
ED	-0.565347	0.0000***	**Δ (ED)**	0.460229	0.0369**
AID	3.334528	0.0000***	**Δ (AID)**	-0.456957	0.5256
REM	1.617604	0.0030***	**Δ (REM)**	-2.596602	0.5095
C	2.19E+09	0.0016	**ECT (-1)**	-0.288102	0.1104
Mean dependent var		2.18E+09	**S.D. dependent var**		2.90E+09
S.E. of regression		2.04E+09	**Akaike info criterion**		40.45042
Sum squared resid		2.17E+20	**Schwarz criterion**		41.66378
Log likelihood		-1936.071	**Hannan-Quinn criter.**		40.94120

Source: Author's analysis using data from the World Bank. **Note:** GDP represents Gross domestic Product, ED represents External debt, FDI represents foreign direct Investment, AID represent foreign aid and REM represents remittances.

*** p<0.01, ** p<0.05, * p<0.1

Based on the ARDL model, the result for the long-run analysis confirmed the relationship between economic growth and foreign capital inflows (foreign direct investment, remittance, debt and aid) in the East African countries, mostly at the 1% significant level. Regarding the control variables used in the model, the study findings indicate that foreign direct investment has a positive and important effect on East African countries' economic growth. this implies FDI leads to economic growth, FDI helps a region's economy by allowing foreign investors to fill investment gaps in manufacturing and infrastructure plays important role in the production of the region, also fallibilities improvements in the institution, human capital and diffusion of technology, as well as improve access to the international market which is a great benefit for economic growth in East African economy.

On the other-hand FDI into sectors has increased particularly oil and gas sectors in Kenya, textile industries in Ethiopia and mining sector in Tanzania which contribute to the economic growth of the region. This result of the study is consistent with the result of Bekere and Bersisa (2018) noted that foreign investment has a positive and marginally significant long-term impact on economic development in East African economies.

Results of the study indicate that the foreign debt has a negative relationship with economic growth in the long run; this is consistent with theoretical expectations means that the increase of long term debt increases debt-to GDP ratio as well as interest payment which hurts production capacity of the region. This is because the payment of interest usually compounds the actual repayment made on long term debt. East African countries have long-term record higher debt and service payments of the debt obligations usually increased the share of recurrent expenditure on government annual budget. Last two years long term debt service payments in the sample of East African countries have increased from $3.3 billion to $5.5 billion from 2017 to 2018. However, this high level of indebtedness causes to reduce the economic growth of East Africa. Similar findings were reported in the study Shittu, Hassan and Nawaz (2018) found that foreign debt has a negative impact on economic growth in Sub-Sahara Africa, this indicates that payment of interest on debts has a similar effect on economic growth as SSA's external debt.

A positive relation was found foreign aid and East Africa's economic development in long run, indicates that foreign aid leading to an increase the living standards and stable growth of the East African countries because foreign aid of the region may have been increased by public investment which turn to the government revenues as well as direct beneficial on private investment such communication, transportation and other infrastructure which lead to increase the productivity growth. A recent study by Museru, Toerien and Gossel (2014) found that foreign aid plays important role overall growth rate of GDP in Sub-Saharan Africa, the result indicates that the impact of foreign aid on productivity growth may have been eroded by public investment, linked to government revenue.

The main result of the study indicated that remittance is a significant factor that positively affects productivity growth in the East African economies. Last five years, East African

countries received more than $17 billion from their citizens living abroad from 2013 to 2018 which substitute for the lack of financial development as well as improved credit constraints of the poor and thus fast-track economic growth. This growth is attributed to the remarkable recovery for the East African Economy. East Africa's remittances contribute to financial service expansion and drive the growth fund transfer institution such as Dahabshil, WorldRemit and Eastpesa. The result for the developing countries are similar to one obtained (Pradhan et al., 2008) found that remittance has a positive effect on economic growth in developing countries although the impact is not large.

The second part of the ARDL model result is the error correction to estimate the parameter short run with adjustment speed. The coefficient for the lagged term for error correction measures the adjustment speed. The short-run coefficients with D sign of the variables show the elasticity in short-run. The coefficient ECM (-1) is (-0.28) but insignificant which implies that after one year an adjustment of approximately 28 percent to the long-run equilibrium. The results obtained in the short-run through the ARDL boundary testing approach suggest a positive effect of foreign debt on the East African economy, this implies foreign debt in the region particularly short-term foreign debt may increase the current regional capital stock and stimulate the current economic growth. Its coefficient at 1% is statistically significant. The size of the coefficient indicates that a 10% rise in foreign debt contributes to a 46% rise in short-run production. However, the findings is in line with Abd Rahman, Ismail and Ridzuan (2019) found that the relationship between public debt and economic growth is positive if the borrowing were used for productive purpose. FDI has a negative impact on the economic growth of the region; this implies that FDI into different sectors such as transportation, communication and industry have a low contribution to productivity growth in short-run. The agriculture sector's contribution to growth is highest in east African. Another study Dinh, Vo, The Vo and Nguyen (2019) found that foreign capital investment can hinder a country's economic growth in the short run.

6.5 Granger Causality Tests

To examine the direction between variable the study a Granger Causality test was performed. The results, which are summarized the nexus between foreign capital inflows and economic growth in selected East African countries.

Table 7: Granger Causality

Pairwise Granger Causality Tests

Null Hypothesis:	Obs	F-Statistic	**Prob.**
FDI → GDP	84	4.80399	**0.0107*** **
GDP → FDI		3.04002	**0.0535** **
ED → GDP	84	0.29330	**0.7466**
GDP → ED		18.8098	**2.E-07**
AID → GDP	84	5.75768	**0.0046*** **
GDP → AID		4.33354	**0.0164** **
REM → GDP	84	1.12221	**0.3307**
GDP → REM		3.84023	**0.0256** **

Source: Author's analysis using data from the World Bank

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

The results from the Granger Causality test, indicating the existence of bidirectional causality between gross domestic product and foreign direct investment which implies that GDP has an important contribution in increasing the level of foreign direct investment in East Africa. Thus, foreign investors came to the region with strong economic development. Also, the result indicated that the existence of bidirectional causality between foreign aid and economic growth. The result indicated the existence of unidirectional causality between gross domestic products.

7. CONCLUSION AND POLICY RECOMMENDATION

The study analyses the impact of foreign capital inflows on economic growth as well as the role of foreign capital inflows and economic growth in the cross-country regression framework on a selected East African economies from 2004 to 2017. This study applied the Autoregressive Distributed Lag (ARDL) structural break to test the cointegration approach to examine long-run and error correction model to determine whether existing short-run relationships between variables. The Unit root and distributive statistics were tested to examine the existence of which could make the regression result spurious and the correlation matrix was used to emanate the relationship among the variables. This research employs and follows the endogenous growth model known as the "AK model" developed by (Pagano, 1993) and its expanded version by (Bailliu, 2000) which implemented to foreign capital inflows in order to capture the relationship between productivity growth and foreign capital flows.

The result of the study confirmed that foreign direct investment has a positive impact on GDP growth in East Africa, this implies FDI contributes rate growth overall positive in east African economy But admit the possibility of negative effect in the short run. Additionally, this study found that foreign debt significantly with negative signs found in many cross-country regressions in the sample of East African countries. The significant negative sign of external debt indicates that a high level of debt leads to the low economic growth of East African countries. But short-run foreign debt has a positive effect on economic growth which is depending on the characteristics of the country and the final allocation of external debt. Also, the study found that there is a positive statistically significant effect remittance variable on the economic growth in the long run. Moreover, remittances improve poor credit constraints; replace lack of financial development and thus fast-track economic growth. The empirical findings obtained from the ARDL bounds testing approach confirmed that foreign aid has a positive and significant association with economic growth in the long run. This indicates that foreign aid plays an important role in the East African long-run economy.

The policy implications of this study are relatively straight forward like a comprehensive structural reform plan for sustainable economic growth such as Economic Recovery Strategy (ERS) launched between 2003 and 2007 in Kenya could be replicated in other East African Countries. In particular, the macroeconomic framework was launched to create opportunities for productive employment, reforming the trade system to foster a more competitive private sector and strained financial system, as well as improving the performance of the remaining public enterprises.

East African countries should balance the cost of policies to attract foreign direct investment over those seeking to improve local conditions. These two strategies must not be incompatible. Better local conditions not only attract foreign companies but encourage host countries to optimize FDI's benefits.

East African governments should promote policies such as the reduction of transfers' fees, which promote the inflow of remittances into East African countries. Foreign capital such as remittances should be put to productive use like an investment in order to translate into economic development in East African countries. The inflow remittances should be invested in small business rather than consumers, creating employment opportunities and income generated. Finally, foreign debt and aid dependence are not bright, so the East African governments should start rethinking on the allocation of foreign debt and aid resource and policymaker could promote a strategy and policy to reduce high dependence on aid and debt that have worked in the past, such as reducing Nigeria's debt during the Okonjo-Iweala reform as the minister of finance who saw Nigeria's debt liability massively reduced. This was achieved through the establishment of a debt management bureau (DMO) to manage the externals debts of the countries. Therefore, before adopting policies to realize the growth effects of foreign capital inflows in East African countries, policymakers should understand their own context.

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APPENDIX

Table 3: Descriptive Statistics

VARIABLES	N	Mean	Std. Dev.	Min	Max	Skewness	Kurtosis
GDP	98	2.09	2.12	6.33	8.17	1.034233	3.194263
FDI	98	5.65	7.64	31593.78	4.02	2.306449	9.753494
ED	98	5.98	6.53	1.31	2.66	1.338923	4.198955
AID	98	1.53	1.14	23139999	4.12	0.469352	2.202097
REM	98	4.04	4.54	11470.97	1.96	1.475419	4.672674
Number of Countries	7	7	7	7	7		

Source: Author's analysis using data from the World Bank.

Table 4: Correlation

	GDP	**FDI**	**ED**	**AID**	**REM**
GDP	1	0.75	0.96	0.84	0.76
FDI	0.75	1	0.76	0.73	0.42
ED	0.96	0.76	1	0.76	0.72
AID	0.84	0.73	0.76	1	0.54
REM	0.76	0.42	0.72	0.54	1

Source: Author's analysis using data from the World Bank.

Table 5: Autoregressive Distributed Lag (ARDL) bound test

Variable	Coefficient	Std. Error	t-Statistic	**Prob.***
		Long Run Equation		
FDI	7.282050	0.960990	7.577651	**0.0000**
ED	-0.565347	0.123271	-4.586224	**0.0000**
AID	3.334528	0.689735	4.834507	**0.0000**
REM	1.617604	0.519800	3.111974	**0.0030**
		Short Run Equation		
COINTEQ01	-0.288102	0.177378	-1.624227	**0.1104**
D(FDI)	-1.469500	0.696615	-2.109487	**0.0397**
D(ED)	0.460229	0.214823	2.142370	**0.0369**
D(AID)	-0.456957	0.715043	-0.639062	**0.5256**
D(REM)	-2.596602	3.909702	-0.664143	**0.5095**
C	2.19E+09	6.58E+08	3.323689	**0.0016**
Mean dependent var	2.18E+09	S.D. dependent var		**2.90E+09**
S.E. of regression	2.04E+09	Akaike info criterion		**40.45042**
Sum squared resid	2.17E+20	Schwarz criterion		**41.66378**
Log likelihood	-1936.071	Hannan-Quinn criter.		**40.94120**

Source: Author's analysis using data from the World Bank.

Table 6: Granger Causality Tests

Null Hypothesis:	Obs	F-Statistic	Prob.
FDI does not Granger Cause GDP	84	4.80399	0.0107
GDP does not Granger Cause FDI		3.04002	0.0535
EX does not Granger Cause GDP	84	0.29330	0.7466
GDP does not Granger Cause EX		18.8098	2.E-07
AID does not Granger Cause GDP	84	5.75768	0.0046
GDP does not Granger Cause AID		4.33354	0.0164
REM does not Granger Cause GDP	84	1.12221	0.3307
GDP does not Granger Cause REM		3.84023	0.0256
EX does not Granger Cause FDI	84	2.56728	0.0831
FDI does not Granger Cause EX		0.23676	0.7897
AID does not Granger Cause FDI	84	2.33979	0.1030
FDI does not Granger Cause AID		0.02656	0.9738
REM does not Granger Cause FDI	84	1.57203	0.2140
FDI does not Granger Cause REM		4.07161	0.0208
AID does not Granger Cause EX	84	3.64052	0.0307
EX does not Granger Cause AID		7.24611	0.0013
REM does not Granger Cause EX	84	5.66414	0.0050
EX does not Granger Cause REM		1.19791	0.3072
REM does not Granger Cause AID	84	0.81560	0.4461
AID does not Granger Cause REM		1.46346	0.2376

Source: Author's analysis using data from the World Bank.

List of Countries

Kenya	Ethiopia	Tanzania	Rwanda
Uganda	Burundi	Comoros	