RELATIONSHIP BETWEEN CORRUPTION AND FDI INFLOW: A CAUSALITY TEST

Abdelhamid A. Mahboub\(^{394}\)  
Hatem Hassan Garamou\(^{395}\)

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Abstract: This research paper aims at (1) testing the direction of causality between corruption and the inflow of foreign direct investment FDI, and (2) estimating the strength (magnitude) of the relation between the two variables. The researchers could not find in the literature an agreement on either the direction or on the strength of such a relationship. In order to test the research hypothesis, a sample of 37 countries is used, 19 OECD (developed) countries and 18 developing countries. The countries in each of these two groups were chosen by picking the ones with the highest GDP growth rates over the past three years. A time series data set (2006 – 2015) for each of the selected countries has been used. After performing the stationarity test and the required transformation, the Granger causality test has found that causality took one direction from corruption to FDI inflow. Then, the regression of FDI inflow on corruption (and other control variables), has shown the following results:

1. In each of the groups; developed (OECD) and developing countries, the effect of corruption on FDI inflow was negative and very significant.
2. The strength (magnitude) of this effect was higher in case of OECD countries than in the case of developing countries.
3. Despite this weakness of the effect in developing countries, it continued to be a negative effect. The hypothesis of “greasing the wheels of business”, which was reported in literature review, does not seem to be supported in this research. There is not enough empirical support for the claim that corruption can grease the business wheels and thus can increase the inflow of the foreign direct investment.

Key words: corruption, FDI inflow, causality test

Abdelhamid Abdelatif Mahboub

Current Position: Chairperson (Head of Department), Department of Finance, College of Business Administration (CBA), University of Business and Technology (UBT), Saudi Arabia (KSA).

MEMBERSHIP of SCIENTIFIC SOCIETIES:
1. Member of the Editorial Board of the Journal of Business Science and Management, USA, 07/05/2016 – now.
2. Egyptian Academy of Scientific Research and Technology (ASRT), the Economic Council – Egypt.
3. Egyptian Association for Political Economy, Legislation and Statistics.
4. Egyptian Supreme Council for Universities, Sector Committee for Economic and Political Studies.

\(^{394}\) Professor of Economics, College of Business Administration (CBA), University of Business and Technology (UBT), Jeddah, KSA (Saudi Arabia)

\(^{395}\) Assistant Professor of Marketing, College of Business Administration (CBA), University of Business and Technology (UBT), Jeddah, KSA (Saudi Arabia)
FIELDS of INTEREST for TEACHING:
1) Development Economics, International Economics, Managerial Economics (graduate level), Macroeconomics and Microeconomics. In these areas, he is willing and able to teach undergraduate as well as graduate levels.
2) Besides, he has several opportunities to teach undergraduate courses in Econometrics, Managerial Economics, Mathematical Economics, and History of Economic Thoughts.

FIELDS of INTEREST for RESEARCH:
Development Economics, Economic Growth, Macroeconomic Policies (especially related to Less Developed Countries), and International Economics.

TEACHING and ACADEMIC WORK EXPERIENCE
In Saudi Arabia 2008- now:
In Egypt 1991- 2008
In Saudi Arabia 1986–1991
In USA 1979 – 1986