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Foreign aid, foreign direct investment and domestic investment nexus in landlocked economies of Central Asia

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Abstract

This paper investigates the relationship between foreign aid (ODA), foreign direct investment (FDI) and their effect on domestic investment in five landlocked and emerging economies of Central Asia. It is important for donor countries to understand whether their aid helps to bring in a private capital essential in transition period or not. If it does, it creates a ground for public-private partnership that could release from financial constraints and restore conditions for economic growth in transition economies. If it does not, then it calls for reassessing mechanisms of 'aid architecture'. We test ODA-FDI link on two levels: regional and country. Our results from seemingly unrelated regression on regional level indicate that (a) aid has a positive role on FDI inflows; (b) aid and FDI are complementing flows, and (c) FDI complements domestic investment, while ODA decrease it. However, on the country level only in Kyrgyzstan and Tajikistan, foreign aid catalyzes FDI inflows. We conclude that the ODA-FDI nexus is present in countries with low per capita GDP and economic growth. There is a need for improvement of aid mechanism and a room for public-private cooperation in economies of Central Asia.

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