

Institutional Capacity and Capital Inflows in Selected Economic Community of West African States (ECOWAS)

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<https://doi.org/10.56201/wjeds.v11.no9.2026pg34.45>

Abstract

This paper examined how governance quality affects capital inflows to the selected ECOWAS countries (Côte d'Ivoire, The Gambia, Ghana, Liberia, Mali, Nigeria, Senegal, and Togo) between 2002 and 2024. The specific objectives are to determine the effects of government effectiveness, regulatory quality, rule of law, control of corruption, and political stability on foreign loan inflows. Given the nature of this study, panel datasets were obtained from the World and IMF Financial Statistics. Descriptive statistics, cross-sectional dependence test, panel unit root and cointegration tests, as well as heterogenous panel model estimation, comprising mean group (MG) and pooled mean group (PMG) were used for the data analysis. The cross-sectional dependence test indicates that there is no cross-sectional dependence across the panels. The panel unit root test results showed evidence of mixed integration in the series. The panel regression estimates indicate that government effectiveness has a significant positive effect on foreign loan inflows in the long run. The results also showed that regulatory quality has a significant negative effect on loan inflows in the long run. Evidence of a significant effect of the rule of law on foreign loan inflows was established in the long run. The results further showed that the control of corruption had a positive and significant effect on foreign loan in the long run. Given the findings, this study recommends that governments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract foreign official loans.

Keywords: Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption, Political Stability, Foreign Loans

1. Introduction

Capital inflows have become an indispensable source of financing for economic growth and sustainable development in developing economies, particularly where domestic savings are inadequate to meet investment needs. They provide financial resources that support capital accumulation, infrastructure development, technology transfer, employment generation, productivity growth, and economic diversification. For member states of the Economic Community of West African States (ECOWAS), capital inflows such as official development assistance, is essential for accelerating industrialization, reducing poverty, and achieving the

Sustainable Development Goals (SDGs). However, beyond favourable macroeconomic fundamentals, recent development literature emphasizes that the ability of countries to attract and sustain international capital increasingly depends on the strength of their institutional capacity. Consequently, institutional capacity has become a critical determinant of investment competitiveness and economic transformation within the ECOWAS region. Institutional capacity has been defined from different scholarly perspectives. The United Nations Development Programme (UNDP, 2023) defines institutional capacity as the ability of governments, public institutions, and organizations to effectively formulate, implement, coordinate, monitor, and evaluate policies while efficiently utilizing available human, financial, and technical resources to achieve sustainable development objectives.

Correspondingly, the World Bank (2023) describes institutional capacity as the effectiveness of public institutions in delivering quality public services, enforcing regulations, ensuring accountability, maintaining the rule of law, and promoting sound governance capable of supporting economic development. Likewise, the Organisation for Economic Co-operation and Development (OECD, 2024) conceptualizes institutional capacity as the capability of public institutions to design and implement coherent policies, coordinate government activities, maintain regulatory efficiency, and respond effectively to emerging economic and governance challenges. Collectively, these definitions suggest that institutional capacity encompasses administrative competence, policy implementation effectiveness, regulatory quality, government effectiveness, transparency, accountability, and institutional resilience necessary for promoting economic stability and attracting investment. The relationship between institutional capacity and capital inflows is well established in institutional economics. Strong institutional capacity enhances investor confidence by ensuring policy consistency, efficient public administration, transparent governance, effective regulatory systems, protection of property rights, and enforcement of contractual obligations. These institutional attributes reduce investment uncertainty, lower transaction costs, and improve the predictability of the business environment, thereby encouraging foreign investors to commit long-term capital.

Conversely, weak institutional capacity characterized by bureaucratic inefficiency, corruption, policy inconsistency, poor regulatory enforcement, and weak judicial systems increases investment risk and discourages international capital inflows. Consequently, countries with stronger institutional capacity are generally more successful in attracting sustainable foreign investment than countries with weak governance structures. The importance of institutional capacity is particularly evident in ECOWAS countries. Although the region possesses abundant natural resources, expanding consumer markets, a youthful labour force, and a population exceeding 430 million people, its investment performance remains below expectation. According to the United Nations Conference on Trade and Development (UNCTAD, 2025), Africa attracted approximately US\$97 billion in foreign direct investment in 2024, representing a significant improvement over previous year. Nevertheless, these inflows remained highly concentrated in a few economies, while many ECOWAS countries continued to attract relatively low levels of foreign investment due to weak institutional capacity, governance deficiencies, political instability, and regulatory uncertainty. Furthermore, the World Bank's Worldwide Governance Indicators (2023) indicate that several ECOWAS countries continue to record relatively low scores in government effectiveness, regulatory quality, rule of law, and control of corruption. Similarly, the OECD (2024) identifies weak institutional coordination, inadequate administrative capacity, inconsistent policy implementation, and limited regulatory effectiveness as major impediments to attracting sustainable private investment across West Africa.

Likewise, empirical evidence supports the significance of institutional capacity in attracting capital inflows. Ewubare and Ozigbu (2019) investigated the relationship between institutional quality and total equity investment in Nigeria using Dynamic Ordinary Least Squares (DOLS) and Error Correction Model (ECM) techniques. The findings revealed that improvements in economic institutions, political institutions, and information flows significantly increased total equity investment in both the short run and the long run, indicating that stronger institutional capacity enhances investment attractiveness. Similarly, Afolabi (2019) examined governance and sustainable development in West Africa and found that government effectiveness, political stability, voice and accountability, and the rule of law significantly promoted development outcomes, suggesting that countries with stronger institutional capacity are more capable of attracting productive investment and sustaining long-term economic growth. Ideally, ECOWAS countries are expected to possess strong institutional capacity characterized by competent public administration, effective regulatory agencies, transparent governance systems, efficient policy implementation, judicial independence, and accountable public institutions capable of creating an enabling environment for domestic and foreign investors. Such institutional conditions enhance investor confidence, improve regulatory predictability, strengthen contract enforcement, and facilitate increased capital inflows necessary for infrastructure development, industrial expansion, employment creation, and economic diversification.

However, despite numerous governance reforms undertaken by ECOWAS member states, institutional capacity remains relatively weak across several countries within the region. Persistent corruption, administrative inefficiency, policy inconsistency, weak regulatory institutions, inadequate public sector capacity, and political instability continue to undermine investor confidence and reduce the region's ability to attract sustainable capital inflows. The World Bank (2023) reports that many ECOWAS countries continue to perform below global averages in governance effectiveness and regulatory quality, while the OECD (2024) similarly emphasizes that institutional weaknesses remain among the principal barriers to private investment and economic competitiveness in the region. Although previous empirical studies generally acknowledge that institutional capacity influences capital inflows, their findings remain inconclusive regarding the magnitude and transmission mechanisms through which institutional capacity affects different categories of foreign capital. Moreover, existing studies have largely focused on individual countries or Sub-Saharan Africa as a whole, with relatively limited comparative evidence specifically examining ECOWAS countries using recent panel data and multidimensional indicators of institutional capacity. This empirical gap therefore provides the motivation for the present study, which seeks to examine the effect of institutional capacity on capital inflows in ECOWAS countries. The findings are expected to provide useful policy insights for strengthening institutional capacity, improving the investment climate, and enhancing the region's ability to attract sustainable international capital required for long-term economic development.

2. Methodology

This study utilise panel data comprising cross-sectional units and time series. Specifically, the cross-sectional units include the selected countries in the ECOWAS region, such as Côte d'Ivoire, The Gambia, Ghana, Liberia, Mali, Nigeria, Senegal, and Togo. Thus, the dataset covers 8 countries, including the anglophone and francophone countries, over the period 2002-2024. This period allows us to analyse the behaviour of capital inflows in response to changes in institutional quality before and after the global financial crisis (2008-2009). Capital inflows data was taken

from the International Financial Statistics of the IMF and the World Bank Development Indicators (WDI). These sources allow for the disaggregation of capital inflows into FDI, portfolio investments, foreign aid, remittances, and foreign loans. Additionally, to assess the role of governance quality as a determinant of capital inflows, a set of governance variables from the Worldwide Governance indicators was utilised. These include annual time-series data on governance quality, including government effectiveness, regulatory quality, rule of law, corruption control, and political stability.

Model Specification

This study closely follows the works of Al Sayed, Omar & Khaled (2025), Ohonba & Akinola (2023), Shammah et al. (2024), Wu et al. (2024) and Bekana (2023). with some improvements. In particular, the models was augmented by expanding the governance quality indicators to include political stability and rule-of-law indexes, which were previously ignored. The functional specifications of the models are presented as follows:

$$FOL = f(GEF, REQ, RUL, COC, PST) \quad 1$$

Where: FOL = foreign loans

GEF = government effectiveness, REQ = regulatory quality, RUL = rule of law, COC = corruption control, PST = political stability

Following the nature of this study, the static panel models involving pooled, fixed effects and random effects shall be specified accordingly:

i. Pooled Regression Model

$$FAI_{it} = \beta_0 + \beta_1 GEF_{it} + \beta_2 REQ_{it} + \beta_3 RUL_{it} + \beta_4 COC_{it} + \beta_5 PST_{it} + \varepsilon_{it} \quad 2$$

Where: β_0 = Intercept, $\beta_1 - \beta_5$ = slope parameters, ε_{it} = error term

$i = 1, \dots, N. t = 1, \dots, T$

i = cross-sectional units, including the selected countries (Côte d'Ivoire, The Gambia, Ghana, Liberia, Mali, Nigeria, Senegal, and Togo) in the ECOWAS

t = time dimension (2002 to 2024)

A Priori Expectation

A priori expectation is a theoretically based prediction regarding how economic variables are related, including their direction and nature. In line with the a priori expectation, government effectiveness, regulatory quality, and rule of law are expected to positively affect capital inflows. Given the following, the a priori expectations based on the regression coefficients are expressed as: $\beta_1 > 0$, $\beta_2 > 0$, $\beta_3 > 0$, $\beta_4 > 0$, and $\beta_5 > 0$.

Variable Description and Measurement

Foreign loan inflows: This refers to the sum of public and publicly guaranteed long-term debt, use of IMF credit, and short-term debt. It is measured by external debt stocks as a percentage of GNI in each of the selected ECOWAS countries.

Government effectiveness (GEF): This refers to perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The estimate for government effectiveness is in units of a standard normal

distribution, ranging from approximately -2.5 to 2.5. A priori, government effectiveness is expected to positively affect capital inflows.

Regulatory quality (REQ): Regulatory quality refers to perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. The estimate for regulatory quality is measured as an aggregate indicator, in units of a standard normal distribution, ranging from approximately -2.5 to 2.5, as provided by the WGI. A priori, regulatory quality is expected to positively affect capital inflows, as sound, transparent, and predictable regulatory frameworks lower investment risk, improve market efficiency, and boost investor confidence.

Rule of law (RUL): This includes perceptions of how much agents trust and follow societal rules, especially regarding the quality of contract enforcement, property rights, the police, and the courts, as well as the chances of crime and violence. It shall be measured by the rule of law index, comprising a composite indicator in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, improvements in the rule of law are expected to boost capital inflows, as strong legal institutions enhance property rights protection, reduce uncertainty, and improve investor confidence.

Control of corruption (COC): This encompasses perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests. The estimate for control of corruption is in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, improvements in anti-corruption are expected to positively affect capital inflows, as enhanced institutional quality boosts investor confidence and reduces investment risk.

Political stability (PST): This defines perceptions of the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism. It shall be measured by the political index, a composite indicator expressed in units of a standard normal distribution, ranging approximately from -2.5 to 2.5. A priori, political stability is expected to positively affect capital inflows, as a stable political environment reduces uncertainty and improves the investment climate.

3. Results and Discussion

Descriptive Statistics

The descriptive analyses focused on the mean, standard deviation, and range, including the minimum and maximum values of each variable. The summary of the descriptive statistics is presented in Table 1.

Table 1: Summary of descriptive statistics

Variable	Observation	Mean	Std. Dev.	Minimum	Maximum
FOL	184	58.95	82.54	6.3	610.45
GEF	184	-.781	.4994	-1.71	.23
REQ	184	-.633	.374	-2.11	.01
RUL	184	-.637	.459	-1.89	.28
COC	184	-.634	.396	-1.69	.36

PST	184	-.748	.8043	-2.56	.48
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Source: STATA 15 Output

Table 1 presents descriptive statistics based on 184 observations. Foreign loans averaged 58.95% of GDP, with a high standard deviation of 82.54, indicating substantial variation in borrowing across countries. The governance indicators generally recorded negative mean values, suggesting relatively weak institutional performance. Government effectiveness averaged -0.781 , regulatory quality -0.633 , rule of law -0.637 , and control of corruption -0.634 . Political stability recorded a mean of -0.748 and the highest variation (SD = 0.8043), reflecting considerable differences in political conditions across countries and periods.

Table 2: Summary of the IPS unit root test results

Variable	Z-t-tilde-bar levels	at Z-t-tilde-bar difference	at 1st Order integration	of
FOL	-0.907 (0.1822)	-6.4369*** (0.0000)	I(1)	
GEF	0.4184 (0.6622)	-7.266*** (0.0000)	I(1)	
REQ	-0.872 (0.1915)	-6.571*** (0.0000)	I(1)	
RUL	-1.499 (0.0669)	-7.058*** (0.0000)	I(1)	
COC	-0.207 (0.4180)	-6.351*** (0.0000)	I(1)	
PST	-3.024*** (0.0012)	-	I(0)	

Source: STATA 15 output

Note: *, **, * denote significant at 1%, 5% and 10% levels, respectively**

The IPS panel unit root test results indicate that foreign loans (FOL), government effectiveness (GEF), regulatory quality (REQ), rule of law (RUL), and control of corruption (COC) are non-stationary at levels but become stationary after first differencing, making them I(1). Their first-difference results are significant at the 1% level ($p = 0.0000$). The variables exhibit a mixed order of integration, I(0) and I(1), with none being I(2). Thus, the data satisfy the requirements for cointegration testing and panel ARDL estimation, including the PMG and MG estimators.

Panel Cointegration Test

The panel cointegration test for each model was conducted using the Kao method, given evidence of mixed integration in the series. The results are presented in Tables 3

Table 3: Kao panel cointegration test results

Series: FOL GEF REQ RUL COC PST			
Ho: No cointegration	Number of panels	=	8
Ha: All panels are cointegrated	Number of periods	=	21
Panel means:	Included	Kernel:	Bartlett
Time trend:	Not included	Lags:	1.75 (Newey-West)
AR parameter:	Same	Augmented lags:	3
		Statistic	p-value

Modified Dickey-Fuller t	-1.4291*	0.0765
Dickey-Fuller t	-2.5588***	0.0053
Augmented Dickey-Fuller t	-4.2491***	0.0000
Unadjusted modified Dickey-Fuller t	-1.1277	0.1297
Unadjusted Dickey-Fuller t	-2.4277***	0.0076

Source: STATA 15 output

Note: *, **, * denote significant at 1%, 5% and 10% levels, respectively**

Table 4 presents the Kao panel cointegration results for foreign loan inflows and governance indicators. Although the MDF and Unadjusted MDF statistics are insignificant, the DF, ADF, and Unadjusted DF statistics are significant at the 1% level. Since three of the five test statistics are significant, the null hypothesis of no cointegration is rejected. This confirms the existence of a long-run equilibrium relationship between foreign loan inflows and the governance indicators across the sampled countries.

Model Estimation

The model estimation is segmented into the long-run and short-run dynamics. The long-run coefficients show the equilibrium relationship between each capital inflow and the governance quality variables, while the short-run coefficients capture how short-term changes in the explanatory variables affect each capital inflow across the sampled countries. The Hausman test results provide the basis for choosing between the PMG and MG estimators.

Table 4: Summary of MG and PMG results

Dependent variable: FOL		
	(1)	(2)
Variables	MG	PMG
Ec	-.3891*** (0.000)	-.0709 (0.425)
D.GEF	-29.055* (0.104)	4.549 (0.513)
D.REQ	-13.05 (0.345)	-8.235 (0.462)
D.RUL	9.708 (0.230)	9.740 (0.567)
D.COC	36.404* (0.181)	7.825 (0.649)
D.PST	6.717 (0.536)	1.2618 (0.830)
GEF	112.03*** (0.000)	-97.178 (0.379)
REQ	-35.287 (0.523)	-235.64*** (0.006)
RUL	-5.225 (0.938)	-42.577 (0.745)
COC	-137.44*** (0.001)	-174.89** (0.021)
PST	-25.214	-109.74***

	(0.401)	(0.005)
Constant	-24.043	-41.981
	(0.494)	(0.345)
Observations	176	176

Source: Author's computation (2026) from STATA 15

Note: *, **, * denote statistically significant at 1%, 5%, and 10% levels, respectively**
Figures in brackets are corresponding p-values of the parameters

Table 4: Hausman test results

Variabl	Mg	Pmg	Difference	S.E.
GEF	112.0312	-97.17764	209.2088	10.7127
REQ	-35.28694	-235.6364	200.3495	5.90145
RUL	-5.225246	-42.57782	37.35257	11.09815
COC	-137.4421	-174.8864	37.44426	6.898015
PST	-25.21419	-109.7397	84.52552	1.707690
chi2(5) = 33.46				
Prob>chi2 = 0.0000				

Source: Author's computation (2026) from STATA 15

Table 4 presents the long- and short-run effects of governance quality on foreign loan inflows across eight selected ECOWAS countries. The Hausman test supports the MG estimator ($\chi^2 = 33.46$, $p = 0.0000$), which is therefore used for interpretation.

The long-run results show that government effectiveness has a positive and significant effect on foreign loan inflows. A one-unit improvement in government effectiveness increases foreign loans by about 112.03 units, suggesting that stronger administrative capacity enhances access to bilateral and multilateral financing. In contrast, control of corruption has a significant negative effect, with a one-unit improvement reducing foreign loan inflows by about 137.44 units. This may indicate that stronger anti-corruption practices improve fiscal management and domestic resource mobilisation, thereby reducing reliance on external borrowing. Regulatory quality, rule of law, and political stability have negative but insignificant long-run effects, suggesting that they do not significantly determine foreign loan inflows in the sampled countries. In the short run, none of the governance indicators significantly affects foreign loans, indicating that lending may also depend on development priorities, geopolitical interests, and donor strategies. Finally, the negative and significant error-correction coefficient (-0.3891) indicates that about 38.91% of short-run deviations from long-run equilibrium are corrected annually, confirming a stable long-run relationship between governance quality and foreign loan inflows.

Discussion of Findings

The results show that government effectiveness has a positive and significant effect on foreign aid inflows in the long run. This suggests that countries with stronger administrative capacity, effective policy implementation, and better public service delivery are more likely to receive external assistance. This finding is consistent with the institutional perspective, which emphasises that effective institutions improve the capacity of governments to manage resources and implement development programmes (Scott, 2014; Grindle, 1997). It also agrees with the OECD (2020) and UNDP (2023), which highlight institutional capacity as an important element of effective public-sector performance. In the ECOWAS context, stronger government capacity may therefore increase donors' confidence in the implementation and monitoring of aid-funded programmes.

Political stability also has a positive and significant long-run effect on foreign aid inflows. This suggests that donors are more likely to provide sustained assistance to countries with relatively stable political environments, where development programmes can be implemented with less disruption. Political stability can improve policy continuity and reduce uncertainty surrounding development projects. This finding is particularly relevant to ECOWAS, where political and institutional conditions vary considerably across countries. It is also consistent with the broader view that governance conditions influence the allocation and effectiveness of external financial resources (World Bank, 2023; Al Sayed et al., 2025).

The findings further show that control of corruption has a positive but insignificant effect on foreign aid inflows. Although better corruption control may improve transparency and the management of aid resources, the insignificant result suggests that it is not, by itself, a major determinant of aid allocation in the sampled countries. Donor decisions may also reflect development needs, existing commitments, strategic considerations, and other institutional factors. This result is consistent with the argument that governance is multidimensional and that improvements in one institutional dimension may not automatically translate into greater external financing (Fukuyama, 2013; World Bank, 2023).

In contrast, regulatory quality has a significant negative effect on foreign aid inflows. While this finding differs from the expectation that better institutions should attract more external resources, it may indicate that improvements in regulatory systems strengthen domestic economic capacity and reduce reliance on foreign assistance. Better regulations can support private investment, entrepreneurship, and domestic resource mobilisation, potentially reducing the need for aid over time. This interpretation is consistent with the broader emphasis on institutional quality and sustainable economic development in West Africa (Afolabi, 2019; OECD, 2024).

The rule of law has a negative but insignificant effect on foreign aid inflows. Although effective legal institutions are important for accountability, contract enforcement, and sustainable development, the result suggests that the rule of law alone does not significantly determine aid allocation in the sampled ECOWAS countries. Donors may instead consider a combination of institutional capacity, development needs, political conditions, and existing aid commitments when making allocation decisions.

Finally, the short-run results show that none of the governance indicators significantly affects foreign aid inflows. This indicates that changes in governance quality do not immediately translate into changes in aid flows. Institutional reforms generally require time to become credible and produce measurable outcomes, while aid allocation is often shaped by existing commitments and longer-term development programmes. The findings suggest that governance quality matters more for foreign aid in the long run than in the short run, with government effectiveness and political stability emerging as the most important significant governance factors in the model.

4. Conclusion and Recommendations

Conclusion

This study examined the effect of governance quality on capital inflows in the ECOWAS region, focusing on five major components of governance quality (government effectiveness, regulatory quality, rule of law, control of corruption, and political stability) and their influence on capital inflows, (FDI). The findings reveal that the relationship between governance quality and capital inflows in the ECOWAS region is multifaceted and varies considerably across the different forms of external capital. The indicate that government effectiveness negatively influences FDI inflows in the long run, suggesting that improvements in administrative efficiency and public sector

performance do not necessarily translate into increased foreign direct investment within the region. Regulatory quality had a significant negative effect on FDI, this suggests that improvements in the regulatory environment may reduce dependence on certain forms of external capital by promoting domestic economic opportunities, strengthening internal resource mobilisation, and enhancing the efficiency of local markets. The results further indicate that the rule of law plays a significant role in influencing capital inflows, however, its effect on FDI was not statistically significant, implying that legal and judicial institutions may be more important to financial investors and official development partners than to multinational corporations and migrants. The study also established that control of corruption is an important determinant of external capital inflows. Improved control of corruption significantly enhances FDI, highlighting the importance of transparency, accountability, and institutional trust in attracting private capital and encouraging diaspora transfers. Furthermore, political stability was found to influence capital inflows. Given the findings, the study concludes that governance quality remains a critical determinant of capital inflows in the ECOWAS region.

Recommendations

- i. Governments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract remittances, foreign aid, and foreign official loans.
- ii. The ECOWAS member states should promote regulatory harmonization and policy coordination to enhance regional integration, facilitate cross-border investment, and create a more attractive and predictable business environment in the region.
- iii. Policymakers in ECOWAS governments should prioritize reforms aimed at strengthening the rule of law through improved judicial system, effective contract enforcement, protection of property rights, and the consistent application of legal framework to create a predictable legal environment that supports for increased inflow of foreign capital.
- iv. The ECOWAS governments should strengthen anti-corruption institutions and promote transparency and accountability in the public sector to increase investor confidence and encourage greater greater inflows to the region.
- v. Finally, The ECOWAS member states should continue to promote political stability through the strengthening of democratic institutions and inclusive governance practices to creating a conducive environment for attracting foreign capital from various external sources.

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