

**UNIVERSITY OF GHANA**

**IMPACT OF FOREIGN AID ON POVERTY REDUCTION IN GHANA**

**(2008-2018)**

**BY**

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**DECLARATION**

I hereby declare that this project work is the result of my own original research under the supervision of Dr. Agyapomaa Gyeke-Dako. The work has never been submitted to any other institution by anyone for any award. I am therefore responsible for any errors in the work. All references cited in this work have been duly acknowledged.

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**CERTIFICATION**

I hereby certify that this thesis was supervised in accordance with procedures laid down by this University.

.....

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**(SUPERVISOR)**

.....

**DATE**

**DEDICATION**

I dedicate this work to my parents Mr. and Mrs. Boye for their immense support.

## **ACKNOWLEDGEMENTS**

I would like to express my profound gratitude to the Almighty God for seeing me through this work. This work could not have been done without the guidance, direction and encouragement of some important people.

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## TABLE OF CONTENTS

DECLARATION .....	i
CERTIFICATION .....	ii
DEDICATION .....	iii
ACKNOWLEDGEMENTS .....	iv
TABLE OF CONTENTS .....	v
LIST OF TABLES .....	viii
LIST OF FIGURES .....	ix
ABSTRACT .....	x
CHAPTER ONE .....	1
INTRODUCTION .....	1
1.1 Research Background .....	1
1.2 Research Problem .....	3
1.3 Research Purpose .....	4
1.4 Research Objectives .....	4
1.5 Research Questions .....	4
1.6 Research Methodology .....	5
1.7 Significance of the Research .....	5
1.8 Research Limitations .....	5
1.9 Chapter Outline .....	6
CHAPTER TWO .....	7
LITERATURE REVIEW .....	7
2.1 Introduction .....	7
2.2. Poverty .....	7
2.2.1 The Causes and Consequences of Poverty .....	9

2.3 Definition of Foreign Aid.....	11
2.3.1 History of Foreign Aid .....	12
2.4 Ghana’s Aid Profile.....	13
2.5 Theories Concerning the Determinants of Aid .....	14
2.6 Theories and Literature Concerning the Effects and Effectiveness of Aid.....	15
2.7 Impact of Foreign Aid on Poverty Reduction .....	27
2.7.1 Advantages of Foreign Aid.....	27
2.7.2 Disadvantages of Foreign Aid .....	28
2.8 Theoretical Review .....	28
2.8.1 Harrod - Domar Model.....	29
2.8.2 Two Gap Theory.....	30
2.8.3 Solow Growth Model .....	31
2.9 Empirical Review .....	32
2.10 Trends of Foreign Aid to Ghana. ....	34
2.11 Total Aid Flows: Trends .....	35
2.12 Aid Programs from Specific Donors to Ghana .....	36
2.12.1 The United Kingdom as a Donor.....	36
2.12.2 The United States as a Donor .....	41
CHAPTER THREE .....	44
RESEARCH METHODOLOGY.....	44
3.1 Introduction .....	44
3.2 Research Method and Approach .....	44
3.3 Data Analysis .....	44
3.3.1. Secondary Data.....	45
3.4 Research Model.....	45
3.5 Data Analysis .....	46
3.6 The Models.....	46

3.7 Tests of Data.....	48
CHAPTER FOUR.....	49
EMPIRICAL RESULTS AND ANALYSIS .....	49
4.1 Introduction .....	49
4.2 Unit Root Test Results .....	49
4.3 Long-run Relationship Results.....	52
4.4 Results of the Short Run Dynamic Model .....	55
4.5 Model Diagnosis and Testing for Stability. ....	57
CHAPTER FIVE .....	61
SUMMARY, RECOMMENDATIONS, AND CONCLUSION.....	61
5.1 Summary of Findings .....	61
5.2 Policy Implications and Recommendations .....	62
5.3 Practical Limitations & Further Research.....	64
5.4 Conclusion.....	65
REFERNCES .....	66
APPENDICES .....	75
APPENDIX A: Figure AI: Plots of Variables in Levels and First Differences .....	75
APPENDIX B: Summary Statistics and Correlation Matrix .....	77
APPENDIX C: Data Used in the Estimation of the Aid Growth Model .....	79

**LIST OF TABLES**

Table 2.1 Total Number of Aid Recipients in Ghana).....	39
Table 4.1: Results of the Unit Root Tests .....	50
Table 4.2: Bounds Tests for Cointegration Estimates .....	52
Table 4.3: Long-Run Estimated Coefficients using the ARDL Approach .....	53
Table 4.4: Estimated Short-Run Error Correction Model using the ARDL Approach .....	56
Table 4.5: Diagnosis and Goodness Model .....	58

**LIST OF FIGURES**

Figure 2.1: Foreign Aid from the United Kingdom to Ghana 1960-2011 .....	37
Figure 4.2: CUSUM and CUSUMQ Plots.....	59

## ABSTRACT

There have been various forms of foreign aid to developing countries of which Ghana is a beneficiary. Many theories have been attributed to the inception of foreign aid to less developed countries. In some researches, Foreign aid have been attributed to having a great impact on poverty reduction however, there are other studies which have come out with findings that show that foreign aid does not have an impact on poverty reduction. This research therefore seeks to examine the trends of foreign aid to Ghana and ascertain whether the foreign aid received by Ghana has had any impact on poverty reduction from the periods 2008 to 2018.

Relevant Time series data on the variables used in the model were obtained from the World Bank and Ministry of finance indicators. This provided the necessary data for which inferences were made. The data for the study was first tested for stationarity of the variables. The Bounds Test for cointegration was also employed to test whether there exist a long-run relationship among the variables.

Findings indicate that there appears to be no important effect of foreign aid on poverty reduction in Ghana. An amount of factors can be ascribed to this unfortunate long-term outcome of foreign aid. Developing nations like Ghana can depend on trade and international direct investment to strengthen their capital markets and empower institutions and individuals to reduce the poverty rates in the country.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Research Background

There have been various forms of foreign aid to developing countries of which Ghana is a beneficiary. The provision of foreign aid has become very necessary and important as part of international relations with other countries. The number of aid donors has also increased over the period. For most developing countries, dependence on aid has become inevitable as these funds go a long way to support their ailing economies. For Western states, the provision of development aid has become an important instrument for achieving international objectives including the cultivating of political allies, opening markets, fighting terrorism and constructing regimes of global governance (Williams, 2013).

The history of Aid has been attributed to many events. Browne (1999) has appropriately asserted that no single event can be attributed to be the cause and stimulus behind the inception of foreign aid. Various processes led to the commencement of the era of international aid. The profound one being in the early 1940's in the form of post war assistance to reconstruct the economy of Western Europe with the statement of the Marshall plan in which its purpose was to reconstruct the war ton economy of Western Europe. This act was replicated in other countries and as a result of its success, aid has been recognized by many and has therefore been used in many countries all over the world, especially in developing countries (Collodel, 2011).

The increase in foreign aid can be attributed to governments of developing countries striving to meet the United Nations Millennium Development Goals (MDG) by 2015. The first goal is to

eradicate extreme poverty and hunger which is very common in developing countries. Due to the ‘perceived’ role aid plays in achieving the (MDGs) of eradicating extreme poverty by 2015, the impact of aid on poverty reduction has received a lot of debate among researchers. According to OECD (2016), Net Official Development Assistance (ODA) to Africa in 2014 alone was estimated at US\$ 54,193 million in real terms. Bilateral (country to country) aid to least-developed countries increased by 4% in real terms to USD 26 billion, following several years of declines. Aid to Africa rose by 3% to USD 29 billion and, within that, aid to sub-Saharan Africa was also up 3% to USD 25 billion. Humanitarian aid rose by 6.1% in real terms to USD 15.5 billion. (OECD, 2017). Most people are of the view that Africa has received more aid than any continent in the world and yet it is still classified as the poorest continent in the world.

Ghana which is also referred to as the star of Africa was the first in sub Saharan Africa to attain independence. This meant that Ghanaians had to develop and build the nation on their own. Dr. Kwame Nkrumah the first president of this country championed this agenda of development. He believed that for a nation to develop and grow there was the need to invest in major infrastructure including building various factories, roads, generating electricity etc. (Woode, 2012). Ghana started these developments on a sound economic background due to the revenue generated from the rich mineral resources such as gold, bauxite, diamond, cocoa etc. This was however short lived as the country’s expenditure increased more than the revenue generated thereby depleting the reserves. By 1961, Ghana began to experience a decline in economic growth and development because the Gross Domestic Product (GDP) per income decreased from \$300 to \$282.716. (Kim 2013). This was the beginning of aid to Ghana as the state of the economy attracted foreign aid to the country. Ghana is recorded as one of the largest recipient’s foreign aid as the nation received aid of about 3.1% between the period 1970-2010/2011 (OECD,2013). Sector analysis revealed

that during the same period, the social sector received within the range of 18% and 41%, the economic sector also received about 16% to 20% of aid (OECD, 2013). Net ODA received (% of GNI) in Ghana was 4.86 as of 2015. Its highest value over the past 55 years was 16.34 in 2004, while its lowest value was 0.23 in 1961 (OECD/DAC). Ghana however has not come out of the poverty bracket despite all the flows of foreign aid even though there have been some improvements in the economy.

## **1.2 Research Problem**

Foreign aid has been identified in some studies to reduce poverty see Masud & Yonchteva, (2005). Ghana is known for its relative political stability and its efforts to attain economic stability. Having experienced steadily increasing economic growth of over 7% per year on average since 2005, Ghana attained lower-middle income country status in 2010 (Amponsah, 2015). Income from offshore oil reserves discovered in 2007 began to flow in 2011, creating double-digit growth for the year. Accompanying income growth has been a rapid reduction in the proportion of its population living below the poverty line of USD 1.25 a day declined from 51.7% to 28.5% between 1991 and 2006, and the poverty level was estimated to be 24% in 2012/2013. Monetary poverty also reduced from 51.7% in 1992 to 24.2% of the population by 2013, meaning that Ghana has achieved the MDG 1 target (UNDP, 2015). This was achieved largely as a result of the foreign aid flows to the country.

Ghana is endowed with rich natural resources ranging from gold, cocoa, bauxite etc. however the country depends largely on foreign aid for its development. Despite the perceived reduction in poverty, the effect cannot be felt in the pockets of most Ghanaians as most people especially in the rural areas live in extreme poverty. It is crucial to determine how aid is used and allocated to curb

the poverty menace. Successive governments have put in place several policies and interventions to address this problem however poverty still persists. This paper specifically examines the impacts foreign aid has on poverty reduction as well as evaluating the interventions by government to reduce poverty from (2008-2018).

### **1.3 Research Purpose**

This paper specifically examines the impacts foreign aid has had on poverty reduction in Ghana. In addition, the study seeks to assess various interventions by successive government to reduce abject poverty in the country from the period (2008-2018).

### **1.4 Research Objectives**

The study has the broad objective to examine the impact of foreign aid on poverty reduction in Ghana for the period (2008-2018).

Specific objectives are to

1. Examine the trend of aid flows to Ghana during the period
2. Examine the efficiency of foreign aid interventions on poverty reduction.

### **1.5 Research Questions**

The study will be guided by these questions

1. What has been the trend of Foreign Aid to Ghana during the period 2008-2018?
2. What has been the effect of foreign aid interventions on poverty reduction?

## **1.6 Research Methodology**

Data for this study will be collected from secondary sources. Relevant data from the Ministry of Finance and the World Bank will be collected to aid in the study. Time series data on variables from the World Bank and Ministry of finance will be used. Multiple regression analysis will be conducted to analyze the data to understand the relationship between foreign aid and poverty.

Annual Gross National Income will be used as the dependent variable. The independent variables will be Government expenditure, foreign aid, and investments. These were selected because of their empirical use and theoretical relevance.

## **1.7 Significance of the Research**

This study would help examine foreign aid trends from (2008-2018). It also seeks to provide a better understanding of various government intervention programmes to reduce poverty as well as the impact such interventions have had on poverty reduction. The research results would be relevant to government, policy makers and society at large in understanding whether Foreign aid flows are channeled towards poverty reduction. There exist few studies on the impact of foreign aid on poverty reduction in Ghana in previous years. This study adds to the existing literature. In so doing the study addresses some of the methodological issues inherent in the literature.

## **1.8 Research Limitations**

The study uses secondary data in its analysis therefore the quality of the data employed may not be accurate and this is a major limitation of the study. This problem is compounded by the complexities involved in gathering data in Ghana. According to Kholdy (1995), data compiled in most developing countries is inaccurate and may therefore bias the empirical results. In addition, the time factor given for this research is a maximum challenge.

## **1.9 Chapter Outline**

This research is organized into five chapters. Chapter one comprise the research background, research problem, research purpose, research objectives, research questions, proposed research methodology, significance of the study, research limitations and the chapter outline. Chapter two presents a review of the relevant literature on the impact of foreign aid on poverty reduction in Ghana. Chapter three gives details of the research methodology and it focuses on the sources of data and empirical design. Chapter four entails report on the empirical results. It covers data presentation, analysis and discussion. Here secondary data obtained using various means outlined in the methodology was organized into a meaningful data format, analysed and discussed in order to draw conclusions. Chapter five presents the findings from the data analysis and offer conclusions and recommendations.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 Introduction

This section of the study examines existing literature on the subject being debated. However, it was divided into two sections: theory and the empirical examination of related literature. The current literature on foreign support and their impact on poverty is analyzed in this section. The chapter begins with the definition of aid and its advantages and inconveniences. It also discusses some theoretical aid models as well as empirical discussions and findings and discusses the trends in foreign aid for Ghana and its impact on the people of Ghana living standards.

#### 2.2. Poverty

Mabughi and Selim (2006) defined poverty as "social deprivation of a decent quality of life." Their article described some of the definitions and measures of the phenomenon of poverty and stressed that it is a broad concept with social and economic implications. The various definitions of poverty arose from the difficulty of defining the quality of life. The first definitions of poverty, which Mabughi and Selim (2006) claim, follow an income or monetary approach, and after the 1970s, a multidimensional approach prevailed.

The currency (or revenue) method defined life quality based on material well-being, often measured by revenue or consumption (Sen & Anand, 1997; Mabughi & Selim, 2006). The poor are those who are deprived of income according to this concept. The easiest way to identify these is by using poverty lines to define minimum living standards based on income or consumption. In 2015, in order to detect extreme poverty, the World Bank defined a \$1.90 daily threshold in 2011.

This is a measurement of poverty by many authors. It is actually one of the measures for poverty

with more country and period of time information available. In addition, the Poverty Headcount Ratio is based on a poverty line known with precision and its easy calculation as mentioned by Mabughi and Selim in 2006. The Poverty Headcount Ratio has certain limitations, despite the benefits and the fact that they are widely used. This indicator does not distinguish the poor, as Chong et al. (2009) pointed out.

In addition, Sen (1976) stated that this indicator did not reflect any change in income distribution among the poor (violated the transferring axiom), which did not include a poor income deficit from the poverty line. The Poverty Gap Index is frequently used to overcome this restriction and is defined as "the average poverty line shortfall in the assessment of the non-poor and as a percentage of the poverty line" (Chong et al.2009).

Furthermore, there is also the squared poverty gap. This index is nearly the same to the former one which shows that poverty gaps are squared and the facts of inequality among the poor are revealed. The same three measures are used in their studies by Alvi and Dollar (2002) and Alvi and Senbeta (2012).

Nonetheless, the Poverty Gap and the Squared Poverty Gap focus more on overcoming certain limitation of the poverty headcount ratio Sen and Anand (1997) suggest the multidimensional approach. The authors argue that poverty "can not only involve a lack of material well-being but also the negation of tolerable living opportunities" (Sen and Anand, 1999). According to the United Nations, the multidimensional approach to poverty "is not only dependent on income but also on access to social services" (UN 1996). The United Nations therefore identifies the poor by applying a Multidimensional Poverty Index which considers not only monetary deprivation, but also other deprivations such as health and education. After that Yontcheva and Masud (2005) have used some

development indicators, such as infant mortality and illiteracy, as multidimensional approach towards poverty.

The Multidimensional Poverty Index, like the previous indicators, has some limitations. First of all, as Todaro and Smith (2012) pointed out, they do not have data on households and cannot identify household differences. Secondly, the same authors point out that the proxies used often provide input rather than output indicators, for example in education where only the year is taken into account instead of literacy. Moreover, the basic assets chosen for evaluating household living standards, such as a bicycle or a radio, are doubtful according to Todaro and Smith (2012). Finally, it hinders calculation through the use of a range of indicators expressed in various units (Mabughi and Selim, 2006). These limitations and the shortage of available information about certain poverty dimensions, lead to a preference for income indicators over multidimensional indicators.

### **2.2.1 The Causes and Consequences of Poverty**

Poverty shows various manifestations, including a lack of income and productive resources to ensure sustainable livelihoods, according to the United Nations (1995) and World Bank (1990). Hunger, malnutrition, increased morbidity, mortality from diseases, homelessness, unsafe and degraded environment, social discrimination and exclusion are all forms of poverty. People who are in abject poverty are usually excluded from participating in decision-making on civil, social and cultural matters. Women, children, the elderly, disabled, indigenous, refugees and internally displaced persons are most often vulnerable to poverty. In places where urbanization as a whole caused issues such as overcrowding, poverty is also rapidly growing. Consequently, poverty has different causes that could be more permanent (e.g. limited resources; lack of capacity) or temporary.

Yahie (1993) reports that the causes of poverty include more permanent structural causes which depend on a range of (exogenous) factors such as limited resources, lack of skills, local disadvantages, and other social and political development factors. This category includes people with disabilities, orphans, farmers without land and women's households; and (ii) transitional causes, mainly due to structural adjustment reforms and domestic economic changes, resulting in price changes, increased unemployment, etc. Poverty factors include: Inadequate access to employment opportunities ; inadequate physical assets such as land and capital and minimal access to credit for the poor, even on a small scale ; inadequate access to support rural development in poor regions ; inadequate access to markets where poor people can sell goods and services ; Low human capital resources ; the destruction of the failure to attract poor people to the development of development programs that affect their lives (Obadan, 1997).

The recent growth in poverty may be linked to macroeconomic distortions caused by globalization and liberalisation, which has aggravated the economic stagnation in several developing countries, especially in Sub Saharan Africa, where there has been little increase in production investments and employment in the last two decades.

One of the main causes of job losses and therefore of growing poverty is the Structural Adjustment Program (SAP) which has been implemented in many developing countries. Some people get poor on a micro level, because they lose their livelihoods or because their purchasing power declined. Poverty for many is a consequence of sudden shock: Loss of adult family income, confiscation of street traders from informal work; loss of home through demolition of illegally situated land or damaged by natural or human disasters; high cost of family diseases. Furthermore, a major source of poverty has been the civil war and the AIDS epidemic (Vanderschueran et al. 1996)

### **2.3 Definition of Foreign Aid**

White, (1997) defines aid as:

“Any transfer of resources from rich countries to poor countries which the former choose to call “aid”, i.e. any transfer the effectiveness of which is publicly assessed, though perhaps hypocritically assessed, in terms of the benefit to the recipient”.

Hoy (1998) described foreign aid as the benevolent donation of funds by rich nations to poor nations so that the poor nations can sufficiently meet the needs of its people. Morlino & Marro (2016) also defined aid as a voluntary transfer of resources from one usually a more developed country to another usually a developing country. The Development Assistance Committee (DAC) defines foreign aid as Official Development Assistance (ODA). They consider this definition as the technical definition of foreign aid.

They define (ODA) as a "transfer of concessional resources by official agencies that have as main objectives promotion of economic development and welfare and a grant element of 25% or more" (Cassen, 1994). Therefore, foreign aid is intended to improve the livelihoods of less developed economies.

Foreign aid can therefore be in the form of bilateral aid or multilateral aid. Bilateral aid flows directly from donor to recipient governments however, multilateral aid is channeled through an intermediary lending institution like the World Bank, IMF etc. (Abuzeid, 2009).

Therefore, foreign aid may take the form of bilateral aid or multilateral aid. Bilateral aid flows directly from donor governments to beneficiary governments, but multilateral aid is channeled through an intermediary lending institution such as the World Bank, the IMF, etc. (Abuzeid, 2009).

### **2.3.1 History of Foreign Aid**

The establishment of the OECD Directorate for Development Cooperation (DAC) and Development Cooperation (DCD) was an essential part of the creation of a network of national and international aid agencies and related institutions. The Marshall Plan's success has created considerable positivity in terms of external assistance to help poorer countries in quite different circumstances.

The Development Assistance Group (DAG), which was established in 1960, was a forum for consultations between donors on aid to less developed countries. Belgium, Canada, France, Germany, Italy, Portugal, the United Kingdom, the United States, the European Economic Community Commission, Japan and the Netherlands were members of this group. The DAG merged with the Development Assistance Committee (DAC) with the establishment of the Organization for Economic Cooperation and Development. The OECD Directorate for Development Cooperation (DCD) works with the DAC to formulate commitments to international development.

The United States was the source of more than 40% of total official aid to developing countries in 1960 / 61, and one-third from France and the United Kingdom (Fuhrer, 1994). The World Bank established the International Development Association (IDA) in 1960, with an initial subscription of approximately \$900 million, to provide poorer developing countries with very soft loans (Fuhrer, 1994).

In view of the impact on developing countries debt and burden-sharing considerations, the DAC was involved in improving and harmonizing the financial conditions of aid. The improvement in the coordination of aid was of great concern to the DAC and therefore approved the guidelines for

the coordination of Technical Assistance in 1966. The DAC also urged developing countries to place strong emphasis on promoting agricultural development and food production and to assist developing countries in this effort.

## **2.4 Ghana's Aid Profile**

Ghana is a British former colony that gained independence on 6 March 1957. The population of the country is approximately 26 million and 28.5% below the poverty line. For decades, Ghana has received support from bilateral and multilateral donors. Despite its fair share of military coups, the country can be described in the West African Sub-Region as one of the most stable countries. Ghana receives an average of \$1 billion per year, which represents approximately 10 percent of its GDP (Gross Domestic Product) according to the British Broadcasting Corporation (BBC News, June 2006). Although the country is heavily dependent on aid, according to a 2011 DFID report (DFID, 2011), it can be classified as one of Africa's success stories economically and politically. Multilateral aid to Ghana in the 1980s was at an all-time high, as institutions such as the International Monetary Fund (IMF) and the World Bank supported the country's economic reform program (ERP).

Over the years, multilateral aid has been aimed at improving infrastructure, governance and education in the country. In the last decade (2000-2011), governments have been transparent about the use of multilateral aid. Multilateral donor agencies such as the government and other local non-governmental organizations (NGOs) have worked closely to promote wealth creation, eradicate poverty, increase education levels and promote good governance. These objectives have been successful in Ghana, according to a 2011 DFID report (DFID 2011). Ghana's foreign aid is ongoing, but donor agencies, such as USAID, DFID and the World Bank, have indicated that aid

is being used and that citizens have benefited. This study analyzes data from these agencies in order to test the effectiveness of aid in Ghana.

## **2.5 Theories Concerning the Determinants of Aid**

There is a vast majority of African countries' literature on foreign aid. Various aspects and views have been expressed on the impact of aid on African countries and citizens. In his paper "The Determinants of Aid," Robert Zimmerman argues that aid literature can be divided into three categories of "aid allocation, aid effects and aid determinants" (Zimmerman 2007). I briefly summarize some of the theories and literature on the determinants of aid flows (i.e. the motivations of aid donors). Foreign aid theories from a realistic, idealistic or neo-Marxist perspective were widely discussed by foreign aid scholars. The idealistic paradigm says that "individual and State actors' motivation for cooperative relationships is more optimistic" (Schraeder et al. 1998). Humanitarian needs are considered important in the idealistic approach to foreign aid. The idealist strongly believes that foreign aid in third world countries can curb and alleviate poverty. The idealistic, economic and political perspectives are relevant to the study of the effectiveness of aid for the purposes of this study. These perspectives focus on the effectiveness of aid in African countries and how it will eradicate poverty and promote development.

"The aid policy is mainly driven by the strategic interest of nations or States," says the realistic paradigm, which was the main aid theory in the cold war era. International relations are established in a Hobbesian state in the primary, if not exclusive, objectives of security and self-preservation "(Schraeder et al 1998). The neo-Marxist approach concentrates on "assumptions on the central importance of economic interests in donor state foreign aid calculations" (Schraeder et al, 1998). The neo-Marxist paradigm suggests the 'north-south' relationship between the donor and the

recipient countries (i. e., third-world countries). It should be noted that the realistic paradigm focuses on the interest of donor agencies and countries in disbursing aid to African countries.

## **2.6 Theories and Literature Concerning the Effects and Effectiveness of Aid**

There is also a large range of theory and research on the impacts of the aid in addition to the theories on the determinants of aid. The 'big push' model is an early version. The "big push model," introduced in the 1950s, is based on the assumption that Africa is plagued by poverty and that the continent does not have the potential to develop without outside help. She explained it best Easterly (2005) when she argued that in order to develop the economy, the continent needs a big financial "push". This "push" should take the form of investments, since it will contribute more effectively to the growth of African countries than aid.

From an economic perspective, external assistance is necessary in order to satisfy two foreign-exchange short-comings or savings, which have depressed developing countries' growth rates below an acceptable ceiling (Lal, 2008). Deepak Lal argues that the aid theory is aligned with humanitarian and political aid theories in particular. He argues that aid packages and reforms will help eradicate poverty in many Third World countries. Jeffery Sachs is one of the advocates of that theory.

A number of studies have discussed whether aid is effective beyond general theories about the effects of aid. In most foreign aid literatures, corruption has been an underlying topic. Werlin (2005) points to the ineffectiveness of foreign aid as a result of African governments' corrupt nature. Dambisa Moyo (Moyo, 2009) presents an analysis that has been very much received by colleagues in her book, *Dead Aid: why aid is not working and how it is better for Africa*. The author is of the opinion that assistance does not improve but rather impoverishes the beneficiary

countries. She questions the world's need to donate assistance to poorer African countries, since "it is right to do or it is a duty," quotes Tony Blair, who says, "The African state is scar for world consciousness" (Moyo, 2009). The author suggests that African countries are no longer in need of help as they tend to become dependent and poverty-stricken. The issue of corruption is also addressed by Moyo, but cannot directly discuss the impact of aid upon ordinary citizens.

In its article, Robert H. Werlin argues that "poor countries are suffering from insufficient help rather than from poor governance quality" (Werlin 2005). The Author argues that although aid to poor countries around the globe is increased in the United States and other NGOs such as the United Nations and World Bank, it is not changing because a majority of these countries are corrupt.

There is so much corruption in African governments, a mixture of bad policies and governance. For example, Werlin (2005) reports that between 1964 and 2000, Zambia received millions of dollars in aid, while average revenue decreased from 540 dollars to 300 dollars. The increase in foreign aid over years has had no effect on living standards and economy in any way, Zambia has received more "assistance per capita than any other country." The author says that Africa is the source of extreme poverty due to the regularity of corruption. Regardless of how much aid is pumped into the economy, there would be no economic growth if corruption was not addressed. The Author proposes how donor countries and agencies should work on a country-by-country basis to achieve positive results. He maintains that the system of Nigeria is plagued by corruption, for example, and that the World Bank could simply stop lending. It also suggests that only if the country revises its public services, police and judiciary should aid be granted. The article of Werlin is important for studying external aid because it gives an insight into aid in many African countries and provides suggestions on ways to ensure the aid's effectiveness in donor and recipient countries.

"Can foreign aid buy growth? William Easterly in his paper 'The correlation between receivers economic policies and aid effectiveness' is discussed (Easterly 2003). For his argument, he uses the work of Burnside and Dollar (2000). He argues that "assistance in good political environments increases growth over a sufficiently short period of time." Easterly's external aid research and growth uses quantitative and qualitative approaches. He argues that the governments of poor countries do not "have the encouragement to increase the poor's productivity potential, particularly if that could lead to political activism threatening the political elite." Donor agencies like the World Bank promote the idea "just around the corner" of the positive effect of aid.

In his article "Turn off Foreign Aid" (Rahn 2003), Richard W. Rahn argues that, over the years, humanitarian aid was the most effective kind of aid. Rahn takes a different position and goes one step further by suggesting that humanitarian aid is the only successful type of foreign aid. On the other hand, development aid is, according to Rahn, an absolute failure. The author makes his claim by referring to Peter Bauer's work, which argues that countries in the third world do not need large amounts of aid to curb poverty. "All countries were once poor, and the rich countries became rich not only by foreign aid, but by the rule of law and the right incentives," he maintains. According to the author, in a country, the kind of political and economic system has a significant impact on support. It cites countries such as Singapore and Hong Kong which seldom received support but still have prosperous and successful economies.

The argument of Rahn is that third world leaders are using help to grow and enhance their own economies or livelihoods in their countries. Foreign aid is not needed in Third World countries, and States must "insert the right policies for capital attraction and economic growth." The author also criticizes organizations such as the World Bank that offer foreign assistance, which has no effects on citizens because government officials abuse the money. He regretted that organisations

that continue to offer support, do not hold these leaders accountable. Rahn closes his paper with proposals on how aid, if any, can affect the lives of the citizens of the recipient countries. He suggested that the USA, for example, moderates its "support for international organizations like the OECD, the UN, and the World Bank, which have programs that discourage economic growth."

Rahn's paper is important to the study of external aid as it points out the loopholes of the aid to countries of the third world and of the widespread pumping of foreign aid to third world economies by international donor organizations, such as the World Bank, which continue to wallow in poverty. It also provides alternatives to external assistance that will make states self-reliant and promote economic growth on a long-term basis. South and Rahn, (2011) also agree that the ineffectiveness of assistance and underdevelopment in the region is influenced by corruption in Africa.

In their article "Foreign Aid & Africa" (Karabegovic and McMohan 2006), Amela Karabegovic and Fred McMahan suggest that the United Nations (UN) and other non-governmental organizations aim to reduce poverty, diseases such as HIV / AIDS, and for decades to increase universal education in poor countries. The authors applaud the existing UN-MDGs and argue that the programme's success will contribute to poverty alleviation in Africa by 2015.

The United Nations suggests that "Africa needs significant increases in public investment, such as good roads, which, it claims, will lead to rapid productivity increases and therefore economic growth." The authors argue that current evidence shows that economic growth and foreign aid are not correlated in African states. The argument is that for decades, African countries have received foreign aid, but citizens' living standards have not increased. Because of the infusion of foreign aid in the economy, citizens have not invested or saved more. In most African countries, foreign

aid has not had a positive effect. The authors mentioned Rajan and Subramanian's works (2005). Easterly et al (2004) and Boone (1996) argue that aid in Africa has not had a positive effect for decades. These scientists have carried out extensive research on the African economy over several decades and concluded that the increase in foreign aid, policy reform and government restructuring has not helped to alleviate poverty and that the continent is poorer than it was a few years ago.

Peter Boone used a quantitative approach to discuss the relationship and dynamics between aid effectiveness and political regimes in his paper "Politics and the Effectiveness of Foreign Aid" (Boone 1995). The author argues that aid does not improve the living standards of the poor in the aid recipient countries, contrary to "human development indicators." It is all about "increasing government size" (p. 1). Boone argues that a recipient country's type of political regime can determine the impact of aid packages. The author's paper focused mainly on East Asian countries. This thesis will examine Ghana's political regimes, as mentioned earlier.

Funso Aluko and Dare Arowolo discuss the issue of "underdevelopment and dependence" on foreign aid in Africa with a case study of Nigeria in their research paper "Foreign aid, the third world debt crisis and the implications for economic development: Nigerian experience" (Aluko and Arowolo 2010). Their analysis is relevant for the study of foreign aid, as it provides an insight into the economies of third world countries and their impact. Aluko and Arowolo make a strong argument that foreign aid affects the masses in third world countries, irrespective of the type. They use a Nigerian case study to reflect how foreign aid and loans have harmed the economy and development of the country as a whole more than beneficial. They recognize that African leaders are misusing aid, which contributes to the failure of aid in African countries. They further intimate that "foreign aid is not and should not be regarded as a mere generosity or manifestation of a benign rapprochement between two countries. The recipient country should have designed a way of

dealing with the conditionality of aid and accommodating it, rather than complaining about its consequences, which they knew before taking such loans.”

The authors simply conclude that leadership in the beneficiary countries should be revamped and that this will be the basis for solving most of Africa's foreign aid problems.

In her article "Foreign Aid and the " Big Push "Theory: Lessons from Sub-Saharan Africa" (Abuzeid 2009), Farah Abuzeid uses a qualitative approach to discuss the impact of foreign aid on countries receiving a case study from sub-Saharan Africa. The author argues that large amounts of aid pumped into a country may harm the economy and overall state development more than good. She admits that the existing paradigm of foreign aid should be revised and that the new system should take a more nuanced view of international development. The author argues that the "big push theory," which interprets the pumping of large amounts of aid into third world economies, has been a failure over time. A comparison of aid flows with GDP over 50 years in Africa has shown that in most African countries there has been no significant increase in GDP. The author argues, "GDP has declined significantly in some cases." Abuzeid also argues that foreign aid in recipient countries indirectly affects governance in several ways. It "creates multiple public sector distortions, promotes the emergence of a "rentier state" effect and delays pressure for effective reform." The government should work to build stable institutions in order to achieve successful economic development in the recipient countries. This is going to be the basis for economic growth. Abuzeid concludes that since the last 50 years, foreign aid has not had a positive impact on the lives of people in third world countries. This suggests that donor countries and agencies should have a total overhaul of the 20 foreign aid policies.

In their article, Simeon Djankov et al., "Does aid help?"(Djankov et al. 2006) argue that the evidence presented over the years has shown that "foreign aid is discouraging" (p.1). The authors argue that foreign aid has a detrimental effect on a country's political system and reduces economic growth. They show empirical evidence that developing countries suffer from the foreign aid "curse of unnatural resources." Many African states receive large amounts of foreign aid in some cases, but these countries have little or no economic development or growth.

The authors discuss whether aid can contribute to economic growth. They propose a number of mechanisms that should be granted as loans to foreign aid in the form of grants. This will make the money efficiently used by governments. For example, if governments know they have to reimburse loans, it will make them more responsible and reduce the need for "rent". The authors conclude that the use of funds by governments should be held more accountable. They believe that giving recipient countries more loans instead of grants will help economic development a great deal. The article used qualitative and quantitative studies to demonstrate that more aid does not increase the effectiveness of aid. Institutions and countries of donors should investigate more effectively how to increase the impact of aid. More aid is not the solution; a criticism of this approach is that, even if such aid is granted in the form of loans, governments may not be encouraged to use it wisely, as they may feel that the repayment would be left to future governments. This may therefore not be a complete proof of the effective use of aid.

In his article, Ranis (2011) argues that the current economic crisis has a negative impact on foreign aid. In the last couple of years, aid to third world countries has fallen. Ranis argues that in the last couple of years, the United States and international organizations have promised to increase aid, but have reneged on the pledge. In most third world countries, there have been several reasons for the failure of foreign aid. There were too many and ineffective conditions associated with aid in

the developing world. Ranis suggests that at some point in time there were as many as 60 conditionalities associated with foreign aid. The introduction of the Poverty Reduction Strategy Paper (PRSP) helped to reduce these conditions to 30, but Ranis argues that this did not improve the effectiveness of the aid.

Ranis argues that aid has had a negative impact on the recipient countries because of the "confusion" caused by non-governmental organizations entering the recipient countries. He argues that these NGOs work with "different recipient country agents, competing for projects and providing conflicting advice, increases the cost of transactions enormously and contributes substantially to the disappointment with a process that was once seen with such optimism in the 1950s." The NGOs are muddling into the recipient countries' affairs, which reduce rather than increase economic growth. Ranis suggests that the current structure, process and policies of foreign aid are defective and that new measures should be adopted to improve aid. This will contribute a great deal to reforming foreign aid and its effectiveness.

The article by Haroon Ashraf, "Aid will only help if African countries initiate reform" (Ashraf, 2001), analyzes the report of the World Bank of 27 March 2001. The author suggests that "development assistance in poor countries has little or no positive influence to avoid economic reforms that could help alleviate poverty and improve health". The leaders of the beneficiary countries must be committed to reform in order to make a positive difference in the economy and in all their countries' development.

In a study conducted in 10 sub-Saharan African countries: Cote d'Ivoire, Ghana, Kenya, Zambia, Ethiopia, the Democratic Republic of Congo, Mali, Tanzania, Nigeria and Kenya, research has shown that Uganda and Ghana have been able to reform their systems effectively, so foreign aid

has helped reduce poverty and increased development. The author proposes that aid should be increased if countries demonstrate reform and have a policy reform strategy in place. There is no empirical evidence in Ashraf's article to support his research. He comments on the World Bank report, but fails to present tangible solutions on how to restructure their systems in the failed beneficiary countries.

Scientists suggest that foreign aid has been effective and that donor countries and agencies should continue to pay aid to poor countries. These authors believe that donor countries and agencies must be committed to more foreign aid in order for Africa to develop. Lindsay Whitfield investigates the economic and political consequences of aid in Ghana in her paper "Political consequences of aid: The Embedded Aid System in Ghana" (Whitfield 2006). The author argues that donors have not understood why aid in African countries is failing. She suggests that the debate should shift to the political impact of aid. An understanding of the African system helps donor countries to disburse foreign aid strategically. This literature makes an excellent contribution to Ghana's aid literature. The paper discusses how aid in some African countries, in particular Ghana, has been successful. Social, economic and political factors should be taken into account in their entirety in order to discuss the failure of aid in African countries and how to improve the distribution of aid.

Article by Alberto Alesina and David Dollar "Who helps and who and why?" searches the pattern of the allocation of foreign aid from different donors to receiving countries" (Alesina and Dollar 2000). The authors argue that foreign aid is determined by several factors: Social, political and colonial factors are all involved when donor countries disburse aid. Whitfield (2006) also advocates taking into account political determinants. Alesina and Dollar addressed relevant issues such as: Why donor countries provide aid? The authors argue that they "find significant evidence that political and strategic considerations dictate the pattern of aid". For example, Ghana receives

a majority of UK aid due to its colonial ties. According to the United Kingdom's DFID, the operational plan document for Ghana, support for several projects such as poverty alleviation, treatment of malaria, education, etc. (DFID 2000) is given to the Ghana government.

Alesina and Dollar study donor patterns in Germany, Japan, France and the United States in particular. They examine the bilateral aid granted to beneficiary countries by these donor countries and the determinants used to disburse aid to these countries. The authors use variables such as the colonial past, the "friend" of the United Nations, links with Egypt and Israel, the recipient's income, openness, democracy and religion to determine why donor countries provide assistance. This research focuses on bilateral and multilateral aid to Ghana. To determine the impact of aid, variables such as economic, political, social and colonial links will be used.

Alesina and Dollar's study results are interesting and compelling. Their findings show that "foreign aid was only partially successful in promoting growth and reducing poverty at best." The type of political regime does not determine whether or not the beneficiary nation receives aid. This article contributes greatly to the study of foreign aid. The relationship between donor countries and beneficiary countries is very important because it determines the level of foreign aid. The authors agree that the aid was only to some extent effective, but they are optimistic about the efficiency of the aid.

Authors like Eastern, Moyo, Boone, Werlin, Aluko and Arowolo, Abuzeid and Ranis believe that foreign aid in African countries has not been effective. According to these authors, the mechanisms established to ensure accountability and the effectiveness of aid established by donor countries and agencies have failed. Ranis argues that there are too many of these mechanisms or conditions. Easterly argues that conditions have not changed and that aid simply does not work. Werlin (2005),

Moyo (2009) and Easterly (2004) agree that the failure of foreign aid plays an important role in corruption.

Whitfield, Alesina, Dollar and Ashraf suggest that aid is effective in African countries and that foreign aid should continue to be paid by those donor countries and agencies. The argument is that poor countries can alleviate poverty over time if donor agencies continue to provide assistance. The conditions established by donor agencies and countries were very effective and helped to ensure the effectiveness of the aid. The payment of aid in installments is a very effective mechanism. Installments are paid after officials on the ground inspect the projects which also helps to reduce corruption. The authors suggest that with or without foreign aid, there is hope for Africa. African countries must assess how they deal with the rest of the world. This is the only variable that will help Africa to overcome poverty.

Although laudable, the argument presented by Moyo et al., (2011) seemed to have failed over the years. The reduction in foreign aid in African countries has not changed effectively. Many states are likely to have deteriorated economies. The idea that reducing or weakening African countries' aid will help African economies is more a myth than a reality. African countries as a whole can be defined as "work in progress." Mistakes in the methods of disbursement of aid and its use have been made by both donor agencies and recipient states, but the authors must recognize that the cancelation of aid is not the best option.

For example, Moyo (2009) is pushing for the cancelation of African aid in its entirety because of its inefficiency. This solution will crush African economies and back the continent for a number of years. There are many conditions usually linked to foreign aid; Werlin, Eastern and Ranis all argue that foreign aid is ineffective. A review of the structure and administration of aid will help

to make foreign aid in African States more effective. Corruption also plays a very important role in aid ineffectiveness, the authors argue. Funds misappropriation has rendered aid in the region ineffective. Aid money is syphoned by government officials and is not used for the intended purposes, and this is one of the donor's main concerns.

Whitfield (2006), Alesina and Dollar (2010) and Ashraf (2001) argue that foreign aid was effective and that African states benefited enormously from aid. African countries such as South Africa, Kenya, Nigeria, Ghana and Ivory Coast have benefited from foreign aid in one way or another. These scholars contradict Moyo et al., (2011), arguing that the conditions imposed by donor agencies and countries were very effective. The argument is that foreign aid contributed to the development of African states and economies. These authors' optimism shows that the continent has hope. The authors suggest that aid can be used to achieve development in the region, which is why more foreign aid is being pushed.

The above literature has shown that Africa has had some successful stories overall, but most nations are still wallowing in abject poverty, even though they have received aid for decades. Both schools of thought have very compelling arguments, but a perfect solution to the problem of aid has not yet been found.

The literature also shows that foreign aid is needed to reduce the continent's poverty. However, many studies highlight the potential impact of corruption in reducing the effectiveness of aid, as noted. My research focuses on the effectiveness of aid for ordinary Ghana citizens. The argument is that aid in Ghana has been successful. On the basis of the literature review, I expect that the levels of corruption can be linked to different levels of effectiveness of aid.

## **2.7 Impact of Foreign Aid on Poverty Reduction**

If properly managed, foreign aid could generate economic growth and reduce poverty and, in the long term, reduce the burden of seeking aid and making it self-sufficient. According to Baner (1967), cited in Miere (1970), foreign aid to less developed countries is essential to their development because of their poverty, which is strengthened by the savings gap, the gap in foreign exchange and the limits of their absorption capacity. In view of these factors, the granting of aid is considered a moral obligation and sometimes also a restitution of past mistakes.

### **2.7.1 Advantages of Foreign Aid**

Foreign aid has been a great tool for developing countries. It is impossible to overemphasize the role of foreign aid. Several reasons for the need for foreign aid have been given. Most of the aid is intended to support economic reforms and improve production methods and improve the living standards and development of developing countries (Recci, 2014). Foreign aid contributes to the supply of public goods in developing countries. Despite their rich resources, developing countries cannot supply public goods such as education, transport systems or drinking water networks. Private investors are not willing to provide such services on a large scale. Foreign aid therefore can be a substitute for private capital (Recci, 2014). Foreign aid has the ability to free countries stuck in the 'poverty trap' thus, in the situation where a country lacks capital to a point where it is too poor to achieve robust high levels of economic growth and in some instances simply too poor to grow at all (Faye et al., 2004).

Private investors are not prepared to provide such large-scale services. Therefore, foreign aid can replace private capital (Recci, 2014). Foreign aid can free countries stuck in the "poverty trap,"

where a country lacks capital to the point where it is too poor to achieve robust high levels of economic growth and, in some cases, simply too poor to grow (Faye et al., 2004).

### **2.7.2 Disadvantages of Foreign Aid**

There have been a number of arguments about the effectiveness of foreign aid despite all the advantages of foreign aid. Most people believe that foreign aid has no real impact on developing countries' economic development. Aid is lost in countries with no technical or administrative skills and is used appropriately (Recci, 2005). It is impossible to overemphasize the imminence of moral danger. For the purpose for which it was received, most developing countries do not use the aid funds. The aid received is sometimes used to finance unproductive projects. The construction of hospitals and chips compound for many years without meeting the health needs of people is a typical example in Ghana.

In other cases, developing countries' dependence on foreign aid reduces their sovereignty in the sense that donor countries can indicate how aid should be used which may be not in the best interest of the nation. At times, employment and other productive sectors of the economy restrict their levels, which will leave the country in a lamentable state in the long term and classify it as the country that is seeking support because the situation is even worse despite the aid (Recci, 2005).

### **2.8 Theoretical Review**

Rostow (1956) argued that strategical action should be taken to manage the natural, physical and human resources of developing nations together while ensuring the development of a vibrant and expanding industry.

The theory of modernization that was the basis for foreign aid essentially suggests that developing countries simply needed a capital injection (aid) to stimulate economic growth. That is to say,

foreign assistance is being provided to developing countries to fill their savings and investment periods and should therefore act as growth facilitators.

According to the Harrod-Domar equation growth is dependent on savings (both domestically and internationally) financed investment. If domestic aid results in a positive way, then it can be stated that aid will increase economic growth. In the alternative, aid is likely to be detrimental to developing countries' economic growth.

The Harrod-Domar growth model states that, despite the ready availability of labor in developing countries, low productivity due to insufficient capital supply tends to restrict economic growth. Morrissey (2001) also supported the argument increases, according to which a country uses its domestic savings to finance productive investments, since domestic savings determine the amount of capital available for productive investment. Therefore, the absence of domestic savings was seen as a significant constraint to economic growth in developing countries. Meanwhile, in the following growth models, the importance of aid is reflected.

### **2.8.1 Harrod - Domar Model**

Aid would increase economic growth by raising capital levels and thereby improving domestic savings and investment, according to Harrod-Domar's growth model. Early aid theories were attributed to a nation's ability to grow. The economist Roy Harrod & Domar in the 1930s can be attributed to a modern theory of growth. The first study on the effectiveness of foreign aid in developing countries is said to have been carried out. In their study, they emphasized the role of accumulation of physical capital in determining economic growth.

This meant that developing countries had a savings challenge, creating a gap to fill with foreign aid. The Harrod-Domar model suggests that the rate of economic growth depends on the savings level and the capital output ratio.

A simplified model of Harrod- Domer:

$$\text{Rate of economic growth (g)} = \frac{\text{Level of savings (s)}}{\text{Capital output ratio (k)}}$$

He argued that higher savings make for higher investment and a lower capital output ratio would result in better investment and higher growth rates. However, this is a challenge for developing countries, which means that savings from developing countries will result in economic growth. It is therefore necessary for external aid. However, researchers have criticized this theory. Harrod & Domer (1930) based their model on the post-depression years of industrialized countries. He later rejects his model because he feels it does not provide a long-term growth model, and the model ignored factors such as labor productivity, technological innovation and corruption levels.

### **2.8.2 Two Gap Theory**

However, the Harrod- Domer model was the foundation of other theories. The "two gaps theory" which seems to be supported in Harold-Domer's growth model was proposed by Chenery and Strout (1968). This two-gap theory is one of the most important theories on the effectiveness of foreign aid. This model poses a constraint on foreign exchange for the import of capital goods, apart from the challenges in saving developed countries are confronted with. Therefore, foreign aid provides the necessary capital goods import funds. They also noted a technological and managerial gap which can be used to produce effectively.

The two gap model defines growth rate as:

$$\text{Rate of economic growth (g)} = \frac{\text{Level of Savings (s)}}{\text{Capital output ratio (k)}} + \frac{\text{Foreign Capital Inflow Ratio (f)}}{\text{Capital Output Ratio (k)}}$$

The two gaps are based on the conditions in which savings and investments are not equal, especially when savings are less than investment. The model of both gaps assumes a linear relationship between investment and short-term savings. The savings gap is linked with the currency gap due to the export impossibility creating problems with the balance of payments. In order to grow and improve livelihoods, developing countries need to fill this gap. In order to make the required foreign exchange fill the gap, they must therefore increase their exports. However, this model was a target of criticism, but it was also open to other researchers.

### 2.8.3 Solow Growth Model

Robert Solow's 1956 Solow growth model concentrates on long-term economic growth. He affirmed the key to economic growth was saving and investment. Savings and investments increase capital stocks unintentionally, thereby increasing full employment, domestic revenue and production. This model is a pure production economy in which international trade is absent, production factors are fully employed, and the rate of labor growth is constant. Solow's growth pattern is a model for accumulation of capital in a pure production economy based on the assumptions: no international commerce, full employment of all production factors, constant growth of labor force and constant use of technology for the production of a commodity.

The growth function is given as:

$$G = snf(k)$$

Where g= growth, s= savings, n= labour growth rate, k= amount of capital per worker.

The capital output ratio ( $k$ ), the labour growth rate ( $n$ ) and the growth rate depends on the savings rate. An increase in the savings rate will lead to a higher economic growth.

The Solow growth model predicts that the higher the population growth rates and lower savings will be equal to investments associated with lower growth levels and standard of living.

## **2.9 Empirical Review**

Baulch (1996) insinuated the failure to understand how much aid is intended for people considered to be poor hinders the study of effectiveness of aid in reducing poverty. The poor are allocated between approximately 15 and 20% in the development countries. The literature on the efficiency of aid, Masud & Yonchtva (2005), has also claimed that it focuses almost entirely on the macroeconomic impact of aid and assesses the impact of aid on economic growth, savings and investments. The analysis framework is robust and therefore heavily dependent on empirical research.

There has been a long-standing discussion of the impact that foreign aid has on poverty levels. According Masud&Yonchteva (2005), three main arguments were put forward to explain the disappointing results of the majority of studies on aid efficiency; support is incorrectly distributed (donors give aid for strategic reasons to the wrong recipients), support is misused (the recipient states pursue non-development plans). Massud & Yonchteva share the same view (Victor, Okoronkwo, & Eyitayo, 2016). They evaluated the effectiveness of foreign aid in Lagos for poverty using both primary and secondary sources of data. They also found serious challenges in combating the effectiveness of external aid in reducing poverty. This means that the aid is misappropriated, that there are not enough statistics and that it is difficult to identify people to profit. In developing countries, these challenges are very common.

By its influence on human development indicators, Masud & Yonchteva (2005) assessed the effectiveness of the external support to reduce poverty. They have used bilateral and non-governmental support flows as a dataset. They deduced that the support provided to NGOs reduces infant mortality, however, the impact on analphabetism was less significant than bilateral aid. Masud & Yonchteva, (2005).

The critical role played by aid effectiveness in poverty reduction has been highlighted by Burnside & Dollar (2000) and Alesina & Dollar (2000). They pointed out that in the aid allocation criterion, the quality of policies and institutions in recipient countries plays an important role. Governments can contribute to the amount of aid a country receives through strong institutions and good policies. However, this is not the case since most poor countries do not have highly good governance systems that limit the support they receive (Koch, Dreher, Nunnenkamp, & Thiele, 2009). If not, the causal relationship between governance and poverty exists significantly in reverse (Collier, 2007). Thirlwall, (2011) believes that support should be provided per capita. This ensures that every country receives the aid it needs at its per capita income level. However, (Asra, Estrada, Kim & Quibria, 2005), it is not solely dependent on the governance and macroeconomic policy quality that aid affects poverty. But they claimed that macroeconomic policies are very significant in reducing poverty. Dalgaard & Hansen (2001) appear to agree with Asra et al. that, independent of the political environment, foreign aid contributes positively to economic growth.

Foreign aid is seen as an essential tool for enriching poor countries' development prospects. Foreign aid inflows should be encouraged and its effectiveness enhanced by Hansen & Tarp, (2001) to mitigate poverty, boost economic growth and increase living standards. Aid for poverty reduction and growth is more efficient if its allocation is inspired by a poverty-focused Matties perspective, (2013). Therefore, positive results can be achieved when aid is allocated in specific

areas to reduce poverty. Poverty reduction could be strengthened through a focus on direct channels for poverty reduction support Senebata (2009). The composition of aid can also contribute to poverty reduction, according to Senebata (2009). Multilateral aid decreases poverty in comparison with bilateral aid, he said. Subsidies also reduce poverty levels more efficiently than loans.

### **2.10 Trends of Foreign Aid to Ghana.**

Ghana's foreign aid is not a new phenomenon, since Ghana was dependent on aid since the 1960s. Ghana became independent of the British and the country has been ruled by Ghanaians since 1957. Dr. Kwame Nkrumah was Ghana's first president. He tried to develop the country by providing basic services such as electricity, roads, infrastructure, industry, etc., Woode (2012). Since expenditure increased more than revenue, we lost the reserves. This put an enormous toll on our income. Until now, Ghana has had official development assistance (ODA). Net ODA and government support from 1960-2015 received an average of \$1,768,290,000 (OECD, 2015).

In particular, Dr. Kwame Nkrumah was not interested in foreign aid after independence, since he tried to make the country truly independent without relying on assistance. However, this was short-lived, since there was a balance of payments crisis between 1965 and 1966 (Quartey, 2014). Ghana therefore approached the IMF for help. The IMF. The country increased aid inflows from 1960 to 1965 as a share of gross domestic product (GDP), although most of these flows were used to pay off accumulated trade debt.

These foreign aid flows did not improve the country's balance of payments, as aid typically received loans instead of grants. Foreign debt increased by \$1.407 million (Harrigan and Younger 2000), from \$895 million in 1975. This is due to the depletion of the country's reserves and the

collapse of the cocoa sector in the 1980s by the country that adopted a program for economic recovery and an adjusted structural programme. However, the ERP and SAP have produced positive results with large inflows of foreign aid to the country. In the mid-1980s, Ghana received massive aid of almost 730 million dollars in 1991, compared to less than 2000 million dollars between 1995 and 1986 (Osei et al. et al., 2005).

This was necessary in 2002 because the ratio of gross government-income debt to GDP increased to 142.6 percent by 2001, and Ghana signed an initiative for the poorest highly indebted country. International aid continued to grow between 2004 and 2007, reaching an average of \$990 million per year (Ashong and Gerster 2010). Since then, the country has received several forms of aid. In 2016, Ghana received foreign aid of \$2.9 billion (OECD, 2017). In order to achieve a real reduction in the rate of poverty, gross national product (GDP) must grow by more than 7 percent per year (Strategy 2003).

The question remains whether all these aid flows affect the reduction of poverty. Ghana's poverty levels are still high, despite recent improvements. However, Ameyaw Domfeh & Ngyimah (2009) found that their impact on poor farming communities is very small and attributes this to the lack of involvement of local people in the formulation of policies. In Ghana, Adom (2015), many poor interventions have also shown that the proliferation of donor agencies in Ghana is not well coordinated. The study was very informative about the impact on poverty of foreign aid.

### **2.11 Total Aid Flows: Trends**

The adjustment of the Marshall Plan in Europe and its success in the early 1950s paved the way for aid to the poorest African countries. The success of the plan has led donor countries and agencies to believe that foreign aid can help developing countries to achieve the status of

industrialization and that aid is an economic growth path. Between 1960 and 1980, most donors tied aid to the recipient country's type of government and ideology. For example, the United States did not give much help to Ghana because after independence, the Nkrumah government adopted a socialist ideology. However, between 1980 and 2000, US and total aid increased to Ghana, as democracy was fully adopted in 1992 and the economy of Ghana became more market-oriented. The Kufour government's adoption of the Highly Indebted Poor Countries (HIPC) initiative in 2000 led to a further increase in foreign aid from the World Bank, the International Monetary Fund, the United Kingdom and the United States.

According to Gyimah-Boadi and Yakah (2012), the inflow of aid to Ghana increased from approximately \$1 billion to \$1.9 billion between 2003 and 2010. Aid increased from 13.2% in 2003 to 14.6 % in 2009 and dropped slightly to 12.8 % in 2010” (GyimahBoadi and Yakah 2012). The Millennium Challenge Corporation has also infused Ghana's economy with a lot of foreign aid. On the other hand, in 2010, Ghana received its highest foreign aid.

## **2.12 Aid Programs from Specific Donors to Ghana**

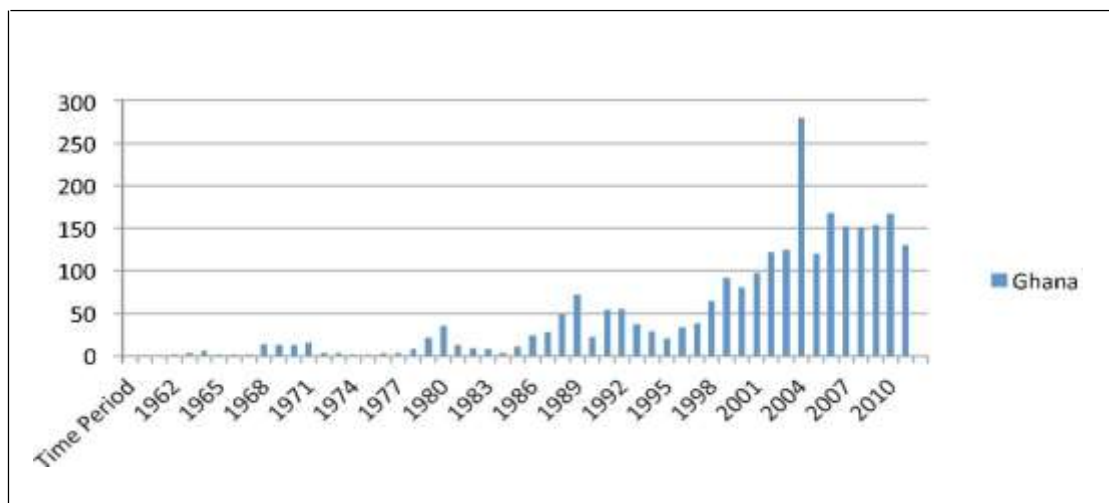
### **2.12.1 The United Kingdom as a Donor**

As noted, the colonial heritage of a country can affect the payment of aid. Ghana is a British colony gaining independence on March 6, 1957. The UK has supported Ghana's economy since independence because of its colonial ties. DFID, United Kingdom through its development agency. Millions of foreign aid have been paid out to help Ghana's government and its citizens. Non-governmental organizations in Ghana have received funding to support their agenda, such as funding for education for young girls, malaria eradication, and supporting government reform to promote economic development. Retired Honorable Andrew Mitchell, Britain's Secretary for

International Development, also noted that "Great Britain's aid will aim to kick - start growth and development in the poorest areas, helping 50,000 entrepreneurs and businessmen to market their goods" (Mitchell 2013).

In a speech in February 2011, the United Kingdom Minister for Africa, Henry Bellingham, reported that both countries have an outstanding relationship because of their shared history. Bellingham (2011) noted, "The UK-Ghana relationship is strong and vibrant, much like the beautiful city of Accra. It is rooted in our long-standing economic, political and cultural ties, shared values and profound ties between our peoples. Mitchell (2012) also argues" ... Ghana shows that political and economic stability works well-targeted, long-term development. British support has played an important role in this, ensuring that Ghana aims to reduce extreme poverty by half by 2015. Aid must always be a means of achieving an end-the end is a prosperous future when countries no longer need to rely on international aid. "This point is echoed in Ghana by Osei et al. (2005), who argue that British aid has been used sensibly" (Osei et al. 2005).

**Figure 2.1: Foreign Aid from the United Kingdom to Ghana 1960-2011**



Source: OCED DAC (various years)

Note: Amount shown in total current U.S. millions of dollars

Figure 2.1 shows the total amount of aid paid to Ghana by the British government between 1960 and 2010. The levels of aid in the 1990s remained negligible and only exceeded US \$50 million annually in two years, 1980 and 1998. However, aid levels have increased in recent years, with the 2004 peaks. Since 2000, the higher levels of aid may be due to the constant improvement of bilateral relations between Ghana and the United Kingdom, as well as the success of Ghana in achieving prior aid targets.

It is useful to examine some of the initiatives supported by DFID, the British foreign aid agency, in order to gain a better appreciation of the UK's aid to Ghana (see Table 2.1). The main areas in which DFID invests are wealth creation, transparent and accountable management and "improving the results of human development" (DFID 2012, p. II). According to DFID in 2009, approximately 60 percent of the aid was provided by "general budget support," while 25 percent was paid by "sector budget support," which focuses primarily on health and education. The agency's operational plan to reduce poverty in Ghana by 2015 was implemented from 2011 to 2015 (DFID 2012). The operational plan was also intended to bridge the gap between the country's northern and southern parts.

Summary of some DFID Aid Programs in Ghana

**Table 2.1 Total Number of Aid Recipients in Ghana)**

Ghanaians using family planning	525,000
Producers accessing business services	50,000
Number of mosquito nets distributed to help prevent malaria	4.75 million
Number of children supported in basic education	140,000
Number of girls staying in school through providing them incentives to remain in education.	70,000
Number of people who were helped to vote through support to the 2012 national election	11,246,982

*Source: DFID Operational Report, June 2013*

The results of the aid have been very positive, according to the operational report of the DFID (2013): Government institutions have been strengthened, the economy has grown, living standards have improved and basic education is on the rise. Importantly, DFID holds governments responsible for the aid they have received, and this measure of accountability has been linked to successful results in Ghana.

Although in a later section of the chapter we will discuss aggregate aid effectiveness indicators, it is useful to briefly note some of the specific results reported by DFID in Ghana. The program "School for Life" of the DFID encouraged and supported children to attend primary school. According to DFID estimates, as a result of this program, a target of 70,000 out of 140,000 remained enrolled in school (DFID 2013). The DFID reports that it is committed to educating children out of school, which will help to reduce poverty in the long term.

The agency has also championed the cause of fairer tax systems, open markets and growth in the private sector. For example, DFID has helped the Brong Ahafo Market Women Association campaign for "fair tax systems" in their region, and the fragmentary evidence suggests that this

has been successful. The association's chair, Cynthia Mensah, argues that "my business and that of other women in the market is better because we have spoken and taken action. We are now also able to provide our families with stable incomes "(DFID 2013). Small-scale loans to companies have helped the private sector a great deal.

The DFID also bridges the gap between Ghana's north and south. The agency supports businesses in the north in order to "stimulate economic growth and create jobs, which will help improve the competitiveness of businesses in Ghana" (DFID 2013). As a result of the disbursement, one aid recipient in Northern Ghana was able to employ more than 153 people. According to the agency, helping small businesses grow will "help improve the competitiveness of Ghana's businesses" (DFID 2013). The DFID's "private sector-led growth" will help create numerous jobs, increase returns and the provision of relevant goods and services.

DFID's assistance has also helped to strengthen civil society. The Ghana Program "Strengthening Transparency, Accountability and Accountability" (STAR) was a key entity in promoting the need for a stronger civil society. The Agency attached great importance to the strengthening of civil society and reported the need of working with civil society to help them better engage in the formulation, implementation and monitoring of the policies of the Ghana government (DFID, 2013). For the last couple of years, civil society groups have been stronger. The Agency's monitoring and evaluation of programs to ensure accountability and eliminate corruption was the key to DFID's success in aid effectiveness. The agency has mechanisms to monitor and monitor all programs in order to ensure efficiency. In addition, the 2012 election helped more than 11 million citizens to register and vote. The DFID launched programs that educated citizens about the importance of civic responsibilities such as voting. These figures show how the developing country has made progress and how foreign aid has oriented the country towards development.

The statistical reform of the Ghana government is financed by DFID. The agency has provided staff to work with the World Bank to establish a strong statistical service in Ghana. "National statistics system to increase the quality, accessibility, timelessness and relevance of official poverty reduction statistics," according to DFID (DFID 2013). "Driving robust discussions between donor and government on monitoring and evaluation" has been successful. The data show that Ghana is on the road to development by using foreign aid effectively. DFID's strict measures and criteria for ensuring the effectiveness of foreign aid pay off in Ghana. The eradication of poverty in the country has become operational and positive signs of development exist. The annual report of the DFID shows progress in the economy of Ghana, although there is room for improvement.

### **2.12.2 The United States as a Donor**

The United States is probably Ghana's second largest donor after the United Kingdom. The United States is committed to supporting Ghana's consolidation of democracy, economic reform, access to education for all and the strengthening of the private sector. USAID reports (USAID 2011) "Ghana's annual growth rate of more than 14 percent in 2011 has led the country to become one of the fastest-growing economies in the world and to achieve a middle-income status. US support will support activities that: Build the capacity of citizens to participate in local government and strengthen the capacity of local government to deliver services effectively; Improve the health status of Ghanaians; improve the quality of education in primary schools; and promote economic growth in Ghana and improve food security in the region.

Although it is difficult to obtain long-term data on USAID disbursement to Ghana, some of the recent data reveal the priorities of the United States as a donor. USAID spent a total of \$87 million

in foreign aid to Ghana in 2011. Of this amount, \$2 million was earmarked for democracy and governance, \$19.3 million for economic development, \$11.7 million for education and social services, \$1.8 million for the environment and \$52.6 million for the health sector. Interestingly, the U.S. aid program's priorities in Ghana have become more diverse over time. In a study of US aid to South Africa, Uganda and Ghana in the 1990s, Hearn found that "in Ghana, USAID proposes to spend \$6 million over five years on building the capacity of local civil society organizations through training in organizational management and lobbying skills" (Hearn, 1997).

In accordance with British DFID reports, USAID has noted favorable results for its aid programmes. The Ghana government has paid more attention to climate change, which has been downplayed in Ghana over the last decade, due to aid flows aimed at research into environmental sustainability. In addition, micro-finance loans to small businesses owned by women helped them to expand their businesses. In the health department, USAID has also made efforts to train medical personnel; educate citizens about HIV / AIDs and how to prevent the disease. The agency has also made patients who have contracted the disease accessible to medicine.

The payment of aid to Ghana by USAID has helped many citizens gain access to health programs that have not been available. For example, in the Brong Ahafo and Upper West regions, there were a few clinics that took care of thousands of patients in one of two nurses, but the agency's aid disbursements helped to improve this situation. Both regions have main hospitals and patients are treated with more doctors and nurses (USAID 2011; 2013).

Economic and local government reform has helped the economy develop and when passed in the legislature, laws are easily implemented at the local level. Due to the efficient training of their staff, regional ministers can effectively carry out their duties.

Finally, a key point to remember is that USAID has tended to use conditionality as aid programs, similar to the DFID programme. The program not only seeks to increase accountability and transparency, but there is evidence of reductions in aid when corruption is identified (USAID 2011).

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The chapter three of this research discusses the method used in assessing the impact of foreign aid on poverty reduction in Ghana. The type of data used and a description of the data source are also discussed in this chapter.

#### **3.2 Research Method and Approach**

I have chosen to conduct this study according to the principles of qualitative research from the research methods used in social sciences. Firstly, the lack of adequate quantitative data cannot be used to answer the research question of this study using econometric models. Secondly, I am convinced that the field requires more qualitative research in light of the limits of the multiple regression analyses conducted on the subject, especially taking account of the narrow range of the case study.

This study uses a deductive research approach. The theoretical Framework on the impact of foreign aid in the fight against poverty was developed in rural Ghana in the context of a comprehensive literary review.

#### **3.3 Data Analysis**

Data analysis of secondary data is a strong foundation for this study. The lack of time and opportunities prevented primary information being collected from the project's final beneficiaries (the rural poor). This study uses secondary data from development indicators of the World Bank and the Ministry of Finance Ghana.

### 3.3.1. Secondary Data

This study mainly used secondary surveys, supplemented by studies conducted by United Nations, World Bank and the Ministry of Finance used in the description of general and rural poverty incidences in the country. The possibility of data triangulation through the availability of alternative sources was particularly important to ensure the creditworthiness of obtained statistical information from public sources. Regional and sectorial poverty reduction data were provided both from the Ministry's official website and programs monitoring and evaluation reports. In addition, updated ODA statistics databases of the World Bank were useful and especially important because such data were not provided by the finance ministry.

### 3.4 Research Model

The fundamental outline of the model used in the study is discussed in this section. The model stems from a productive function that introduces foreign aid as an input, as well as labor and domestic capital. The production feature can be denoted as follows in the usual notation:

$$Y=f(L,K,A).....1$$

Gross domestic product (GDP) in real terms is indicated by Y, Labor input is indicated by L, domestic capital stock is represented by K, and the stock of foreign aid is represented by A.

Assuming equation 1 to be linear in logs, the subsequent expression describes how the determinant of the growth rate of GDP (real) is obtained:

$$y=b_0+b_1l+b_2k+b_3a+e.....2,$$

The small letters indicate growth rate of the single variables. The capital stock growth rate is estimated by the part in GDP based on the example set in many earlier studies. Moreover, the amount of labor change has also been swapped by the population growth rate (Karras, 2006).

### 3.5 Data Analysis

A multiple linear regression model will be used in this study to evaluate the impact of foreign aid in Ghana in reducing poverty. In addition, a number of other variables which are often supposed to have a satisfactory effect on growth are also factored in the regression model.

### 3.6 The Models

The study aims to determine whether aid to poverty reduction in Ghana is effective. The study therefore adopted a simple literature model and added a support variable as another factor in poverty. The two main determinants of poverty are Gross Domestic Product and Economic growth Ravallion and Chen (1997). Their model is extended to include a help variable as the third determinant for this study. Therefore, Equation (1) gives our model of base:

$$POV_{it} = \alpha_i + \beta_1 Y_{it} + \beta_2 INI_{it} + \beta_3 BAID_{it} + \varepsilon_{it}$$

All variables are expressed in natural logarithms.  $POV_{it}$  measures poverty in country  $i$  at time  $t$ ,  $\alpha_i$  is the  $i$  country-specific effect,  $Y_{it}$  is the GDP per capita of the country at time  $t$ ,  $INI_{it}$  is the Gini coefficient for country  $i$  at time  $t$ ,  $BAID_{it}$  is the ratio of the bilateral aid to GDP and  $\varepsilon_{it}$  is an error term. In most development works, economic growth is extensively viewed as the essential condition for poverty reduction, we therefore expect  $\beta_1$  to be negative. However, the inequality effect is likely to encumber poverty reduction. Hence, we assume  $\beta_2$  to be positive. Finally,  $BAID_{it}$ , which is our variable of interest, is estimated to have a negative coefficient.

This study also discusses additional ways in which external aid can influence poverty reduction in the developing aid beneficiaries focusing on policies and institutions that contribute to the entire poor. The study also considers that some government policies contribute to increasing poor productivity. In addition, Ghana needs to have the institutional framework in place, which enables economic players to participate fully and benefit from their optimization decisions. Consequently, the study extends Model (1), by including a social programming variable SOC<sub>it</sub>. Thus,

$$POV_{it} = \alpha_i + \beta_1 Y_{it} + \beta_2 INI_{it} + \beta_3 BAID_{it} + \beta_4 SOC_{it} + \varepsilon_{it}$$

The main effects of social programs on poverty are reflected in Model (2). The fact that we can't assume to reduce poverty without increasing the levels of productivity of the poor through access to quality healthcare and education programs justifies the inclusion of this variable. In developing countries, health programs are vital. If productivity is increased by improving the health care system as well as the educational system, the poor who are usually less productive could be empowered to be more productive.

The sum of public health and education expenditure is used as an SOC variable proxy for this study. Both variables have an enormous impact on the productivity of the poor who incidentally lack basic education and could not totally take advantage of the opportunities they have in order to compete on an extremely competitive labor market.

Finally, on the basis of the literature review this study seeks to gain a measure of the quality of institutional measures to capture the impact of government interventions on poverty. Taking into account both political and economic interventions. Economic institutions are private property security institutions. They exist to safeguard properties of individuals and the nation as a whole. This can be achieved by governments ensuring that cost of business transactions is minimized to

encourage full participation of citizens. In addition, the market should be allowed to operate freely without unnecessary government intervention. Good institutions free from bribery and corruption makes individuals confident and helps them to achieve maximum output. Therefore, we add the variable GOV<sub>it</sub> in order to capture the impact of government intervention on poverty.

$$POV_{it} = \alpha_i + \beta_1 Y_{it} + \beta_2 INI_{it} + \beta_3 BAID_{it} + \beta_4 SOC_{it} + \beta_5 GOV_{it} + \varepsilon_{it}$$

Notwithstanding the increasing attention generated by the impact on economic parameters of the quality of institutions, a satisfactory quality index of the institutions has been difficult to achieve. Various measures have been proposed by different economist. This study considers the Index of Institutional Quality as used by earlier researchers Knack & Keefer (1995), Mauro (1995) will be adopted.

### **3.7 Tests of Data**

Each data on the variables adopted will be tested for significance before regressing the data. Insignificant variables will be replaced by different variables that affect economic growth.

## CHAPTER FOUR

### EMPIRICAL RESULTS AND ANALYSIS

#### 4.1 Introduction

Chapter two stressed the need for aid-receiving countries to mobilize national and internal funds, as this effort will enable them in addressing resource and overseas exchange constraints on accretion of capital and financial growth. Moreover, even if it is fungible, a stable inflow of aid contributes to economic growth, which indicates that there was no concern about the distribution of aid in the fungibility of aid. This section provides the empirical outcomes of the corresponding models identified in the previous section, analyzes and discusses the results to address the issue of aid and its impact on poverty.

#### 4.2 Unit Root Test Results

Estimating equations by incorporating non-stationary factors in macroeconomic models through conventional linear regression has been prevalent for a long time. It was not well known that checking coefficients hypothesis using conventional statistical inference could result in totally spurious outcomes. Most factors of the time series are not stationary, however, and therefore their use in the model may lead to spurious regression (Granger, 1969).

**Table 4.1: Results of the Unit Root Tests**

<b>Panel A: Level</b>				
<b>Variable</b>	<b>ADF</b>		<b>PP</b>	
	Constant No Trend	Constant Trend	Constant No Trend	Constant Trend
Data Period: 2008-2018				
POV	-1.902187	-4.173922**	-1.610641	-1.174744
$\alpha_i$	-1.114965	-2.300395	-1.111031	-2.300363
$\beta_1 Y$	-1.519155	1.046121	-1.949953	0.432501
$\beta_3 \text{BAID}_{it}$	-1.360355	-1.552920	-1.412073	-3.015563
$\beta_2 \text{INI}_i$	0.034693	-3.323516*	-1.304462	-3.160226
$\beta_4 \text{SOC}_{it}$	-1.591558	-3.159471	-2.302657	-2.866843
$\varepsilon_{it}$	-5.229952***	-3.848306**	-5.240666***	-5.055040***
<b>Panel B: First Difference</b>				
<b>Variable</b>	<b>ADF</b>		<b>PP</b>	
	Constant No Trend	Constant Trend	Constant No Trend	Constant Trend
Data Period: 1970-2005				
<input type="checkbox"/> POV	-16.81843***	-18.90489***	-4.323096***	-5.087394***
<input type="checkbox"/> $\alpha_i$	-5.975127***	-5.973530***	-6.013544***	-6.023454***
<input type="checkbox"/> $\beta_1 Y$	-3.157288**	-3.144662*	-3.170929**	-3.086507*
<input type="checkbox"/> $\beta_3 \text{BAID}_{it}$	-9.271091***	-9.149645***	-10.10392***	-10.00449***
<input type="checkbox"/> $\beta_2 \text{INI}_i$	-8.525902***	-5.877201***	-9.299780***	-9.580081***
<input type="checkbox"/> $\beta_4 \text{SOC}_{it}$	-8.497271***	-8.375972***	-9.293614***	-9.279192***
<input type="checkbox"/> $\varepsilon_{it}$	-4.630774***	-4.825611***	-9.359366***	-9.701069***

The null hypothesis shows the series ' non-stationary conduct or the existence of a root unit For both ADF and PP exams, the MacKinnon critical values are used to estimate the refusal of the null hypothesis. \*,\*\* and\*\*\* \* indicate that the non-stationary null hypothesis is rejectec at 10%, 5% and 1%, respectively.

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This study supplemented the predicted method with unit root tests to guarantee that some factors are not incorporated at a greater cost. While the plan for ARDL cointegration does not involve prior-testing of the inclusion process, the factors must be either  $I(0)$  or  $I(1)$ , hence the need to check the unit root to determine the nonexistence of  $I(2)$  factors. To this end, the first graphical inspection of their advances observes all variables (see Appendix A). From the graph, all factors can be viewed as non-stationary except for money supply, inflation, and complete private inflows showing linear trends at prices. However, the charts of all the factors show some static pattern in their first variations.

The conventional unit root tests proposed by Dickey and Fuller (1979) and Phillips and Perron (1988) are used to officially evaluate the sequence of inclusion of the factors, namely the Augmented Dickey-Fuller (ADF) and the Phillips-Perron (PP) tests. These may be either  $I(0)$  or  $I(1)$  experiment outcomes. The ADF results show, however, that it is  $I(0)$  for variable  $\ln Y$ , while the PP examination demonstrates that it is  $I(1)$ . In addition, the shift in the ADF results indicates that it's not  $I(0)$  or  $I(1)$ , whereas the PP examination demonstrates that it is  $I(1)$  at a pace of 1%  $\beta$ 3AIDit. Since we have verified the lack of  $I(2)$  inputs, the ARDL methodology can now be applied.

### **Bound Test for Cointegration**

The study first confirmed the presence of long-run relationships in matrix (3.2) in the first phase of the ARDL assessment. Table 4.2 presents the outcomes of this linked experiment method for analyzing cointegration between financial development and its determinant. The F-statistic is above the 10% critical bottom limits calculated by Nayaran et al (2004), suggesting that it is

possible to reject the false assumption of no cointegration. Alternatively, there is a long-term connection between our model's factors.

**Table 4.2: Bounds Tests for Cointegration Estimates**

<i>Critical Value Bounds of the F-Statistic: intercept and no trend (Case II)</i>						
K	90% Level		95% Level		99% Level	
	I(0)	I(1)	I(0)	I(1)	I(0)	I(1)
7	2.205	3.350	2.519	3.821	3.436	5.228
<i>Calculated F-Statistic:</i>						
$F_Y(\text{POV}, \alpha_i, \beta_1 Y, \beta_3 \text{BAID}_{it}, \beta_2 \text{INI}_i, \beta_4 \text{SOC}_{it}, \varepsilon_{it})$			3.7203*			

Notes: Narayan (2004a, b), Appendix A1-A3, pp.26-28, obtains critical values. \* Denotes a 10 percent level of statistical importance. K is the regressor number.

We use the ARDL cointegration technique in the next step to assess equation 2.2 parameters after establishing the presence of a long-run connection between factors.

### 4.3 Long-run Relationship Results

Equation (2.2) for Ghana is calculated using the 2008-2018 era annual documents. Results are based on the Akaike Information Criterion (AIC) using one lag based on the original character of the data and relatively brief features of the sample. Table 4.3 demonstrates long-run estimation outcomes. Not all of the predicted scores have their anticipated theoretical indications as stated in the chart. With the exception of labor, aid, country-specific effect, the findings show theoretically right indications for the explanatory variables.

**Table 4.3: Long-Run Estimated Coefficients using the ARDL Approach**

ARDL(1,0,1,0,0,0,0,0)selected based on <i>AIC</i>			Dependent variable: $\ln Y$	
Regressor	Coefficient	Standard Error	T-Ratio	P-values
Constant	8.3444	2.8740	2.9034***	0.008
POV	0.18953	0.079671	2.3790**	0.026
$\alpha_i$	-0.096940	0.20273	-0.47818	0.637
$\beta_1 Y$	0.18008	0.073336	-2.4555**	0.021
$\beta_3 \text{BAID}_{it}$	-0.0510841	0.046873	-0.023129	0.982
$\beta_2 \text{INI}_i$	-0.19299	0.15127	-3.7642***	0.001
$\beta_4 \text{SOC}_{it}$	0.071484	0.02605	2.7441**	0.004
$\varepsilon_{it}$	-0.057559	0.012597	-4.5693***	0.000
$\beta_5 \text{GOV}_{it}$	-0.14489	0.062409	2.3216**	0.029

Note: \*\*\*, \*\*, denote significance at 1% and 5% respectively

The findings moreover show that at a meaning rate of 5 percent or lower, most figures are statistically important. The values of the variables are the long-term elasticity in the long-term development equation.

From Table 4.3, the projected assistance ratio is -0,0512 and at a rate of 5% is important. This means that a 1% rise in international assistance will lead to a decrease in actual GDP per annum by around 0.06%. The adverse aid-growth relationship conflicts with the apriori (favorable) mark of the research and the results of some empirical research that recorded a favorable aid-growth connection (Papanek, 1973; Aryeetey & Tarp, 2000; Dalgaard et al., 2004 and Karras, 2006). Osew (2012) argues that the adverse impact of assistance on development could be ascribed to the previous factors: (1) Foreign aid may not be used for the planned intent and may result in unlawful operations such as the use of international assistance to promote political campaigns contributing to the perpetuation of poor practices. (2) The embezzlement or use of foreign aid (in the type of loans) to enrich a few political leaders constitutes a major financial strain on obtaining nations as reimbursement of main concerns and is detrimental to economic growth.

All long-term factors are inelastic. Specifically, the findings verify the theoretical assumption that equity adds favorably to GDP development due to the favorable and substantial coefficient of investment at 5 percent stage in the long-term development equation. This implies that capital gains have the ability to enhance growth in Ghana in the lengthy term. The investment coefficient (0.18008) stated from the outcomes that a percent change in investment output outcomes in a shift in real GDP of 0.19 small, *ceteris paribus*.

In contrast to expectations, the labor force equation is wrongly marked and statistically irrelevant. Additional labor was anticipated to add to production, but a rather unforeseen outcome is achieved here. A viable interpretation of this unforeseen result is not unthinkable as the Ghanaian economy is marked by increasing unemployment and low productivity. Many emerging economies, and especially the Ghanaian economy, focus on subsistence-intensive, agriculture and labour-intensive small-scale trading, which has restricted the nation's jobs and thus generated income benefits.

The findings show that a percentage increase in labour power reduces productivity by 0.1. Furthermore, the findings indicate that the impact of foreign assistance on growth appears to be perverse; a substantial adverse effect is accomplished although a favourable coefficient is expected a priori. A number of factors can be ascribed to this unfortunate long-term outcome of foreign assistance.

The effect of economic programs on poverty is a rather fascinating consequence. For this research, social programs that include spending on public safety and schooling are used as a SOC varying marker. Social programs have a beneficial effect on the productivity of the elderly who, by the way, neglected adequate education and were unable to bring full benefit of their bad chances to work on a highly profitable labor market.

Turning to GDP, it is easy to discern that this variable has a beneficial impact on poverty as well. Each country's GDP reflects its importance, so if a GDP development that eventually has a beneficial effect on economic growth also affirms the significant impact of GDP on poverty alleviation. This outcome does not conflict with the economy of Ghanaian. This variable's coefficient is also statistically important at the significance level of 1 percent.

It can also be seen that the Gini coefficient has beneficial impacts on poverty as it is a significant measure of short-term economic growth. Economic development will improve by 0.03% if the allocation of revenue is improved by 1%. This is also important at the importance stage of 1 percent. This outcome presupposes the need for an industrial economy in which there will be more labor demand to enhance people's living standards that will eventually promote development.

Finally, in line with expectations, a favorable indication emerged from the government action variable weighing system of government and is statistically crucial at 5 percent. The government interference variable figure indicates that continuous political environment is a stimulus for personal businesses and therefore economic growth and poverty reduction.

#### **4.4 Results of the Short Run Dynamic Model**

The last phase is to explore the immediate dynamics within the ARDL framework, having evaluated the long-term model of cointegration. Therefore, the lagged value of all variables at the stage is maintained in the ARDL model. Table 4.4 presents estimated outcomes depending on the Akaike Information Criterion.

**Table 4.4: Estimated Short-Run Error Correction Model using the ARDL Approach**

ARDL(1,0,1,0,0,0,0,0,0) selected based on AIC      Dependent variable: $\ln Y$				
Regressor	Coefficient	Standard Error	T-Ratio	P-Values
Constant	2.9633	1.7442	1.6990*	0.101
POV	0.067312	0.021456	3.1370***	0.003
$\alpha_i$	5.5047	1.8107	-3.0400***	0.004
$\beta_1 Y$	0.063952	0.026072	-2.4530**	0.020
$\beta_3 AID_{it}$	0.003851	0.016613	-0.23177	0.981
$\beta_2 INE_i$	0.068532	0.021695	-3.1591***	0.003
$\beta_4 SOC_{it}$	0.025386	0.006762	3.7537***	0.000
$\varepsilon_{it}$	0.020441	0.014137	-1.4461	0.160
$\square D_t$	0.051454	0.02321	2.2162**	0.035
$ECM_{t-1}$	0.35513	0.11830	-3.0017***	0.005

$$ECM = \ln Y - 0.18953 * POV + 0.096940 * \ln \alpha_i + 0.18008 * \ln AID + 0.0010841 * \ln INE + 0.19299 * \ln SOC_i + 0.057559 * \ln \varepsilon_{it} - 0.14489 * D - 8.3444 * C$$

In the poverty-aid equation, the coefficient of the country-specific impact factor is good and substantial at 1 percent meaning stage. This is compatible with the outcome of the equation of long-term development. This demonstrates the essential role that country-specific effect in Ghana's poverty reduction technique plays as its figure is favorable in model of poverty-aid model just as it is in the long-term model.

As in the long-run development matrix, the GDP ratio in the poverty-aid system retains its favorable value. This shows the instant effect on reducing poverty. In the poverty-aid system, the GDP ratio is also statistically important at a rate of 1%.

In addition, the AID coefficient is a favorable indication as well. That is, the effect of a rise in AID does not decrease poverty in the long run. The findings confirmed that of research such as Mosley

et al., 1987, Griffin (1970), Lavy and Sehefer (1991) which discovered adverse effect on poverty reduction from aid. Therefore, it can be found that AID does not inherently decrease inequality.

Finally, for rapid economic growth, a comparatively stable socio-political climate is important. This is expressed in the important beneficial effect that the dummy variable has on legislative regime eras. From the outcomes, if the stable political climate increases by 1 item, economic growth will improve by 0.05. This conclusion verifies those discovered by Stasavage (2002) where significant legislative shift was discovered to boost personal business stream and thus economic growth.

#### **4.5 Model Diagnosis and Testing for Stability.**

The significance of variables and other test studies such as ad serial correlation, mental type, normality, heteroskedasticity and model structural stability are regarded for testing for the anticipated ARDL model. As shown in the table. 4.5, in the first phase, both models usually pass all diagnostic tests.

**Table 4.5: Diagnosis and Goodness Model**

<i>Model Criteria/Goodness of Fit</i>				
$R^2$	0.77879	$\bar{R}^2$		0.61746
S.E. of Regression	0.033909	F-stat.	F( 9, 25)	3.7183[0.004]
Akaike Info. Criterion	63.3549	Schwarz Bayesian Criterion		54.8105
DW-statistic	1.4029	Residual Sum of Squares		0.028248

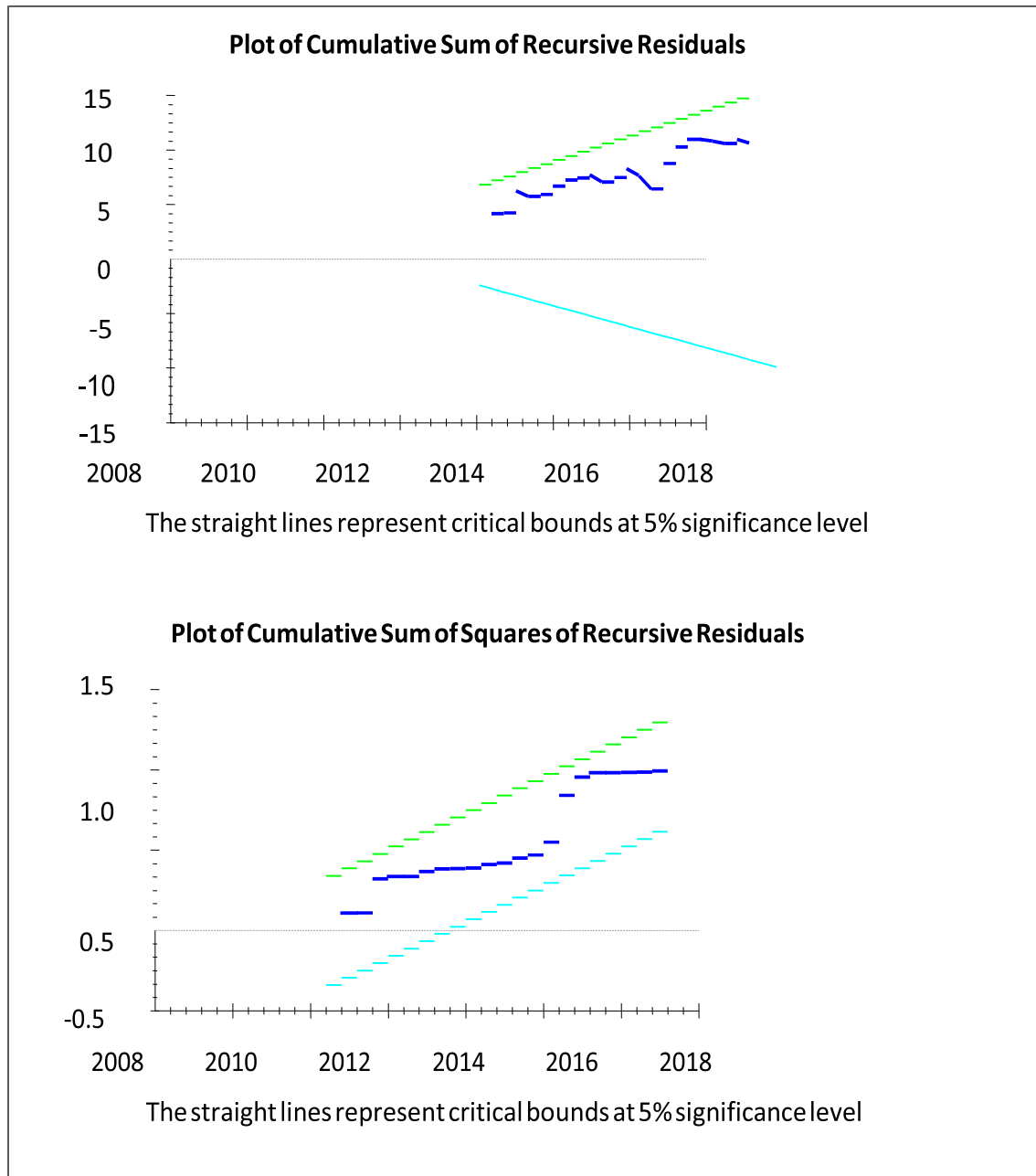
<i>Diagnostics</i>	<i>Test Statistic</i>
$F_{Auto}(1, 23)$	1.7274 [0.190]
$\chi^2_{Auto}(1)$	2.5462 [0.108]
$\chi^2_{Re\ set}(1)$	0.19093 [0.671]
$\chi^2_{Norm}(2)$	0.70227 [0.840]
$\chi^2_{White}(1)$	1.9397 [0.265]

$\chi^2_{Auto}$ ,  $\chi^2_{Re\ set}$ ,  $\chi^2_{Norm}$  and  $\chi^2_{White}$  are Lagrange multiplier statistics for test of serial correlation, functional form misspecification, non-normal errors and heteroskedasticity respectively. These statistics are distributed as Chi-square values with degree of freedom in parentheses. Values in parentheses [ ] are probability values.

It shows that there is no evidence of autocorrelation and that the models exceed normality, and the experiment shows that the inaccuracy is normally distributed. The R2 demonstrates that the regressors in both designs explain about 72 percent of the variability in actual GDP. In addition, both designs take the heteroskedasticity white test as well as the RESET test for right model configuration.

Finally, when assessing the power of the long-run figures along with the short-run statistics, the Cumulative Sum (CUSUM) and Cumulative Sum of Squares (CUSUMQ) are applied. Following the Bahmani-Oskooee (2001) quoted by Pesaran and Pesaran, the validity of the regression variables is assessed by validity trials and they can demonstrate if the regression equation is robust over moment or not. In time series data, this stabilization exam is suitable particularly once we are unsure when structural change might have occurred.

**Figure 4.2: CUSUM and CUSUMQ Plots**



The null hypothesis is that the coefficient vector is the same in each era and the option is simply that it is not the same (Bahmani-Oskooee, 2001). The statistics of CUSUM and CUSUMQ are mapped against the 5 % significance. According to Bahmani-Oskooee (2002), if the range of these statistics remains within the critical boundary of the 5-digit significant stage, the null hypothesis (i.e. all coefficients in the error correction model are stable) cannot be rejected. Figure 4.3 presents the distribution of the total amount of recursive remaining. As shown, within the limits are the array of both CUSUM and CUSUMQ residuals. In other words, the parameter stabilization stayed within its critical parameter stabilization boundaries. It is evident from both the graphs in Figure 4.3 that both the studies of CUSUM and CUSUMQ verify the strength of the true GDP function in the long-run results in equation 3.2.

It can be stated on the basis of the above debate that a rise in aid only decreases poverty in Ghana's short-run. Indeed, assistance has a positive effect on income, as shown in Table 4.7 i.e., a rise in assistance inflow contributes to a short-term revenue rise of 1,166 percent. This means that aid aimed at promoting economic development ends up harming Ghana's economy, primarily owing to corruption and heavy interest rates on loan-shaped instruments. In order to gain the complete advantage of foreign aid, the research proposes providing financial aid aimed at capital creation and labor abilities development through schooling and preparation rather than political aid, since the research findings demonstrate that equity and labor have a beneficial effect on growth. The research also proposes the requirement of more subsidies and less credit because the research discovered tax billing on external debt to have an adverse impact on economic growth as most foreign aid is not spent profitably in Ghana.

## CHAPTER FIVE

### SUMMARY, RECOMMENDATIONS, AND CONCLUSION

#### 5.1 Summary of Findings

Over the previous centuries, the conviction that foreign aid encourages beneficial effect in emerging nations on poverty reduction has impregnated much debate in international development cooperation. Based on current literature for most developing countries, this research aims to examine empirically the impact of foreign aid on poverty reduction in Ghana from 2010 to 2018. It summarizes the empirical results analyzed in the previous section as follows:

Analysis in Chapter 4 indicates that there appears to be no important effect of foreign aid on poverty reduction. An amount of factors can be ascribed to this unfortunate long-term outcome of foreign aid. Under the stabilization programs, Ghana State is encouraged to take demand-reducing initiatives that included promoting public expenditure, raising tariffs to reduce deficit deficits, rising exchange prices, and limiting national borrowing to improve the current account balance. Such strategic measures should be endorsed to adversely impact poverty decrease as obviously included in the model.

Furthermore, poor long-term assistance production may be attributable to how cash reaches the nation. Donor conditionality sometimes impacts efficient loan allocation, leading in bad aid development impacts. Consequently, a substantial amount of aid inflows into the nation over the years under consideration originated in the sort of loans that have to be kept as long-term liability. Finally, the fungibility of aid can be ascribed to the poor effect of aid on poverty reduction. Results indicate that an increase in aid inflows by 1% will significantly hamper long-term growth by 0.18%, decreasing inequality.

Turning to GDP, the fact that this variable also has a positive effect on poverty is simple to discern. Each country's per GDP reflects its importance, so if a continuously favorable impact of GDP development on economic growth also affirms the significant impact of GDP on poverty alleviation. This result does not interfere with Ghanaian's industry. Typically, as seen in section four of the evaluation note, the aid flow had a small effect of GDP which subsequently had a negligible effect on poverty reduction. This can be ascribed again not to aid channeled to the economy's targeted productive sector, but rather to unproductive sectors.

Again, as an important statistic of short-term economic growth, it can also be seen that the Gini coefficient has positive effects on poverty. Economic growth will enhance by 0.03% if the income distribution improves by 1%. This is also crucial in the 1 percent significant phase. This result presupposes the need for an industrial economy in which more labour will be required to improve the living standards of people, which will eventually encourage growth.

In accordance with expectations, the government intervention variable measuring scheme has given rise to a favourable sign and is statistically significant at 5 percent. The variable coefficient of public interference shows that a constant political climate is a stimulus for private business, hence economic growth and decrease of poverty.

Lastly, the projected multiplier scores show that on three occasions, foreign aid to Ghana is fungible. First, aid for public investment did not increase the value of public investment to the same extent as the value of aid inflow. Second, to boost public consumption, a rise in assistance inflow was used to finance tax cuts, and lastly, a rise in aid inflow was used.

## **5.2 Policy Implications and Recommendations**

The empirical findings provide valuable data for strategy formulation and execution with regard to strategy consequences. The results of the estimate showed that the overall impact of

foreign aid on poverty reduction was negative, so aid seemed to have replaced domestic savings and increased debt burden.

The initiatives most probable to have beneficial long-term effects on Ghana's development are those that generate government resources that enhance the efficiency of big organizations of individuals and their personal equity. Help can help in this situation to reassign funds back from operations that generate normal goods to operations that generate public goods that profit more individuals. Examples of such public goods are initiatives that decrease corruption, studies that help eliminate diseases, systems that strengthen ownership rights and initiatives that boost the country's implementation of appropriate technologies. Projects that support small and medium-sized enterprises in the consumer goods industry also have a comparatively elevated capacity for poverty reduction, as this industry supports the two large metropolitan and rural impoverished communities. The allocation of assistance to such industries is therefore extremely advised.

Policies are also crucial in foreign aid effectiveness, as assistance has a more beneficial effect on development in nations with strong fiscal, financial and trade strategies. On the other hand, aid has no beneficial impact on development in the existence of bad strategies. There is therefore a need not only for excellent practices, but also for these strategies to be implemented and for adequate surveillance of aid-using initiatives to prevent misuse and mismanagement of foreign investment funds. We can therefore conclude that assistance can only be useful in boosting economic growth if suitable financial, fiscal and trade strategies are in place.

Ghana's state should harness inner funds and create revenue from domestic sources in an attempt to decrease or stop the aid system, with effective and efficient use of funds to boost the speed of its economic development and render its poverty alleviation programs more

prudent. Using the natural resources of the nation effectively could encourage the much-needed growth of the nation, rather than relying on the "begging bowl" as if the world owes us a living.

Protecting the infant industries is another region of interest. Ghana must safeguard its baby sectors from dumping advanced world products and facilities. The nation must also carry on hostile trade within the sub-region of West Africa, Africa as a whole, and the international community, just as infant industries are shielded. Instead of clamoring for donor aid, therefore, the nation needs to seek more fair trade with the ability to promote economic growth and development.

Lastly, it is highly suggested that developing nations and Ghana in specific get rid of over-dependence on foreign aid and donor conditionality for budget support. In most developing countries, the aid model has not functioned over the years. Therefore, developing nations can depend on trade, international direct investment, and strengthen their capital markets as the primary causes of development enhancement.

### **5.3 Practical Limitations & Further Research**

The significant restriction experienced by the research, typical of such research in developing nations, was the reliability and limited availability of information on some of the main factors used to estimate development as well as the designs of fungibility. An effort to increase the information duration to 2000 or subsequently was restricted by the non-availability of these micro sequence from formal national records as the investigator had to rely on primarily international outlets such as the World Bank, IMF, among others at enormous economic cost.

Obviously, the ability of Ghana to raise investment remains heavily dependent on the stability of foreign capital inflows and adequate reforms in government institutions. However, the analysis conducted in this study did not elaborate on ways to strengthen the institutional capacity of the state to ensure sustainable economic growth could be achieved by the country.

Maintaining internal viability problems in particular are often linked to the adoption of prudent macroeconomic policies, gaining foreign aid and foreign direct investment, and connections to international trade. These are some very complicated problems that still need to be assessed.

Furthermore, the primary input of this research is the implementation of econometric modeling to analyze the prospective economic growth impacts of foreign aid. While the model can explain how Ghana's economic performance can be influenced by aid inflow, the model established in this research is in aggregate shape. More exciting would be to disaggregate the effect of assistance on poverty decrease in at least three significant industries: (i) the agricultural industry, (ii) the manufacturing industry, and (iii) the health sector. By doing so, it may be possible to highlight the pathways which support may influence economic development and reduce poverty.

#### **5.4 Conclusion**

This research found that although Ghana has become one of the largest donor aid recipients in the world, not much has been accomplished in terms of economic development and poverty alleviation with foreign assistance. As indicated in the analysis, foreign donor aid cannot help alleviate poverty in its entirety and promote economic development in Ghana. This is evident because for over 2 decades of Ghana being a beneficiary of donor assistance, the expected transformation has not been too encouraging as the country is battling with underdevelopment, inadequate infrastructure, poverty, high mortality rate as well as high levels of unemployment. Foreign aid can however help alleviate poverty in Ghana if the funds met for development are channeled and judiciously used to bring about the needed development. Indeed, the “Ghana beyond aid” mantra by President Nana Addo Danquah Akuffo–Addo is plausible if we start channeling our resources to the right areas.

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## **APPENDICES**

### **APPENDIX A: Figure AI: Plots of Variables in Levels and First Differences**



**APPENDIX B: Summary Statistics and Correlation Matrix**



**APPENDIX C: Data Used in the Estimation of the Aid Growth Model**