EFFECTIVENESS OF FOREIGN AID: THE CASE OF KENYA

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Abstract

The principal economic rationale for aid is to increase growth rate of GDP in recipient countries. The recipients are low-income countries faced with two fundamental constraints, or financing gaps, viz, insufficient domestic savings and inadequate foreign exchange earnings. Consequently, such countries are constrained in their ability to achieve a target growth rate. Capital inflows, including aid, are meant to fill these gaps and hence contribute to achieving target growth rates.

The debate on aid effectiveness has drawn mixed reactions among scholars and policy makers both in the donor and recipient countries. Studies in most Sub-Saharan African countries do not show a positive statistical relationship between aid and growth. But elsewhere, aid has produced impressive results. This paper therefore aims at providing an explanation for the robust and consistent relationship between aid, investment and economic growth in Kenya. It estimates a structural growth model involving aid and other control variables for the period 1970-2004. Using causality tests, the paper finds that, for the period under study, aid does not cause investment and growth. But there is causality running from investment to growth.

The results of structural regression of the model show that aid has had negative impact on growth. Evidence of no causality between aid and growth and also between aid and investment implies aid is not invested but is possibly directed to other uses. The vital structural link between growth and aid is missing in Kenya