ASHESI UNIVERSITY

EXPLORING THE IMPACT OF FOREIGN AID ON GOVERNANCE IN GHANA

Undergraduate Thesis submitted to the Department of Business Administration, Ashesi University, in partial fulfilment of the requirement for the award of Bachelor of Science degree in Business Administration

B. Sc. Business Administration

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DECLARATION

I hereby declare that this thesis is my original work and that no part of it has been presented for another degree in this university or elsewhere.

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Date: 11th May 2020

I hereby declare that the preparation and presentation of the thesis were supervised in accordance with the guidelines on supervision of thesis laid down by Ashesi University.

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Date: 11th May 2020

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ABSTRACT

This thesis is a contribution to the body of knowledge on aid and governance. African countries depend on official development assistance to conduct primary governmental functions. However, few countries are well governed or show signs of aid efficacy. Also, various accounts of the impact of aid on development are divergent in their conclusions but regardless of this, there is an influx of aid to solve Africa's problems. On the other hand, the crucial role of governance quality in establishing development is rather apparent. With the continuous flow of aid in the face of deteriorate governance, there is the apparent question: Is aid dependency deteriorating governance? Mainstream theory suggest that the two variables are related. Therefore, this thesis sought to explore if indeed the relationship between foreign aid and governance holds for Ghana, the flagship country for IFI programs and a country known for its stable governance. With the use of OLS regression on time series data (1984 – 2018), it was found that aid rather promotes governance in Ghana. Governance is measured using the International Country Risk Guide Quality of Governance index and aid dependence is measured by aid percentage of GDP. This finding should be used to spearhead further research into deriving lessons for Africa from the mechanisms that contribute to the aid-governance efficacy in Ghana. Also, since Ghana, through the Ghana Beyond Aid agenda is bent on reducing foreign aid, it is important to consider the performance capacity of both Ghana and Africa with less foreign aid.

Keywords: Official Development Aid, foreign aid, governance, good governance, time series data, OLS regression.

LIST OF ACRONYMS

Acronym	Meaning
ODA	Official Development Aid
SSA	Sub Saharan Africa
ADF	Augmented Dickey Fuller
PP	Philip Perron
BLUE	Best Linear Unbiased Estimators
HAC	Heteroskedasticity and Autocorrelation Consistent
VIF	Variance Inflation Factor
OLS	Ordinary Least Squares
ICRG	International Country Risk Guide
CPIA	Country Policy Institutional Assessment
GOG	Government of Ghana
GNI	Gross National Income
PAMSCAD	Programme of Action to Mitigate the Social Costs of Adjustment
GDP	Gross Domestic Product
MDGs	Millennium Development Goals
SDGs	Sustainable Development Goals
OECD	Organization for Economic Co-operation and Development
MDRI	Multilateral Debt Relief Initiative
HIPC	Highly Indebted Poor Country
FDI	Foreign Direct Investment
SAPs	Structural Adjustment Programs
IMF	International Monetary Fund
UN	United Nations
UNDP	United Nations Development Programme
IFIs	International Financial Institutions
PRS	Political Risk Services

DEFINITION OF TERMS

Official Development Aid: Official Development Aid or Foreign Aid is assistance provided either bilaterally, from donor to the recipient or multilaterally through a development agency for developmental purposes (OECD, 2016). The scope of this assistance includes cash, expert advice, loans at concessional rates as well as technical assistance (Riddell, 2008).

Governance: Governance is a nexus that relies on the interaction between a number of concepts and economic policies by which the public participates in project planning according to the UNDP (As cited by Jaouadi & Hermass, 2012).

Good Governance: According to the World Bank, this is "the management of public resources, accounting, legal framework, free information and transparency" (as cited in Jaouadi et al., 2012, p. 186). Good governance can be perceived in the form of institutions that demonstrate predictable, unbiased, and consistently enforced frameworks and rules for investors (Knack, 1999).

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CHAPTER 1: INTRODUCTION

1.1 Background

The former United States President Harry Truman made the first mention of the notion of foreign aid in development policies. This proposal addressed the urgency for some manner of development assistance to underdeveloped areas as a result of the Second World War. This spoke to the inequalities and severe poverty that had gripped countries at that time. It also showed a resolve on the part of wealthier and developed countries to foster development and alleviate the suffering of the impoverished. Consequently, the preponderant goal of disbursing foreign aid is to "help people help themselves, i.e. help to self-help" (Abeselom, 2018). Foreign aid is described by the Organization for Economic Co-operation and Development (2016) as assistance provided either bilaterally, from donor to the recipient or multilaterally through a development agency for developmental purposes. The scope of this assistance includes cash, expert advice, loans at concessional rates as well as technical assistance (Riddell, 2008).

This call for aid was first steered towards the reconstruction of Europe due to the turmoil caused by the war. The United States initiated the European Recovery Plan or Marshall Plan, a 4-year development agenda, to bring reformation to Europe after the Second World War. For this purpose, some USD13 billion in aid flows went to western Europe (Riddell, 2008). This goal of rebuilding slowly led into another goal of combating the furtherance of communism in Europe. This eventually resulted in the Cold War era where the role of foreign aid became a means to secure allies in both Latin America and Africa in relation to loyalty to either the United States or the Soviet Union (Riddell, 2008). On the African continent, Mozambique and Angola aligned and received aid from the Soviet Union while Democratic Republic of Congo received aid and aligned with the United States (Sousa, 2016).

Foreign aid, as it is organized today, began during the 1960s through institutionalization. Here, the engagement of foreign governmental agencies from 29 members of the Development Assistance Committee, more than 29 other donor countries, non-governmental organizations and multilateral agencies evolved to form an interconnected network (Gulrajani, 2016; Schaaf, 2013). This structured process was geared towards Official Development Aid (ODA) outlays to third world countries. Initially, this new focus on developing countries employed a development approach which was and still is skewed towards the modernity theory. The modernity theory favors a linear path towards development to look like that of the West. This is often characterized by implementing limiting the role of government and free market policies. However, with the argument becoming more nuanced with time, human development and shared responsibility approaches to development undertaken by multilateral donors such as the United Nations (UN) are increasingly the selected option in making development pro-poor (Hulme, 2016). These undertakings include the Millennium Development Goals (MDGs) and the Sustainable Development Goals (SDGs).

The change in the ODA structure during the Cold War towards the current institutionalization should make aid more effective; however, this has not been the case (Sunberg & Gelb, 2006). One of the reasons that some scholars are reproving the effectiveness of aid is that most of African countries have high corruption rate and authoritarian governments. (Farah, Önder & Ayhan, 2018). According to LaFraniere (2005), most of the ODA flows have been depleted through fraud, waste and malfeasance. This can be attributed to the lack of quality institutions. In Nigeria, audits disclosed many uncompleted projects financed with funds in hundreds of millions in international loans (LaFraniere, 2005). In the late 1990's to the early 2000's, large amounts of ODA flows were administered to countries that became politically unstable; A fourth of all ODA flows to Africa from 1980 – 2000 were allocated to countries experiencing political instability (Sunberg & Gelb, 2006). However, newer trends show that aid is being allocated to states with better civil liberties and political rights (Sunberg et al, 2006). This indicates that policy selectivity in aid allocation has risen. On the other hand, ODA is also believed to foster growth in countries with political stability (Dalgaard, Hansen, & Tarp, 2004; Armah, 2010). This likely link between aid and governance is made apparent from trend development over the years.

1.2 Problem Statement

Though the logical aim of ODA is to foster economic growth and reduce extreme poverty, ODA flows to recipient countries are often associated with its failure to deliver development to third world countries and this is for a good reason. Africa, to a large extent, has been a recipient of ODA since the 1960's, with total ODA amounts to the continent exceeding USD568 billion between 1965 and 2007 (Easterly, 2007). Despite the fact that the effectiveness of aid is varied in accounts, there is still a reliance on aid inflow to solve global issues.

Regarding the impact of aid through human development and shared responsibility approaches, Sachs holds the view that the MDGs could have been achieved by 2015 if only there was an increase in aid flows from donor countries (as cited in Riddell, 2008). However, Easterly disagrees, stating that though USD 2.3 trillion in foreign aid has been disbursed in the past 50 years, there are still cases of malaria deaths that could be prevented by 12 cent medications (as cited in Riddell, 2008). In relation to the SDGs, 4 years after its implementation, the UN Statistical Statistics Division for the SDGs Reports in 2018 shared that the progress on the goals is not fast enough to achieve the set target by the year 2030. To remedy this, donor countries must increase their aid as a percentage of gross national income to the criterion of 0.7% set by the Organization for Economic Co-operation and Development and target half of their aid to poverty-stricken countries (Udsholt, 2018, Yanguas, 2018). The publication also mentions that a gap of USD 2.7 trillion needs to be filled to accomplish SDG 1 by 2030; this can only be realized through deploying private funds.

The limits of the aid programmes intended for development may be ascribed to governmental structures in recipient countries. Moss, Pettersson, Gelander & Van de Walle (2006) argue that aid only works when recipient countries employ good governance. Here, there is a need for well-functioning institutions as a prerequisite for aid effectiveness due to their higher absorption capacities. However, this may be counterproductive to the need for large amounts of aid for building sound institutions (Moss et al., 2006). Therefore, there is a paradoxical relationship that shows that although strong management and administrative systems are needed to ensure effective use of aid, there is the need for aid to enhance governance systems. This is shown on the one hand, when aid frees up revenue constraints which allows governments to build their institutions and provides technical assistance and training to strengthen their legal and accounting systems. Seasoned personnel (in some cases expatriates) manage significant aid programs, and this addition of resources and technical expertise may improve the efficiency of governance (Brautigam & Knack, 2004). On the other hand, it is possible, even with these benefits, that prolonged periods of large aid receipts may cause more difficulty for good governance to develop. Issues of aid fungibility, corruption and rent seeking crop up (Newby, 2010). However, Brautigam et al. (2004) believe that governance reforms occur, and they can take place in poor countries; aid can contribute. Again, even the paradoxical effect of aid on governance, scholars in this field, advocate for more aid; it just needs to be disbursed more selectively in ways that increase governance quality (Brautigam et al., 2004).

If aid can contribute to governance reforms, it is important to research into cases in which aid has had a positive effect on governance. Country-specific cases where aid increased governance quality can be used in further researches and case studies to investigate effective mechanisms in which aid can be disbursed to support a virtuous cycle of development. International financial institutions (IFIs) have often cited Ghana as the flagship country of their aid programs (Thomson, 2010). Ghana is therefore a good country-specific case to investigate a positive impact of aid on governance. Lloyd, Morrissey and Osei (2001) as well as Newby (2010) mention that to enhance the understanding of ODA efficiency, it is relevant to conduct country-specific studies on the impact of aid on development. These studies also provide a better view and clarification on varying factors and contexts (Newby, 2010). Therefore, a deeper investigation into the relationship between foreign aid and governance in Ghana is crucial in further understanding the nature and impact of foreign aid on governance and establishing a basis for further research into aid mechanisms that improve governance.

1.3 Aid Profile of Ghana

After Ghana gained its independence in 1957, Ghana's economic outlook seemed prosperous as it was one of the wealthier colonies. It had substantial mineral deposits, vast tropical forests that would serve as a source of timber, a fairly good transport system and the prospect of generating hydroelectricity. Fast forward into the 1980’s, and the economy had collapsed; food production was lagging behind population growth, a stable manufacturing sector was yet to materialize, education, health and transport systems were in shambles and timber and cocoa production outputs had fallen (Thomson, 2010). This turn of economic outlook brought about the structural adjustment program.

1.3.1 Structural Adjustment of the 1980’s

The Structural Adjustment Programme (SAP) was introduced in 1983 by the PNDC government to salvage a deteriorating economy. At the time, Ghana, and Africa, were suffering from unequal exchange on the international market, and the effects of continuous budget deficits. As part of the programme, the IMF delivered approximately USD 6 billion in concessional loans in exchange for implementing new economic policies. This included increasing cocoa producer prices by 67%, eliminating price controls on other products such as maize and reducing the number of state-owned enterprises by privatizing 80 parastatals; 195 state-owned enterprises had been privatized by the end of 1995 (Odutayo, 2015; Thomson, 2010).

The success of this programme was seen in the stabilization of the country’s economy, with GDP increasing from USD 4.06 billion in 1983 to USD 4.41 billion in 1984, a year after implementing SAPs. GDP continued to rise and peaked in 1986 at USD 5.73 billion, three years after the implementation of the SAPs. Also, inflation rates fell drastically to an annual average of 13% from 73% and industrial capacity grew from 25% to 46% in the period of two decades (1970-1990). This boost led to an overall balance of payments position becoming significantly favorable (Odutayo, 2015). The extent at which Ghana adopted the neoliberal policies introduced by the IMF and World

Bank made Ghana the flagship country for the SAPs. This raised global confidence in Ghana's economy, leading to an increase in credit rating and FDI into mining and infrastructure.

Despite some economic redemption made possible by the SAPs, employment fell from 337,000 jobs in 1980 to 215,000 jobs in 1989, showing employment rates falling by 36.2% over the period (Addo, Korboe, Williams, & Mensah, 2010). During this period of SAPs, the government cut out subsidies, and introduced education and health user fees. Consequently, the school enrolment and healthcare for poor urban and rural homes worsened (Thomson, 2010). Last but not least, the perquisites of an increase in real minimum wage by 75% could not be felt as the increase in food prices and welfare services ate into the gains (Odutayo, 2015).

Notwithstanding, the SAPs had a notable impact on the political system. With a cutdown in public services, supporters of the PNDC were hit hard. 40% of personnel working with the state cocoa board were dismissed together with 3,600 other civil servants working in the public sector (Thomson, 2010). Industrial workers were worse off with the removal of trade barriers, and professional workers such as nurses and doctors were also affected by the downsizing of public services. With the introduction of user fees, many students could not afford access to higher education as well as healthcare, thereby excluding many from schooling. The PNDC, therefore, encountered substantial opposition from these disadvantaged groups. These groups were initially contained through harassment and suppression. The Programme of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) was initiated too late to convince Ghanaians of the advantage of the SAPs. However, the push for political change continuously rose, leading to organized movements geared towards the multi-party democracy advocacy. In due course, the PNDC yielded and contested open elections.

The PNDC's accurate calculation of winning through rural support in any poll, while simultaneously deactivating the rising pressure from urban opposition, paid off. Lt. Jerry Rawlings won the elections with 58% of the vote. With this refreshed constitutional stamp on the regime, Rawlings won approval from developed countries for returning Ghana to democracy.

1.3.2 Multilateral Debt Relief Initiative (MDRI), Highly Indebted Poor Countries (HIPC).

The 1990s were marked with continuous increasing debts, and the World Bank and the IMF worked in unison to write off highly indebted poor countries (IMF, n.d). The initiative for HIPC began to ensure that no less developed country faced intractable debts. Though the initiative was implemented in 1996, it was not until the 2005 Gleneagles summit, with the conception of the MDRI, that some African countries were relieved from indebtedness (Thomson, 2010). Since the 2000s, Ghana has closely followed the international financial institution prescription, maintaining an internationally approved macro-economic ecosystem. Therefore, Ghana was one of the first countries in Africa to benefit from the MDRI. The country's initial total debt relief amount was USD 4.2 billion, which represented almost three-fourths of Ghana's total debt of USD 6 billion.

From 2001 through to 2008, ODA flows to Ghana rose from USD 578 million to USD 1.4 billion, a percentage increase of 23% (United Nations, 2010). Even with the outlook of high dependence on aid, Ghana has been branded as one of the successful stories of aid effectiveness in Africa (LaFraniere, 2005). However, the Department for International Development (DFID) in 2014 reported that this progress has lagged. As at 2010, external aid accounted for 10% of the country's GDP.

Stability in Ghana’s politics has been a constant feature since the millennium began. Following Rawlings’s retirement, all transitions of power have been peaceful and democratic in spite of extreme narrow margins of victory. John Kufuor, who obtained power at the beginning of the millennium, served for two terms. John Atta-Mills and John Mahama have all democratically served as presidents of the country’s fourth republic. The fifth and current president of Ghana is Nana Akuffo Addo, who came into power in December 2016.

1.3.3 Ghana Beyond Aid Agenda

Ghana Beyond Aid Agenda is a vision of the current president of Ghana, which is directed at transforming Ghana from her present socio-economic status to a thriving and flourishing economy that has her destiny at the helm; in other words, it is the current national transformational agenda that focuses on the vision of a self-confident Ghana that is in control of her economic destiny and thrives without aid (Government of Ghana (GOG), 2018).

For three years, 2016 to 2018, aid as a percentage of central government expenditure stands at an average of 5.7%. Aid in this context is a sum of grants and concessional loans. The average of the grant component alone stands at an average of 3.2%. For the year 2018, the numbers were below the average, as aid was 3.1% and grant was 2% of government expenditure. ODA flows to Ghana has been falling. In 2015, ODA flows totaled USD1.7 billion. However, in 2016, it fell to USD1.3 billion and further to USD1.2 billion in 2018 (OECD, 2018).

However, on the overall budget, if interest payments, statutory transfers and compensation payments (i.e. wages, salaries, allowances, and pensions) are eliminated, aid averages 38.3% of government expenditure over the 2016 - 2018 period. On the ministerial level, these percentages are even higher. Aid as a percentage of expenditure on goods and services and capital for the Ministry of Food and Agriculture, Water and Sanitation, and Local Government are 102.8, 312.1 and 104.1% respectively. The Ministry of Health and Gender, Children and Social Protection currently has aid levels at 46.9 and 54.3 percent of expenditure on goods and services.

These numbers at the ministerial level show that though the government pays salaries, the operation of the ministries with the purchase of goods and services as well as capital expenditure is mostly hinged on the generosity of donors. Therefore, the marginal aid from donors is influential in shaping agenda and precedence even with the government handling majority of the expenditure.

With that said, the target of this agenda is to increase the government's own contribution to the budget. Therefore, on the overall budget, the target is to reduce the grant component of central government expenditure on goods, services and capital from an average of 21% between 2016 to 2018, to a value below 5% and 2% by the end of 2023 and 2028 respectively. Also, the target for every Ministry and Service is to reduce grants as a percentage of GOG expenditure on goods and services and on capital to less than 10 percent by 2023, and below 5 percent by 2028. Thirdly, aid conditions not aligned to the country's agenda and priorities will not be accepted.

1.4 Research Question and Objectives

The overarching objective of this study is to investigate the effectiveness of aid on political development, particularly governance, in Ghana. This study tested the hypothesis that aid increases the governance quality of Ghana. This hypothesis was based on the parodox Newby (2010) presents which realizes the need for aid to promote quality institutions while aid effectiveness is dependent on governance present in the recipient country.

This leads to the following research question that will guide the rest of the study.

- Does aid increase the quality of governance in Ghana?

1.5 Methodology

Secondary data were accessed from the World Bank's Databank Indicators, International Country Risk Indicators, The Political Risk Services (PRS) Group and The Quality of Governance (QOG) Institute. It was assumed that Official Development Assistance would have a positive impact on democracy level as proposed by Newby. Time series data were used to test the hypotheses stated above with regression analysis. In order to evaluate how foreign aid influences the political development of Ghana, the influence of foreign aid on governance was assessed.

1.6 Significance of the study

The motivation for this paper was to assess the aid – development relationship through empirical data that would shed light, on the effect of aid on the political conditions in Ghana. Scholars such as Easterly (2007) and Moyo (2009) are pessimistic about the effect of aid in Africa. This is highly contrasted with scholars such as Sachs (2005) and Collier (2007) who present a more optimistic view on aid. An Ethiopian case study by Farah, Önder and Ayhan (2018) showed that aid has a negative impact on democracy and corruption levels, in support of Moyo's (2009) argument. However, Newby (2010) believes that aid is also needed to build strong institutions. Armah (2010) argued that aid promotes growth in low corruption and politically stable environments. Armah and Amoah (2010) argued that media freedom was important in reducing corruption and guaranteeing the political stability needed to make aid work. However, both Armah (2010) and Armah and Amoah (2010) did not focus on aid as a determinant of democracy. As different aid volumes and democracy levels experienced in Ghana may yield different results, the current research problem was therefore worth studying.

The findings of this study would provide a clearer understanding of the aid governance relationship in Ghana. This adds more knowledge to the existing contributions in the aid-governance nexus. With scholars calling for more aid, it is very important to investigate single cases to understand the situation for individual countries. It will then feed into further research into the aid mechanisms that facilitate a positive impact on governance. This is in the hopes of carrying lessons and modifying aid mechanisms in other countries which show that aid weakens governance quality to improve the situation.

This research is also relevant in marking the way forward in the Ghana Beyond aid agenda. Scholars such as Armah and Adei (2018) have written on the need for quality governance to achieve the Ghana Beyond Aid agenda. However, aid has a potential to improve governance quality (Moss et al, 2006; Brautigam et al, 2004). With the findings of this research, policy makers can then look into mechanisms to ensure good quality governance in the absence of aid.

1.7 Organization of the Paper

The rest of this study is divided into 4 chapters. The second chapter examines related literature. A review of scholarly works will present gaps that will be addressed by this thesis. The third chapter presents the methodology that was employed in the study, including the data that were used and their sources. The results section of the paper, the fourth chapter, will present the findings from applying the methodology.

These findings are discussed in conjunction with the hypothesis and relevant literature. Lastly, the fifth chapter will conclude the study and give recommendations based on the research findings.

CHAPTER 2: LITERATURE REVIEW

2.1 Overview

This chapter reviews the existing body of knowledge and current discussions on Official Development Aid and its effectiveness on the continent. Discussions of the literature will first explore the question of whether or not aid works, and then delve into the correlational relationship between aid and governance. Finally, the empirical evidence reviewed throughout the chapter would be used to establish the theoretical frameworks that underpin and set the foundation of the current study.

2.2 Exploring Aid; Does Aid Work?

Perhaps, the most intriguing aspect and, perhaps, oldest question in the aid debate is whether or not aid works. Extensive literature on the effectiveness of aid is still inconclusive on this matter. However, according to Pedrosa-Garcia (2017), four features of the conversation surrounding the effectiveness of aid can be highlighted. At the core of these features is whether aid contributes to development or not.

The first feature is the argument that aid leads to growth (Hansen and Tarp, 2001). Dalgaard, Hansen & Tarp (2004), in their empirical analysis of the effectiveness of aid, showed that many countries have improved productivity, which can be attributed to aid. They relate this to increased growth and development, as well as poverty alleviation. Morrissey (2001) establishes mechanisms through which aid can improve economic growth. He concludes that aid increases investment (both human and physical capital), improves import capacity for capital goods and also has no inverse impact on investment and savings rate. Bauer (1981) also supports ODA by advancing the following: a) it facilitates economic growth; b) it is instrumental in poverty alleviation; c) it is a good medium for income redistribution.

Furthermore, White (1993) puts forward the idea that the adverse effect of aid on taxes is dependent, among other things, on the impact of aid on private investment. This means that the effect of aid on private investment determines if aid has an adverse or positive effect on taxes. Using annual data from 1960 to 1997 for a sample of 71 developing countries, Karras (2006) found from his study on the relationship between foreign aid and growth in GDP per capita that foreign aid has a favourable, permanent and statistically significant impact on economic growth. Lastly, Gamanee, Girma and Morrisey (2005) established in a pooled paneled regression representing 25 Sub-Saharan African countries for the period 1970-1997, that aid has a positive impact on growth through transmission mechanisms such as public investment. They therefore conclude that aid ineffectiveness is not the cause of Africa's growth problems.

The second feature is the conditional elements of aid needed to engender development. Here, Burnside and Dollar (2000) find that aid's capacity to positively impact growth rests on the presence of good policies in the recipient countries. However, Dalgaard et al. (2004) find that the relationship between policy and aid is weak, and therefore, not a good justification for why aid will work in one country and not the other. Further conditional elements presented in the literature include the presence of an appropriate climatic environment (Guillaumount, Chauvet, 2001). Dalgaard et al. (2004), in establishing that aid spurs growth, acknowledged that the magnitude of this effect is dependent upon "climate-related circumstances" measured by fraction of land in tropical areas. Strikingly, they realize that aid does not work in the tropics because: (1) climate may directly impact productivity; (2) climatic conditions may have affected the development of "slow-moving structural characteristics" such as institutions. However, their examination is far from conclusive as to whether climate poses a factor in aid efficiency. Moyo (2009) also mentions that climate affects productivity, stating that though the tropics needs aid, its present underdevelopment is due to an innate incapacity to improve.

In addition, Mosley, Hudson and Verschoor (2004) establish another conditional feature that aid has a potential to reduce poverty if well allocated. They specify that three factors (inequality, corruption and composition of public expenditure) are tied to aid effectiveness using the public expenditure index. This is supplemented with inequality and corruption indexes for a sample of 34 countries for a period from 1980 - 2000. The public expenditure index is generally constructed with sectors considered to be pro poor such as education where their poverty elasticities are taken, and a composite policy indicator is devised that evaluates sectoral outflows. Also, Armah (2010) argues that aid promotes growth in low corruption and politically stable environments. In a cross-sectional approach, a dataset of 31 Sub-Saharan Africa (SSA) countries from 1984-2007 was analyzed to demonstrate the relevance of political stability in achieving a positive aid-growth relationship. This conclusion is corroborated by an earlier study by Islam (2005) who also showed the pertinence of political stability to the aid-growth relationship.

The third feature is that some authors argue that aid is clearly counterproductive to growth. Friedman (1995) argues that aid should cease altogether. He mentions that economic growth is required to achieve democracy and freedom. He states that the aid efficacy concept rests on three basic propositions: first, that the answer to economic growth is capital availability; second, that undeveloped countries are too poor to rely on themselves for the needed capital; third, that a centralized economic plan and control by government is significantly required for economic development. These propositions, according to Friedman (1995) are essentially half-truths. He argues that the aid given to provide the needed capital leads to inefficiencies, mostly characterized by inefficient production rather than comparative production as capital will be channeled into production projects that will not contribute to economic strength. A possible way to control this is to control the use of aid inflows into recipient countries, violating recipient government sovereignty in policy formation. This then renders foreign aid as a tradeoff where the set of inherited ignorant values which limits the potential of a people is replaced with an equally limiting set of political and economic controls (Friedman, 1995). He then proposes a robust free market which he believes is consistent with political freedom and democracy.

Also, Easterly (2002) is of the opinion that the absence of economic incentives in policy formation nullifies aid. Here, he reasons that the gap theory, along with the Harrod-Domar model is flawed in the sense that it lacks the incentive needed to make aid effective (Chenery & Strout, 1966). The gap theory contends that aid promotes growth by expanding the foreign exchange and investment required for growth. The incentive needed in here is the one to invest rather than spend. Thinking of the incentives which aid recipient face, the rational path to follow is to invest in the future when a high return on investment is yielded now and not to invest when high returns are not seen. Aid will therefore not push its recipients to increase their investment; the obvious incentive is to purchase more consumption goods. Hence, “on balance there is no relationship” between aid and growth (Easterly, 2002, p.34).

The last feature is that aid efficacy depends on aid objectives. In this case, authors consider specific goal setting such as poverty reduction and other non-economic factors such as education, health or political support. Tilak (1998) supposes that educational aid results in growth, poverty reduction, and income redistribution. Also, findings show that school feeding programs significantly improve the cognitive performance of unprivileged children in underdeveloped countries (Greenhalgh, Kristjansson & Robinson 2007).

The reason aid conversations are quite divergent in nature is the numerous factors that affect the impact of aid. Therefore, one of the ways aid can be more understood is through the conditional feature aid efficacy presents. Therefore, this study considered, in particular, the governmental conditionality feature of aid efficacy.

2.3 How Might Governance Affect Aid Effectiveness?

Though the central point of this study does not focus on governance as the dependent variable in the relationship between aid and development, the empirical evidence of increased country selectivity in disbursing aid makes this topic worth investigating. It further feeds into the analysis of the efficacy of aid on governance which will be discussed shortly.

The governance dimension is a focal point in the discussion of aid effectiveness. This is often used against aid. Using regression techniques on 1971 - 1990 non-military aid flow data from 96 countries, Boone (1996) analyzed aid effectiveness across several governance styles (laissez faire, egalitarian and elitist) and concluded that aid does not increase investment or alleviate poverty across political regimes. His argument that the political regime does not affect the effectiveness of aid is also supported by Kosack and Tobin (2006) who find that democracy does not directly affect foreign aid efficacy. Similar results are presented by Hansen and Tarp (2000) who, using an analytic framework (in a form of a survey) for evaluating the empirical work on linear regressions of foreign aid beginning in 1961, find that there is no relationship between foreign aid and growth, despite the presence or absence of strong policies.

On the contrary, Islam (2003) finds that there is some correlation between political regimes and aid effectiveness. He finds that in tinpot regimes, aid has had very little impact on growth as compared to totalitarian regimes where aid has a significantly positive influence on growth. A tinpot regime is a regime which displays poor leadership style but is not dominant enough to be termed a totalitarian regime. Though his research focuses on authoritarian style regimes, it still puts across similar points of the influence of good policies on aid effectiveness to that of Burnside and Dollar (2000). This is in the sense that tinpot regimes have a lack of central control that affects institutional quality greater than a fully totalitarian regime. Findings by Feeny (2007) also posit that the manner that recipient governments utilise aid is a vital determinant of aid effectiveness. Moreover, research by Economides, Kalyvitis and Philippopoulos (2008) also support the theory that political institutional factors influence aid effectiveness, particularly, that corruption hampers the aid efficacy on economic development.

Burnside and Dollar (2000) suggest that good policies are a prerequisite for aid effectiveness. They measure good policies by evaluating policy variables such as inflation rates, budget surplus and trade openness in correlation to growth. This is known as the Burnside and Dollar Index. A good combination of policy variables is greatly dependent on the democratic responsiveness of recipient governments. The lack of democracy can arguably be linked with institutional structure of donors and recipients of aid. Regarding the institutional structure of recipient countries, Easterly (2002) argues that aid flows to countries with good policies who use aid in an effective manner. On the other hand, countries with failing polices receive little aid and hence realize little growth. This consequently brings about country selectivity. However, good governance as a conditional factor in disbursing aid (country selectivity) is not always seen: According to Alesina and Weder (2002), corrupt countries receive more aid.

Institutional structure on the recipient side indicates that aid alone cannot sustain development (Moss, Pettersson Gelander & Van de Walle 2006). A state's capacity to collect tax depends on its political development. If recipient states do not have well-functioning institutions, then it cannot gradually substitute aid with other sources of revenue, thereby trapping them in aid dependency. However, countries receiving large amounts of aid will have fewer incentives to strengthen administrative efforts and tax collection (Ghura 1998). This leads to aid dependence, which is well defined by Riddell as "that process by which the continued provision of aid appears to be making no significant contribution to the achievement of self-sustaining development." (Riddell, 1996, p. 24). When aid flows are unaffected or not informed by government efficiency, there is then no incentive to use this aid to improve state capacity (Bräutigan et al, 2004).

2.4 How Might Foreign Aid Affect Governance

The previous section explores how governance affects the effectiveness of aid, as well as the quantum of aid given. However, this section expatiates on how aid affects governance. This relationship is the focal point of this thesis.

Once again, there are varying conclusions about the effect of foreign aid on governance. According to Bräutigam et al. (2004), high aid levels can improve governance, but they can also decrease governance quality. On the positive side, aid sent to countries with clear goal sets can be employed to reinforce policy and planning capability, upgrade the quality of the civil service and set up strong central institutions.

Nonetheless, Bräutigam et al. (2004) suggest that high aid levels might hinder governance development in 2 major ways. Firstly, high aid levels may create incentives that make it more problematic to overcome issues involved in building a more capable and effective governance in recipient countries. Also, large amounts of aid may weaken institutions rather than build them. The ways that this may occur are through aid fragmentation, high transaction costs, poaching, destruction of learning opportunities, as well as distortion of the budgetary process. According to Moss et al. (2006), studies from Ghana show that a rise in foreign aid results in discrepancies between planned and actual spending. Also, Moyo (2009) affirms a total negative effect of aid on governance in Africa. She maintains that aid has been of more harm than good in Africa. She states that the relationship between foreign aid and corruption goes both ways; foreign aid leads to corruption, resulting in underdevelopment and corruption causes impractical use of aid which again results in underdevelopment rather than development. She establishes that though development is the prime target of foreign aid, the unintended effects aid causes include domestic corruption and a continuous dependence on aid and international resources. In the natural progression of these occurrences, aid in itself hinders African development. This expatiates on the paradox of Moss et al. (2006) that drives the motivation of the study. Moss et al. (2006) believe that on the one hand, well-functioning public institutions are a prerequisite of aid efficacy due to their higher absorption capacity. However, in the same light, he posits that “the absorption of large aid flows may be counterproductive in committing recipient governments to building sound and sustainable institutions” (as cited in Newby, 2010)

The issue of the impact of aid on public institutions and corruption leads to the question of absorption capacities. Absorption capacity is the mechanism where foreign aid flows and projects funded by ODA reach a certain point after which development becomes stagnant or even declines. Berg (2000) suggests that aid as little as 5% of GDP may affect public institutions negatively. Ghana's national agenda of a nation beyond aid has a target to reduce the grant component of GDP, an average of 21% between 2016 and 2018, to a value below 5% by the end of 2028. However, other studies have shown that aid starts failing at higher levels between 15% to 45% based on country-specific circumstances (Clemens & Radelet, 2003).

The question of absorption capacities also leads to a breakdown of accountability structures. Large aid flows can reduce the incentives for democratic accountability. Accountability is naturally enforced when most revenue sources are obtained internally, mostly through taxes. However, when aid flows, which are parallel to other non-earned revenue sources such as royalties from mineral extraction, are large, accountability is reduced. Here, there is less incentive to be accountable to citizens. This is because citizens are not contributing to the state's revenue and therefore there is no need to be accountable to them. Thus, accountability largely depends on citizens' contribution to revenue (Newby, 2010). Aid dependency builds accountability as one between aid donors and the executive arm of government rather than one between state and citizens; this weakens a relevant aspect of governance. (Bräutigam et al, 2004).

The element of accountability also speaks to Easterly's point of incentives discussed earlier. The lack of incentives can lead to the collective actions problem. This is when aid is used on projects recipient countries have not included in developmental plans. Weak economies need to concentrate their resources on a limited number of essential activities. However, political elites usually have little incentive to fix the situation as the aid flows provide remarkable resources for fringe benefits (salary increments, vehicles, study tours, etc.) and patronage which would not have been available (Brautigam et al, 2004).As a result of the incentives needed for aid to work, aid should be disbursed as a rewarding element to high performing nations. This is because most of the issues underlying underdevelopment in Africa are attributed to bad governance and resource mismanagement rather than the lack resources (Hansen et al, 2000)

2.5 An Enquiry into the Measurement of Governance

Governance has become the focal point of international economy in economic debates because it indicates the development of the socio-political environment (Jaouadi & Hermass, 2012). Governance, according to the UNDP, is a nexus that relies on the interaction between a number of concepts and economic policies by which the public participates in project planning. Good governance is then indicated by transparency, effective rule of law, and participation (as cited in Jaouadi et al., 2012). Knack (1999) also perceives good governance in the form of institutions that demonstrate predictable, unbiased, and consistently enforced frameworks and rules for investors. The World Bank bases its definition on “the management of public resources, accounting, legal framework, free information and transparency” (as cited in Jaouadi et al., 2012, p. 186). However, Smout bases the notion of governance on concepts of good governance: “Good governance implies a rule of law, good administration, transparency and accountability of political leaders to their people” (as cited in Jaouadi et al, 2012)

As the literature has shown so far, aid is likely to have an effect on governance, which reflects socio-political conditions in a country. This thesis, therefore, through empirical evidence similar to other studies to be discussed below, deduced the relationship between aid and governance. However, unlike other studies, this study is a case study on Ghana as compared to the many cross-sectional and panel data analysis conducted by other scholars.

The International Country Risk Guide (ICRG) is a subjective index that measures the quality of governance. ICGR has been employed previously by Knack and Keefer (1995), Rodrik (1999) and others in demonstrating cross-country differences in economic performance. However, in the domain of aid and governance quality, Knack (1999) examined the relationship between aid and governance quality using ICGR measure of governance. He found a significant negative relationship between aid and the quality of governance in recipient countries over the period 1982 – 1995. Bräutigam et al. (2004) also make use of ICRG data to examine the relationship between aid and governance, restricting the study to Sub-Saharan Africa. The ICGR data used are supplemented with an objective measure, central government tax collections as a share of GDP. The study also concluded on similar results as Knack (1999), stating that there is a strong negative relationship between aid levels and governance quality.

However, Goldsmith (2001) found that aid is positively associated with governance, using cross sectional time series regression analysis on the Freedom House Index of political freedom. Also, using the Freedom House data for specific country case studies, Farah, Önder and Ayhan (2018) find that, again, foreign aid can be associated with higher levels of governance and democracy. This thesis also examines the relationship between aid and governance with a specific case study on Ghana using the Freedom House Index. The Freedom House Index is used based on the limited funds available and the ICRG data must be purchased. However, the Freedom house Index which rates a country as free, partly free or not free, is a good governance metric on which the aid-governance relationship can be built.

2.60 Theoretical Framework

The efficacy of aid started with the modernity theory, where the advancement of aid favored a linear path towards growth to mirror the West. This ideology of thinking gave rise to the application of growth theories such as the neoclassical models and the Harrod-Domar model to study aid and economic growth. Here, it was assumed that investment is the key to growth. Deeply related to this was the use of the Solow model in the aid field, which in addition to the concept of capital accumulation through investment, expected that aid will assist countries to escape the poverty trap, and once started on a virtuous cycle, growth would remain and there will be no need for aid (Pedrosa-Garcia, 2017). However, it was seen that aid was not resulting in growth and that policies and other lurking issues such as governance were important (Krueger, Michalopoulos & Ruttan, 1989).

2.61 Principal Agent Theory

To build the argument of the thesis, the framework for thinking about the determinants of aid effectiveness proposed by Howes (2014) is needed. Howes (2014) states that there are three schools of thought on aid effectiveness: the recipient, donor, and transaction costs schools. Of particular importance to this thesis is the recipient school of thought. The framework is built on the principal-agent theory which is well suited for the analysis of the aid relationship. The theory establishes that donors, as principals, cannot fully control recipient countries. To further establish basis for the analysis, three concepts must be understood, two of which are important to this study; first is the performance of the recipient; second is the performance of the donor. Performance is measured by governance. Here, the better the performance of both the recipient and donor country, the greater the effectiveness of aid.

Under the recipient school, it is claimed that aid efficacy is dependent of sound policies in recipient countries (Burnside & Dollar 2004). It ties in with the view that domestic institutions primarily determine economic performance (Rodrik 2003). Good governance is also important because it has been found that aid is fungible, where more aid funding to a particular sector leads to a decrease in government expenditure to that same sector. Here, aid frees up funds for other purposes not preconceived by donors and usually does not benefit citizens (Swaroop & Devarajan 1998). Howes (2014) believes that if the holistic impact of aid considers domains outside the sector directly receiving the aid, then donors must be concerned with governance overall and not individual aid-funded causes.

If aid effectiveness is determined by governance, then donors as principals should utilize aid to improve the performance levels of their agents (Howes, 2014). According to Howes (2014), there are two ways to do this: country selectivity or attempting to improve the performance of all its recipient governments through using aid to promote good governance and aid conditionality. Collier, an important author in the recipient school writes that 'aid should be assessed by its ability to promote reform' (Collier 2002, p. 2). As the literature shows, aid is likely to have a negative effect on governance without good institutions (Abuzeid, 2009).

2.62 Threshold Theory

This theory posits that aid contributes to socio-political development in recipient countries up to a certain level after which the aid flows begin to have a negative impact on governance. This theory is explored by Jaouadi and Hermassi (2012) using empirical work done by Knack in 1999 on the relationship between aid flows and governance quality. The test by Jaouadi and Hermassi (2012) find the following in support of the theory:

- Recipient countries with a higher ICRG compared to other countries at the beginning of the period showed a boost in their governance
- An increase in GDP per capita assists in improving quality of governance in recipient countries (whether or not there is a threshold)
- Therefore, a change in GDP per capita is an indication of wealth, assisting to increase the quality of governance as it shows that the country's financial ability to offset the adjustment costs is linked with institutional reforms.

However, without the existence of the threshold, similar results to that of Knack (1999) were obtained, where, in the short run, aid has a negative effect on governance. Here, the initial advantage of a higher ICRG does not contribute to governance improvement. This shows that the countries with high governance scores must work extra hard to maintain the improvement which can be compromised by aid. Therefore, aid can present a harmful effect on governance as aid commitments superficially tend to increase corruption opportunities in recipient countries. However, from the study, the threshold at which aid will be beneficial to governance is unknown.

2.63 Big Push Theory

The big push theory in the aid sphere is the belief that most of the problems in developing countries will be solved by the influx of aid into those areas. Proponents of aid such as Sachs (2005) have stuck to the need for more aid to meet the needs of the third world; he argues that the world could have met its MDGs in 2015 if there was more aid given. However, Easterly (2006) has greatly disputed the big push theory, stating that with this massive influx of aid, there are deaths caused by illnesses that have one cent vaccines. However, he advocates for better aid.

Evidence of economic growth also goes contrary to the big push theory. In the last 50 years, aid inflows to Sub-Saharan Africa came up to USD1 trillion; however, GDP per capita has declined over the same period (Abuzeid, 2009). According to Abuzeid (2009), World Bank estimations show that aid transfers to Zambia should place its GDP per capita at over USD20,000 now. However, it has remained at USD 600 for years.

In another light, the big push theory has been disputed to erode the quality of governance. Opponents of the theory such as Moyo (2009) argue that aid perpetuates corruption and rather does more harm than good. Brautigan (2000) also, through empirical evidence, suggests that an influx of aid erodes governance. According to Abuzeid (2009), the influx of aid has also distorted power balance in recipient countries, resulting in politicization of economic life and an increase in rent-seeking activities.

Though the big push theory has been widely disputed, it is important, with the threshold theory, to know to what extent foreign aid is beneficial to governance. In other words, to what extent should a push be made for the influx of foreign aid that will still have a net positive impact on governance.

CHAPTER 3: METHODOLOGY

3.1 Overview

This research aimed to investigate the relationship between aid and the quality of governance in Ghana. A similar study is conducted by Farah, Önder, and Ayhan (2018) to evaluate the impact of aid to the socio-economic advancement of Ethiopia using time series data and regression analysis. However, this study sought to explore the socio-political impact of aid in Ghana using similar time series data and regression analysis. In light of this, this chapter expands on the research design, research variables, and data analysis procedures.

3.2 Research Design

The research question required a quantitative research approach. This method makes use of figures, mathematical formulas, statistical computations and inferences in response to the research question; it does this by evaluating relationships or making predictions by analyzing data quantitatively (Leedy, 1993). This approach is best for this study because it lends itself to hypothesis testing and analyses of data statistically to establish relationships (Jupp, 2011). In this case, the form of the data for the variables under analysis, which is both aid and governance quality, is quantitative, and to establish the relationship between them, quantitative methods, specifically regression had to be used.

3.3 Research Scope and Data Sources

Since this is a country-specific case study, the study was limited to only Ghana. This research utilized times series data on the various variables under observation, ranging from 1984 – 2018, a period of 34 years. Data measuring foreign aid dependency were obtained from the World Development Indicators. On the other hand, data in relation to the quality of governance, that is, International Country Risk Guide (ICRG) data were obtained from the Quality of Governance Institute and Political Risk Services (PRS) Group. Variables, GDP per capita and population and trade openness, intended to be moderating factors were obtained from the World Development Indicators.

3.4 Data Description

The specific variables, foreign aid and governance quality, act as the explanatory and response variables for this study. Other explanatory variables include GDP per capita, trade openness and population.

Most studies on the impact of aid utilize aid as a percentage of gross domestic product (GDP) (Boone, 1996). However, according to Brautigan et al. (2004), aid as a percentage of government expenditure also serves as a plausible measure of the dependency of aid. Brautigan et al. (2004) makes use of both variables in their analysis. However, data on aid as a percentage of central government expense for Ghana available from the World Bank Development Indicators are from 2001 to 2015 with data gaps in 2012 and 2013. Therefore, this dataset cannot be used due to the data gaps present.

Governance is measured using the International Country Risk Guide (ICGR) Indicator of Quality of Government index obtained from the Quality of Governance (QOG) Institute database, an independent research organization at the University of Gothenburg. The ICRG collects and converts financial, political information and economic data into risk points. The ICRG Indicator of Quality of Government is the mean value of ICRG variables “Corruption”, “Law and Order” and “Bureaucracy Quality” on a scale of 0-1 according to the QOG Institute codebook. Higher quality of government is indicated by higher mean values. Due to the inclusion of corruption in the mean value of the indicator, I did not include the Transparency International Corruption index in the model as done in Farah et al. (2018). Papers such as Knack (1999) and Brautigan et al. (2004) have made use of ICGR Indicator of Quality of Government to measure governance. However, data to be obtained from ICGR starts from 1984, fewer points than the Freedom House Index which has been used by Farah et al (2018), and Goldsmith (2001) in measuring governance and democracy. Both the Freedom House Index and the International Country Risk Guide (ICGR) are subjective indexes and are unique among various quality of governance measures used in empirical studies on growth as they include a greater number of African countries for a comparatively longer period of time. However, the Freedom of House index for the period under consideration has gap years of no data for Ghana.

In suggestions made in Brautigam et al (2004), changes in population and GDP per capita are added explanatory variables. Here, change in population controls for economies of scale (a product of population growth) that may lead to building effective institutions and consequently, an increase in the ICRG index. Also, an increase in per capita income feeds into a larger number and size of transactions which then increase the quality of developing institutions, enforcement and adjudication mechanisms. ICRG ratings may even be influenced by income changes (Brautigam et al, 2004). In times that corruption and bureaucratic information is unavailable or hard to come by, ICRG may deduce governance quality from economic performance. Therefore, in periods where there is high economic growth coupled with a rise in institutional quality and low aid levels – or periods of low economic performance coupled with deteriorating governance quality and high aid levels, failing to control for income changes could lead to a ‘spurious negative relation between aid dependence and the quality’ (Brautigam et al, 2004, p. 269). In other areas, the trade openness may be associated with good governance and vice versa; therefore, trade openness, calculated as exports plus imports as percent of GDP is also accounted for.

3.4 Hypothesis

This study sought to investigate if foreign aid influences governance. Thus, the hypothesis for the study are as follows:

Null hypothesis, H_0: There is no relationship between foreign aid and governance in Ghana

Alternate hypothesis, H_a: There is a relationship between foreign aid and governance in Ghana

3.6 Empirical Approach

To determine the relationship between the variables of interest, the OLS regression model was employed. OLS regression is a statistical technique employed to evaluate the intensity and direction of the relationship between an explanatory and response variable that has been collected over a period of time. This model therefore allows for grasping the magnitude of the effect of aid on governance, highlighting the threshold theory and was therefore employed in estimating the variables (Farah et al, 2018). It was chosen for two reasons: it was widely accepted as a statistical technique for evaluating and forecasting relationships between variables, and, secondly, its results are easy to explain. The results from this analytical technique are discussed in the subsequent chapter.

The OLS regression evaluates variables in the following general format

$$y_t = \alpha_1 + \beta_1 x_t + u_t, t = 1, 2, \dots n. \qquad (1)$$

where y and x represent the dependent and explanatory variable respectively. α_1 and β_1 represent the intercept and coefficient of the explanatory variable and u captures all unobserved variables that have an effect on the dependent variable.

From this, a multivariate model is used to factor in four explanatory variables. Similar multivariate regression have been employed in Knack (1999), Brautigan et al. (2004) and Jaouadi et al. (2012) to study the impact of aid on quality of governance. The OLS regression model will therefore be modified as follows:

$$ICRG_t = \alpha_1 + \beta_1 AID_t + \beta_2 \Delta GDPPC/GDPPC\_1984_t + \beta_3 \Delta POP/POP\_1984\ _t + \beta_4 TRADE_t + u_t \quad (2)$$

where *ICRG* represents the ICRG Quality of Governance index, a measurement of governance, for each time period, *t*. *AID* denotes the annual aid flows over the period, *t*, measured as aid as a percentage of GNI. $\Delta GDPPC/GDPPC\_1984$ denotes GDP per capita changes over the sample time period with the first year of the sample data, 1984, being the base year. Similarly, Δ*POP/POP_1984* represents the change in population over the sample time period with the first year of the sample data, 1984 in respect to time, t, respectively. *TRADE* denotes trade openness which is measured as net exports as a percent of GDP. The time period from 1984 to 2018 is denoted by *t*. $\alpha_1$denotes the intercept, and

β_1, β_2, β_3, and β_4, are the relevant parameters.

All explanatory variables are log transformed to provide a convenient way to interpret the coefficients, that is, in percentages. Also, the log transformation would compress the data, and make the variable approach normality, an assumption in OLS regressions. Also, since the literature review spoke to a bi-directional relationship between aid and governance, a regression was carried out with aid on the left-hand side and quality of governance on the right-hand side. This was to illustrate if governance affects the volume of aid. It also enabled the notion that aid flows to countries with better governance to be tested by noticing if a high index of governance quality is associated with larger aid flows.

Since the variables are represented using time series data, there is a need to ensure that the data and OLS regression satisfy the following time-series assumptions, This is to avoid spurious results in the OLS model and ensuring that the model provides the Best Linear Unbiased Estimators (BLUE) (Wooldridge, 2013).

To ensure that the linearity and weak dependence assumption is met, the stationarity properties of the model were investigated using the augmented Dickey Fuller test (ADF) (Dickey & Fuller 1979). Common critiques of the ADF test include sensitivity to inappropriate lag estimations and low power properties. Given these weaknesses, the Phillips-Perron (PP) test, which gives room for a deterministic time trend and a non-zero mean, was also conducted (Phillip & Perron, 1988). If the data is found to be non-stationary at level I(0), that is there is a presence of unit roots, the data is differenced. With no serious issues with stationarity, the OLS regression is estimated

Another assumption is the condition of zero conditional mean where all independent variables have an expected error term value for each time period of zero. Another assumption is that no explanatory variable should be constant, nor have a perfect linear combination with other explanatory variables to ensure there is no perfect collinearity; to establish this, the Variance Inflation Factor (VIF) method was estimated (Wooldridge, 2013). To add on, there should be no serial correlation, meaning that errors in two distinct time periods should have no correlation. Lastly is the assumption that the error term of the OLS regression has a constant variance over time. The assumption of no serial correlation and homoscedasticity in errors was ensured by using the Newey & West (1987, 1994) Homoskedasticity and Autocorrelation Consistent

(HAC) covariance matric estimators to test the coefficients of the regression (as cited in Zeileis, 2004).

These asymptotic time series assumptions apply to large sampled data, thereby, the normality assumption is well satisfied under the central limit theory (Wooldridge, 2013). However, since the time period under observation presented a small sample size, normality was corrected using log transformations.

3.7 Data Analysis

The OLS regression coefficient was employed to establish whether foreign aid negatively or positively affects governance quality. Also, the coefficient of the governance variable was to determine the magnitude at which foreign aid affects governance in Ghana. The p-value was used to determine if the relationships found between aid and governance were statistically significant or not. A significant level of 5% is the benchmark that was used to evaluate the p-value.

The statistical software for the study were Excel and R Studio. Data collection was done in Excel and R studio used for filtering and data analysis, that is, for graphing, summary statistics, test assumptions, the regression model, test statistics and robustness tests.

CHAPTER 4: RESULTS

4.1 Overview

This chapter presents the results of the statistical analysis of data obtained from the World Bank Databank Indicators, the International Country Risk Indicators, the PRS Group and The Quality of Governance Institute. This chapter starts with summary statistics of the variables under analysis, followed by an overview of the preparation of the data for analyses, which includes the test assumptions for times series data. Following this is the execution of the multiple OLS regression and the discussion of the regression results. The methods, and analysis of the data are discussed in the context of the theoretical framework and methodology outlined.

4.2 Summary Statistics

The results of the summary statistics in Table 1 show that on average ICRG index is 0.45, with ICRG index ranging from 0.14 to 0.62 over the period from 1983 – 2017. Aid as a percentage of GNI had a mean percentage of 7.86% for the period under observation, with a standard deviation of 3.98%. Observed values of aid intensity as measured by aid as a percentage of GNI were within the bounds of 1.66% and 16.34%.

The average change in GDP per capita relative to 1984 over the period was 0.04%, with a similar standard deviation. The highest change in GDP per capita was 0.2%, with the minimum being a decline in GDP per capita by 0.003%. Change in population relative to 1984 had an annual average of 0.04% with a standard deviation of 0.01%. The highest annual population growth was 0.05% and the lowest was a 0.03% growth rate.

Table 1: *Summary statistics for basic sample of time series data used in multiple regression*

Variable	Count	Mean	SD	Min	Max
ICRG value	35	0.45	0.11	0.14	0.62
Aid as a percentage of GNI	35	7.86	3.98	1.66	16.34
GDP per capita change/1984 GDP per capita	35	0.04	0.04	-0.003	0.20
Population change/1984 population	35	0.04	0.01	0.03	0.05
Trade openness	35	68.45	23.53	18.81	116.05

Note: SD = Standard Deviation. Source: Author's own calculation based on data from the World Bank's Databank Indicators, International Country Risk Indicators, The PRS Group and The Quality of Governance Institute

4.3 Test Assumptions for Time Series OLS Regression

This section elaborates on the data preparation process of testing the data to be analyzed to ensure that it meets the time series regression assumptions mentioned in the methodology. This section covers both pre- and post-estimation tests.

4.3.1 Test for Zero Conditional Mean

To ensure the presence of a zero-conditional mean, the average of the errors for the dependent variable given values of the independent variable was computed. The average of the residuals was zero, satisfying the assumption of a zero-conditional mean.

4.3.2 Test for Multicollinearity

This test is to confirm the absence of a perfect correlation between the independent variables. This implies that a presence of some level of correlation between the explanatory variables is not an issue, but a very high or perfect correlation of one would lead to biased regression estimations. To test multicollinearity, I employed the Variance Inflation Factor (VIF) method. The results from the test are below in Table 2.

Table 2: *VIF results for collinearity test*

Variables	*VIF*
Aid as a percentage of GNI	1.682
Change in income per capita	1.815
Population growth	2.53
Trade openness	1.40

Source: Author's calculations using R

With the use of this method, a VIF that exceeds 10 indicates the presence of multicollinearity. With values computed at most 50% below the rule of thumb, the assumption of no multicollinearity has been met.

4.3.3 Stationarity Test

Another assumption for time series regressions is the presence of stationarity in the variables. The absence of stationarity variables can lead to spurious regressions. Here, the variables must display a constant mean over different time periods. To test the stationarity of the data under observation, I applied both the Phillips-Perron and Augmented Dickey Fuller test for stationarity. Both tests are run in order to firmly conclude on the order of integration for the variables under observation.

The ADF test is an extension of the Dickey Fuller test. It tests the null and alternate hypotheses of:

H_0: Series contains unit roots

H_a: Series is stationary

Using, the "urca" package in R, a further implementation of both the Augmented Dickey Fuller test and the PP test is carried out over the standard adf.test and pp.test functions in the "tseries" package. I conducted the ADF test under two conditions: (1) when there is a constant only and; (2) when there is a constant and trend.

To further establish the results of the Augmented Dickey Fuller test, the Phillips-Perron test for stationarity, which is also an extension of the Dickey Fuller test, was carried out. Using the same null and alternate hypotheses as that of the Augmented Dickey Fuller test, it tested the stationarity of the time series variables under two conditions: (1) when there is presence of a constant and trend and; (2)when there is no constant and trend in the series.

The results of the following tests presented in Table 3 establish that all the variables are stationary at level except aid as a percentage of GNI, which is stationary at first difference. Since there are no serious issues with stationarity, there is no need to check for cointegration. The regression is estimated using variables at level and first order integration.

Table 3*: Augmented Dickey Fuller and Phillip-Perron Stationarity Test Results*

	ADF Test		PP Test		*Order of integration*
	Drift	Trend	Without Trend	With Trend	
ICRG value	-2.67*	-2.48	-4.40***	-3.80**	I(0)
Aid as a percentage of GNI	-0.44 (-3.91)***	-2.46 (-4.12)***	-0.46 (-6.42)***	-1.88 (-6.76)***	I(1)
Change in income per capita	-2.62*	-3.57**	-2.80**	-3.66**	I(0)
Population growth	-1.33	-6.34***	-0.80	-1.79	I(0)
Trade openness	-3.11**	-2.54	-3.68***	-2.67	I(0)

Significance level: *** .01, **.05, *.1. First order integration stationarity test results shown in parenthesis

Source: Author’s calculations using R.

4.3.4 Test for Heteroskedasticity and Serial Correlation

The Heteroscedasticity and Autocorrelation Consistent (HAC) estimator is employed in conducting the coefficient test for robust standard errors to ensure that the errors of all coefficient estimates are both homoscedastic and not serially correlated (Zeileis, 2004). Here, there should be a constant variance in the error term and uncorrelated errors between 2 time periods

4.4 Presentation of Regression Results

Since the results of the stationarity test show no serious unit root issues, the OLS regression is estimated without the need for a cointegration test and an error correction model. The results of the OLS regression estimates are presented in Table 4

Table 4*: Regression estimates for ICRG Quality-of-Governance Index for Ghana*

	Dependent variable:
	ICRG Governance Index (in logs)
Constant	1.48* (0.479)
Aid as a percentage of GDP (in logs) (lag = 1)	0.166**(0.086)
Change in GDP per capita (in logs)	-0.128(0.041)***
Population growth (in logs)	1.227(0.479)**
Trade openness (in logs)	0.07(0.12)
Observations	34
R^2	0.47
Adjusted R^2	0.39
Residual Std. Error	0.056 (df=28)
F Statistic	3.867*** (df = 4; 28)

Note. HAC robust standard errors reported in parenthesis; Significance level: *** .01, **.05, *.1
Source: Author's estimations using R.

The regression shows that there is a small positive effect of foreign aid on the level of governance. The coefficients show that a percentage increase in the aid/GNI ratio will lead to an increase in the ICRG Quality of Governance Index by 0.166%. Other significant coefficients are that of change in population relative to 1984 and change in GDP per capita relative to 1984. Surprisingly, change in GDP per capita relative to 1984 has a significant negative effect on the ICRG index. The R^2 and adjusted R^2 of 47% and 39% show the variability in the ICRG index that is accounted for by explanatory variables. This shows that the A significant f-value of 3.867 at 1% shows that the variables are jointly zero.

It appears that contrary to the perversity theory, aid has a small beneficial influence on quality governance. It is therefore difficult to maintain that moral hazard associated with aid undermines governance quality in Ghana. The principal-agent theory has not caused a negative effect on governance. In actual fact, both donors and recipient countries indicate they have been trying to achieve higher governance quality, and not a contrary outcome. Both Goldsmith (2001) and Farah et al (2018) using the Freedom House Index conclude on a similar association that higher levels of aid is positively linked with governance. Farah et al (2018), a country specific study showed this relationship for Ethiopia, a country known for its high aid dependency. This similarity of country specific studies, Farah et al (2018) and this thesis, show the need for country specific instances to offer new accounts on aid dependence.

Although this research design does not show empirically why there is a positive impact of aid on governance, the principal agent theory attributes a positive impact of aid on governance to the good performance of both the recipient and donor countries. Outcomes of these performance may include solving the collective action problem and introducing hard budget constraints that reduce aid fungibility. Hard budget constraints include restrictions on the size of a budget deficit and the option to carry budget deficit into the next year. These restrictions create good policy practices in recipient countries and leads to the effective use of aid funds. A classic example of hard budget constraints used over the period under observation is during the SAPs. The hard budget constraints, together with other conditionalities, that accompanied the disbursement of aid over the period led to high fiscal discipline on the part of government.

The results also suggest that there may be too much emphasis on the negative effects of aid on governance. The big push theory does not inevitably erode the quality of governance. This is not to discredit opponents of the big push theory who have provided anecdotal and empirical evidence of the negative effects of aid on governance (Moyo, 2009; Brautigam et al, 2004). It is however important to look at aid delivery and the big push theory in context with the threshold theory to know to what extent foreign aid is beneficial to governance.

The worrisome aspect of this regression is the existence of reverse causality. If aid seems to increase governance, in Ghana, then it likely that donors deliver aid based on the notion of the country's governance indicators. Indeed, many aid scholars maintain that aid should be targeted on states with good democracies and governance. Studies have shown that aid targeted on states with good institutions leads to aid efficacy (Armah, 2010). Also, the paradox mentioned by Moss et al (2006) where the aid requirement to build well-functioning institutions counters the requirement for good institutions for aid effectiveness also points to aid delivery based on governance. However, the essential point from this regression is that it shows for period under observation that, aid can be associated with good governance (Goldsmith, 2001).

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

In this concluding chapter of the report, I present a recap of the highlights of this thesis including the research issue and significance, the research question asked, the empirical method as well as the findings. I move on to provide conclusions, recommendations and suggest viable areas for future study.

5.1 Summary

This thesis explores the impact of aid dependence on governance in Ghana. Even with few countries being well governed or showing signs of aid efficacy, there is still an influx of aid to solve Africa's problems. On the other hand, the crucial role of governance quality in establishing development is rather apparent. With the continuous flow of aid in the face of deteriorating governance, there is the apparent question: "Does aid dependency deteriorate governance?" This study therefore sought to establish the aid-governance relationship for Ghana by asking the question, "Does aid increase governance quality in Ghana?"

Secondary data were collected from the World Bank's Databank Indicators, International Country Risk Indicators, The PRS Group and The Quality of Governance Institute for a 1982 to 2018 time period. Based on theoretical frameworks, the OLS regression model was employed to explore the relationship between aid and governance. However, since time series data were being used, there was a need to ensure that tall time series assumptions were met to avoid spurious results. With all the assumptions satisfied, the regression model was estimated.

The results of this estimation showed that aid has a positive impact on governance. Though this was contrary to the mainstream thesis that aid has a negative effect on governance, it shows that aid can have a positive effect on governance in country-specific studies. However, due to the paradox that Moss et al (2006) presents, the issue of causality is not strictly established in this study.

5.2 Conclusion

Foreign aid supplements government efforts to run basic functions such as paying salaries and purchasing goods and services. However, aid dependence does not indicate that Ghana has lost some state capacity, nor does it show that governance outlook will be more favorable without or with less aid. Based on the OLS results, it can be seen that there is a slight positive relationship between aid and governance. Looking at this, I believe that aid has boosted Ghana's governance quality more than it has deteriorated it.

5.3 Recommendations

The results suggest that aid actually has a positive impact on governance in Ghana may have implications on socio-political development. The Ghana Beyond Aid agenda will mean that there will be absence of aid, calling into question the outlook of state capacity with time as it can be seen that aid contributes to governance. Scholars such as Armah and Adei (2018) have spoken on the need for quality governance to achieve the Ghana Beyond Aid agenda. However, since aid can be seen to contribute to governance, policy makers need to investigate new mechanisms that will ensure good quality governance in the absence of aid.

The results will also mean that governance issues that are typically associated with aid such as fungibility, rent seeking, unaccountability may not be associated with deteriorating governance. Therefore, other causes of deteriorating governance should be considered in the diagnosis of poor governance facets such as corruption and bureaucracy.

Lastly, the case of Ghana showing a positive impact of aid on governance should be used as a foundation to investigate and carry on lessons from the case of Ghana to modify aid mechanisms in other countries which show that aid weakens governance quality. These lessons should be applied tactfully and with discretion, taking into account unique socio-cultural and eco-political factors present in other countries

5.3.1 Future Study Areas

The aid-governance literature is a field with many research prospects. Country-specific studies are particularly important to facilitate unique diagnosis of the aid-governance relationship to inform policy on both the donor and recipient sides. Moreover, other good quality governance measures such as the Country Policy Institutional Assessment (CPIA) from the World Bank and the Mo Ibrahim's index of governance by the Mo Ibrahim Foundation can be substituted for the ICRG index in the distant future, as the current data do not present samples large enough for BLUE country-specific result estimates. Lastly, other estimation methods such as the two stage least squared methods, as well as other econometrical approaches may be used to investigate this country as well as other country cases in the aid-governance field.

5.4 Limitation

Since this study is meant to be country specific, the results from this research cannot provide a generalization to other countries. Also, since the ICRG data on quality of governance for Ghana begins in 1984, it made the period under consideration only 34 years. This is a relatively small sample for OLS regressions using time series data.

Lastly, the empirical approached used does not explore the existence of reverse causality between the aid and governance.

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