EFFECTS OF FOREIGN AID ON ECONOMIC GROWTH IN KENYA

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ABSTRACT

This study sought to determine the effects of foreign aid on economic growth in Kenya by disaggregating foreign aid into three categories namely; net loans, grant aid and technical aid. The study adopted Samuelson's equilibrium analysis model that captures the need for government financing of public goods done through foreign aid and taxes and all foreign aid received is assumed to be used for financing public investments which ultimately influence economic growth by influencing private sector investments. The study used secondary data on all variables, sourced from credible government and international institutions, and time series data approach was employed. The time series data was investigated and any non-compliance corrected before investigation. Vector auto-regression (VAR) modeling technique and the error correction model (ECM) were employed to estimate the effects of the three components of foreign aid on economic growth in Kenya. Data was analyzed and presented in descriptive statistics using simple graphs and tables. The finding of this study revealed that net loans had a positive but an insignificant relationship with economic growth in Kenya. Similarly, the findings revealed that grant aid was positively and significantly related to economic growth such that an increase in grant aid by 1unit accounted for a 27.3 units increase in GDP. Finally, the study established that technical aid was negatively and significantly related to economic growth such that an increase in 1 unit of technical aid resulted to a decrease of 25.2 units in GDP. The study concluded that there exist a positive and significant relationship between foreign aid and economic growth in Kenya. The study recommends that the government of Kenya should cautiously use borrowing to supplement other revenue sources and the funds be directed to productive public investments. In addition, appropriate loan and aid funds management policies should be put in place to enhance both domestic and foreign private investments to increase economy's production, employment, stabilize exchange rate, interest rate and inflation rate. Stringent measures should also be adopted to curb wastage and embezzlements of aid funds.

Keywords*: Foreign aid, Economic growth, Net loans, Grand aid, Technical aid and Policy implications*

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