THE IMPACT OF FOREIGN AID ON ECONOMIC GROWTH IN KENYA

BY

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ABSTRACT

The study undertaken sought to explain the impact of aid on economic growth in Kenya. Cointegration analysis was employed to establish the existence of a long-run relationship between GDP, external loans, grants, technical aid and total aid with each foreign aid entered independently into a unique equation alongside other macro-economic variables of gross fixed capital formulation, effective labour, broad money as a percentage of GDP, population growth rate, Official exchange rate and Inflation using quarterly data for the period 1995 to 2015.

Post affirming the existence of cointegrating relationships, error correction models are obtained to help decipher the short run dynamics. The long relationships indicated that economic growth is explained significantly by foreign aid in the form of loans and technical aid and all the other macro-economic variables in the anticipated direction except broad money and inflation that have ambiguous signs. The short ECM indicates that only loans affect growth in the short run significantly with a negative direction similar to grants. All of this points to the fact that economic growth in Kenya can be rationally explained by the models.

The key recommendations from this study are that the government should consider adopting alternate sources of finance say through taxation and minimise borrowing externally to avoid compromising economic growth. The government should also commit more resources to investment in human capital training as effectively labour has the impact of fostering economic growth across all models in the short run. Notably population growth rate should be controlled through expanding use of social services like family planning or sensitisation to avoid piling pressure on limited resources which discourages economic growth.