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# AN INSIGHT INTO AID AND ECONOMIC PERFORMANCE UNDER THE STRUCTURAL ADJUSTMENT AND HEAVILY INDEBTED POOR COUNTRIES INITIATIVE: A CASE STUDY OF GHANA

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**ABSTRACT**

The paper provides a schematic overview of aid in least developed countries and examines the trend and relationship between aid and exports, imports, investment, savings, real exchange rate, government expenditure, debt and growth during the structural adjustment and heavily indebted poor countries initiatives in Ghana. It is found that increase in aid had a positive effect on economic growth, exports, government expenditure, investment, and debt service payments and aid did not displace savings. The negative effect of aid was on the real exchange rate appreciation but this was restrained as it had a small impact on export performance. The debt servicing was reduced during the post heavily indebted poor countries initiative period. Notwithstanding, Foreign aid has to be a secondary factor to local revenue if Ghana is to achieve sustained growth and poverty reduction.



## INTRODUCTION

The early logic of foreign aid was straight forward: poor countries lack capital, so if wealthy countries transfer capital to them, they should grow out of poverty. Yet a remarkably wide range of economic analysis had produced ambiguous results as to whether foreign aid has a positive impact on economic performance. The British ruled Ghana from 1844 until 1957, and developed the beloved colony. Ghana was securely placed among the club of middle income countries. In 1960, Ghana's per capita income of £70 was still higher than that of Nigeria (£29), India (£25), and Egypt (£56) and the growth rate was around 6% (Huq, 1989, p.2). After independence, Ghana was characterized by economic woes. Since 1983, Ghana has implemented IMF/World Bank supported programmes of stabilization and structural adjustment. Undoubtedly, the country has made a remarkable transition from a dirigisme economy to an open economy using imperfect markets to allocate resources. The International Monetary Fund (IMF) and the World Bank assert that 'Ghana represents a showcase of Africa success story' (IMF and World Bank, 1990; 1991; 1995). Ghana's decision to participate in the Heavily Indebted Poor Country (HIPC) debt-relief initiative was greeted with a great deal of enthusiasm by some of its key development benefactors. The United Kingdom, a major advocate of HIPC's debt relief programme, immediately pledged millions of pounds in development assistance. Despite that eagerness, however, the disbursement of foreign loans and grants to the country remained, as it had over the pre-HIPC years, erratic and typically below target. This inevitably created problems of budget implementation and economic management. The purpose of this paper is to assess what happened to economic performance during the Structural adjustment (SAP) and the HIPC initiatives.[1]

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[1] Structural Adjustment refers to measures to achieve structural changes that will contribute to economic recovery and growth (Duncan and Howell, 1992, p.5). It is official trade mark for the package of policies adopted by a government of a less developed country (LDC), usually the result of a co-operation with the IMF and the World Bank (Gibbon et al., 1996). HIPC initiative was launched in 1996 by the IMF and World Bank. The initiative entails coordinated action by the International Financial Community including multilateral organizations and governments to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. The relief is of two stages – decision point meant for interim relief and completion point meant for irrevocable reduction in the stock of debt (World Bank, 2000; 2002).

The focus on Ghana is important for at least two reasons. First, Ghana is one of the few countries in the Sub Saharan Africa region that had a great record of substantial performance with foreign aid and also pursued more consistently the neo-liberal economic policy reforms of Stabilization and Structural Adjustment. Secondly, Ghana's case may not represent the entire Sub-Saharan Africa region but it will provide an important background for development policy makers in thinking of foreign aid and development. This paper provides a review of the trend of foreign aid in developing setting and attempts to explain the relationship between aid and macroeconomic variables such as exports, imports, investment, savings, government expenditure, real exchange rate, debt and growth before HIPC (Structural adjustment period) and after the HIPC initiative in Ghana. The paper is organized as follows. Section 2 provides the literature review. Section 3 outlines the hypothesis, data and methodology. Section 4 and 5 provide the overview of foreign aid and the analysis of aid and selected macroeconomic indicators. Section 6 presents the conclusions and policy implications.

## Literature Review

Foreign aid in different times and different places has been highly effective, totally ineffective, and everything in between. The bulk of the theoretical analysis on aid has been on the question of whether foreign aid promotes or retards economic growth, and on whether it supplements or displaces domestic savings in recipient countries. Capital formation is identified as the basic problem of developing countries in general. Thus, rich countries and development agencies who give aid to developing countries are motivated by the argument that foreign aid promotes economic development and welfare in those recipient countries. According to Chenery and Strout (1966), foreign aid or overseas development Assistant (ODA) is another source of finance which LDCs can use to supplement their domestic savings and export earnings in the short-run. From the income accounting identity, $Y = I + C + X - M$, a country needs external private capital to finance its requirements for investment and imports. Y is gross domestic income, I is gross domestic private and public investment, C is total final consumption expenditures (private and government), X is export earnings and M is import payments. Savings, $S = Y - C$. So re-arranging the income accounting identity, we have

$$S - I = X - M.$$

The domestic savings gap on the left hand side and the foreign exchange gap on the right hand side. Thus foreign aid bridges the gap between savings and required investment, and enables recipient countries to achieve their target rates of economic growth. However, in the long-run, the marginal propensity to save must be higher than the required rate of investment. Rostow (1960) identifies three conditions for less developed countries to reach the stage of developed countries: firstly there must be significant increase in the rate of net investment; secondly one or more of the manufacturing sectors has to exhibit a high rate of growth and lastly the institutional environment must be conducive. Rosenstein-Rodan (1961) argues that the purpose of foreign aid is not directly to raise the standard of living in the recipient countries but to permit them to make the transition from economic stagnation to self-sustaining growth. Bacha (1990) asserts that, in many highly indebted developing countries, the major constraint to economic growth and inflation difficulties emanates from government budget limitations rather than from foreign exchange constraints or overall saving restrictions. Bacha (1990, p.288) identifies that in a situation where foreign transfers decline, the "fiscal gap" will be binding while the savings gap is no longer binding and investment falls. Some papers challenge the pro-aid camp's hypothesis that foreign aid promotes economic development (Griffin, 1970; Griffin and Enos, 1970; Weisskopf, 1972). These scholars argue that foreign aid does not supplement domestic savings and that a large percentage of foreign aid is used to increase consumption rather than investment. Collier and Dollar (2002, p.1477) attempt to determine the "poverty efficient allocation of aid" and suggest that the actual allocation of aid is radically different from the poverty-efficient allocation: "With the present allocation, aid lifts around 10 million people annually out of poverty. With a poverty-efficient allocation, aid will lift 19 million people out of poverty".

The theoretical viewpoint of Chenery and Strout (1966) became debatable in the mid 1990s when the World Bank made data on foreign aid available for a large number of developing countries. Many papers investigate the aid-growth relationship. Some find statistical results that suggest that aid is growth enhancing with the results often conditional on good policies.[2]. Other scholars conclude that neither a positive nor negative statistically significant relationship exists between aid and growth.[3] Some papers reveal statistically significant evidence that aid inhibits growth.[4] Thus, there is no general agreement regarding the relationship between aid and growth. Alvi and Senbeta (2012) find that foreign aid is associated with a decline in poverty. Chong et al. (2009) find weak evidence that foreign aid is conducive to the improvement of the distribution of income when the quality of institutions is taken into account. Asra (2005) suggests that aid is effective when it is relatively moderate but becomes ineffective when the size exceeds the critical value defined by the absorptive capacity.

## Hypothesis, methodology and data

The study is guided by the hypothesis that foreign aid is associated with improvement in macroeconomic indicators. The method used in this study is a descriptive analysis of economic variables. The approach adopted is essentially

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[2] For a detailed review see Durbarry *et al*. (1998), Svensson (2000), Burnside and Dollar (2000), Hansen and Tarp (2000, 2001), Lensink and White (2001), Collier and Dehn (2001), Dalgaard and Hansen (2001), Collier and Dollar (2002), Burnside and Dollar (2004), Dalgaard *et al*. (2004) Clemens (2004), Heckelman and Knack (2009) and Bearce and Tirone (2010).

[3] For a detailed discussion see Boone (1996), Easterly (2003), Easterly *et al*. (2004), Kraay and Raddatz (2007), Rajan and Subramanian (2008), Williamson (2008) and Ekanayake and Chatma (2010)

[4] Refer to Brumm (2003) and Rajan and Subramanian (2005, 2011) for an interesting discussion on this.

historical–comparative. This methodology involves adopting a descriptive approach to events. The study depends substantially on secondary material. The secondary sources consist of relevant publications, such as government of Ghana documents, journals, books and discussion papers and the political frameworks of reform as well as documents from The World Bank and the IMF. The advantage of data from archive sources is their validity. At the same time such sources could pose problems for research. First, data assembled for certain research problem may not always be suitable for others. Secondary information using different techniques in collection has to be handled in different ways to become data for analysis. In addition, a pairwise correlation analysis is used alongside the descriptive analysis.

**Overview of foreign aid**

In the modern era the issue of aid began to surface in the 19th and early 20th centuries as the western powers considered their colonies and other poor countries. In Britain the Colonial Development Act of 1929 was the culmination of a long process of moving from laissez faire in the economic operation of the colonies to assistance (Little and Clifford, 1965, p.31; Kanbur, 2000, p.3). The drastic cuts in the aid budgets of the G7 countries led to a decline in aid during the 1990s. This resulted in cumulative real-term losses in aid to recipient countries of over $40 billion by 1999 (in constant 2003 dollars). Between 2000 and 2004, aid increases generated $42 billion cumulatively in new resources (over and above 1999), effectively cancelling out the losses of the 1990s (Reality of Aid Report, 2006).[5]

Donors have failed to significantly close their generosity gap, which according to Reality of Aid Reports had been growing since the mid-1990s. ODA per capita in donor countries increased by about 50% from $55 in 1961 to $83 in 2004. On the other hand, wealth per capita (GNI) in these same countries grew by about 230% from $9,887 to $32,462 during the same period as demonstrated by Figure 1.

***Patterns and trends of foreign aid in Least Developed Countries (LDCs)***

The relative importance of overseas development assistant (ODA) among external financial flows to developing countries as a whole has steadily declined over time. Having accounted for almost 70% of total net external transfers to developing countries at its peak in the early 1990s, the share of aid has been drastically cut to roughly one-third of total net external disbursements (World Bank, 2006). We can infer from Figures 2 and 3 that aid inflows to LDCs and Sub-Saharan Africa countries have gone through three distinct phases. The first phase, starting from the 1970s to 1991 shows a clear upward trend. In particular the period 1977 to 1991 saw a rapid increase in ODA largely as a consequence of the substantial rise in oil prices of the 1970s with the subsequent debt crisis in the 1980s in many Latin American and African Countries. The second phase, 1995 to 2001, witnessed a sharp decline in ODA. The reasons for the decline in foreign aid in the second half of the 1990s as put forward by the literatures are the end of the cold war, globalization, budgetary constraint on donor resources, disappointment with aid effectiveness, fewer aid lobbyists

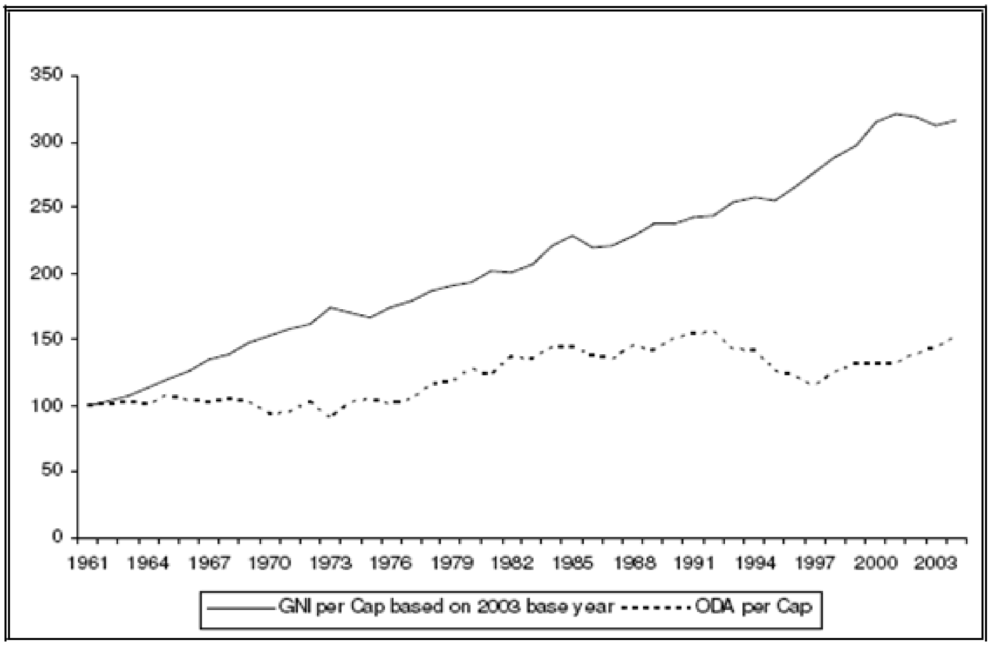


**Figure 1. GNI per capita vs. overseas development assistant per capita in donor countries in 2003 prices and exchange rate (1961-2003).**

Source: OECD, 2004, adapted from Reality of Aid Report, 2006

[5] New aid resources is the cumulative net difference in aid each year compared to a reference year (OECD, 2004).

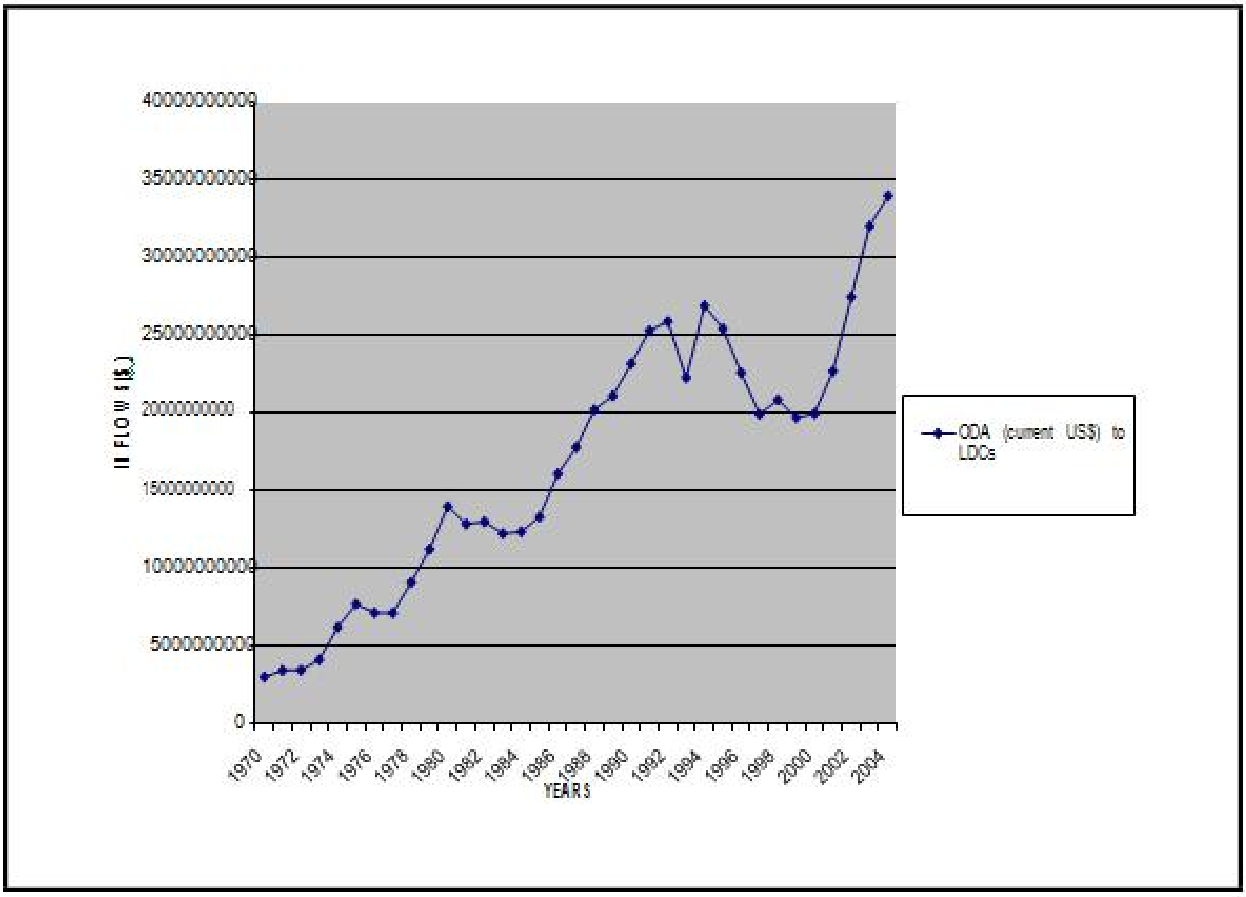


**Figure 2. Official Development Assistant to LDCs**
Source: Author, using World Bank (2006)

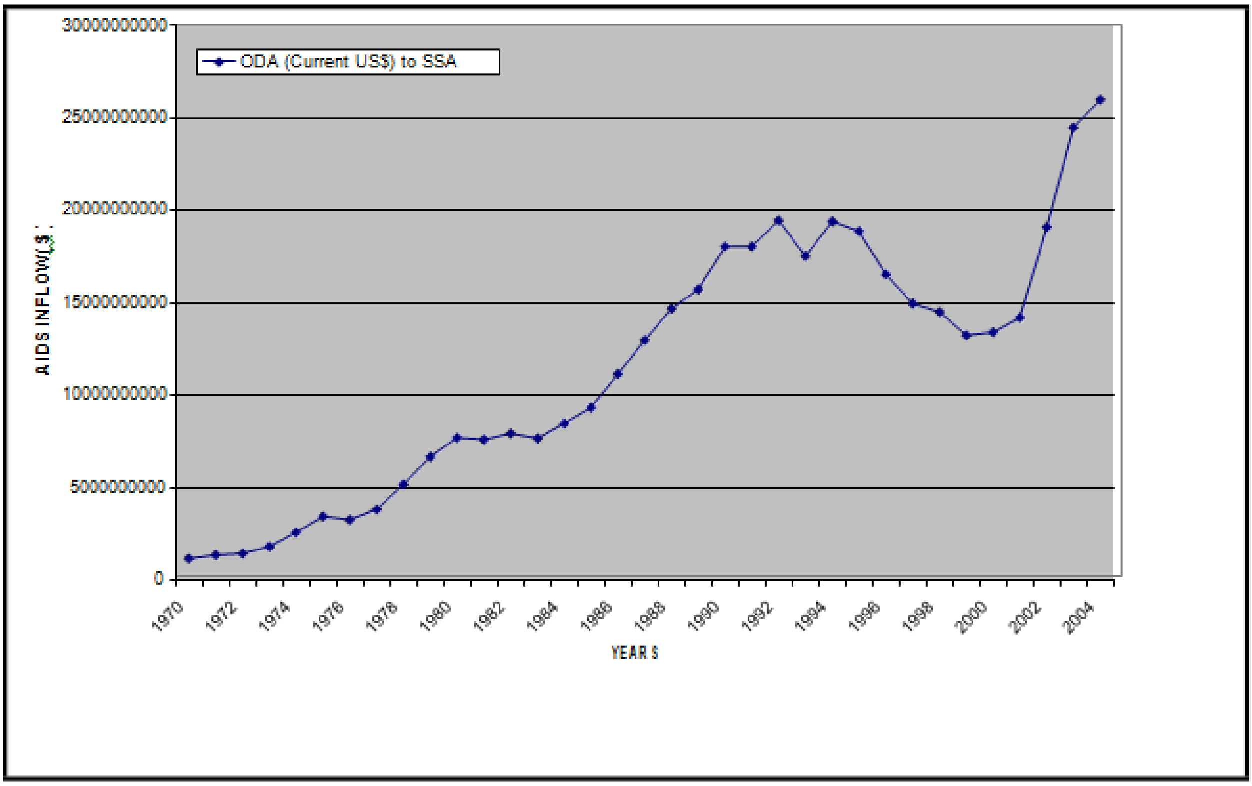


**Figure 3. Official Development Assistant to Sub-Saharan Africa (1970 - 2004)**
*Source*: Author using World Bank (2006)

groups in donor countries, private sector flows and the dominance of the neo-liberal views on the public system of aid allocation. The third phase was from 2001 to 2004. Statistics from this final sub–period show a marked increase in the absolute value of foreign aid transfers (See Figures 2 and 3). Some analysts suggest that the upsurge in foreign aid is no more than a recovery to historical trend levels after the blighted years of the second half of the 1990s. Others have pointed out that the additional aid comprised largely of international assistance in the form of food aid and emergency relief to many Sub-Saharan African countries plagued by HIV/AIDS such as Zambia and Uganda, civil war such as Rwanda and natural Disasters such as famine and drought in Malawi and Niger. Figures 4 illustrates that before aid volumes started decreasing in the late 1990s the relationship between aid and growth in Africa has always appeared inconclusive.

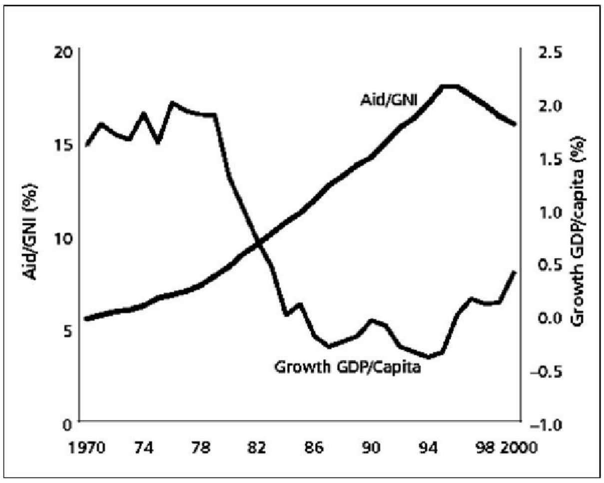


**Figure 4. Aid and growth in Africa (10-year moving average, 1970-2000)**
Source: World Development Indicators, adapted from Erixon, 2005, Figure 1, p. 8

Despite an increase in ODA, average per capita growth was less than 3% in 125 developing countries of which 38 are in SSA, where progress has stagnated and where development assistance should be directed (Fukuda-Parr, 2005, p. 395). The total ODA comprising of both bilateral and multilateral assistance from Development Assistant Committee (DAC) members[6] fell from $66 billion in 1994 to $54 billion in 1995 and $55 billion in 1996. In real terms, aid flows reduced by 41% in 1996 compared to 1995, by 16% compared with 1992 and by 8% compared with 1990-1995. By 1996 total aid came to only 0.25% of the combined GNP of DAC members (Kankwenda, 2000, as reported by Abdullahia and Muoghalu, 2006, p.246) as against the 0.7% promise made in the 1970s. Moreover, the share of ODA given to least developed countries (LDC's) in the GNP of the member countries of the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) dropped from 0.09% in 1990 to 0.07% in 1995. Specifically, Africa received $20 billion aid assistance in 1996 compared to over $21 billion in 1993. Sub-Saharan Africa got $16.7 billion in 1996 compared to $17.3 billion in 1993 (Kankwenda, 2000, as reported by Abdullahia and Muoghalu, 2006, p.246). There are operational variations in the disbursement of aid to countries in Sub- Saharan African. Table 2 and Figure 5 below show the net ODA from all sources to selected countries in Sub-Saharan Africa (SSA) for the period 1980 and 1994-2003 at 1978 prices. We can infer from Table 2 or Figure 5 that Ghana ranks fourth in terms of the quantum of net aid inflows. Table 2 indicates that aid flows have taken on new dimensions and by 2002 the increase in overall aid was 5% (World Bank, 2005).

## *Aid profile and trends in Ghana*

*"If Ghana is to reach its growth targets of 8% by 2008, more investment and donor flows are needed" (Governor of Bank of Ghana - Dr Paul Acquah, 2006, as quoted by BBC News,15/06/2006).*

**Table 2. Net aid to selected Sub-Saharan Africa Countries 1980, 1994-2003 in US$ Million at 1978 prices**

| COUNTRY | 1980 | 1994 | 199 | 199 | 199 | 199 | 199 | 200 | 2001 | 2002 | 2003 | TOTAL | RANK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ethiopia | 338 | 1026 | 774 | 716 | 550 | 632 | 622 | 710 | 1164 | 1307 | 1362 | 9201 | 1st |
| Cote D'Ivoire | 305 | 1456 | 982 | 815 | 411 | 918 | 418 | 362 | 184 | 1069 | 216 | 7136 | 2nd |
| Uganda | 188 | 721 | 725 | 600 | 772 | 628 | 571 | 850 | 835 | 638 | 84 | 6612 | 3rd |
| *Ghana* | 316 | 506 | 46 | 566 | 467 | 680 | 579 | 597 | 676 | 650 | 795 | 5878 | *4th* |
| Cameroun | 403 | 664 | 355 | 338 | 456 | 467 | 408 | 391 | 512 | 609 | 738 | 5341 | 5th |
| Kenya | 644 | 626 | 605 | 515 | 419 | 398 | 295 | 512 | 486 | 394 | 430 | 5324 | 6th |
| Madagascar | 373 | 264 | 250 | 305 | 769 | 452 | 338 | 325 | 390 | 373 | 466 | 4305 | 7th |
| Angola | 79 | 437 | 369 | 413 | 338 | 325 | 377 | 316 | 305 | 421 | 444 | 3824 | 8th |
| Sudan | 1028 | 397 | 207 | 193 | 133 | 205 | 242 | 232 | 197 | 351 | 545 | 3730 | 9th |
| Niger | 263 | 341 | 230 | 213 | 308 | 273 | 176 | 214 | 270 | 298 | 387 | 2973 | 10th |
| Zimbabwe | 271 | 39 | 422 | 321 | 316 | 254 | 231 | 174 | 171 | 201 | 165 | 2565 | 11th |
| Nigeria | 55 | 183 | 179 | 170 | 191 | 197 | 146 | 187 | 193 | 314 | 288 | 2103 | 12th |
| Chad | 57 | 196 | 194 | 248 | 210 | 156 | 178 | 135 | 198 | 229 | 212 | 2013 | 13th |
| Liberia | 176 | 64 | 108 | 147 | 73 | 69 | 94 | 70 | 41 | 52 | 95 | 989 | 14th |
| Botswana | 168 | 84 | 80 | 65 | 114 | 101 | 57 | 31 | 30 | 38 | 28 | 796 | 15th |
| Mauritius | 50 | 13 | 20 | 17 | 40 | 38 | 39 | 21 | 23 | 24 | -12 | 273 | 16th |
| Equatorial Guinea | 15 | 28 | 28 | 26 | 23 | 21 | 20 | 23 | 14 | 20 | 17 | 235 | 17th |
| Seychelles | 34 | 12 | 10 | 16 | 16 | 23 | 12 | 19 | 14 | 8 | 8 | 172 | 18th |

Source: Word Bank, 2005

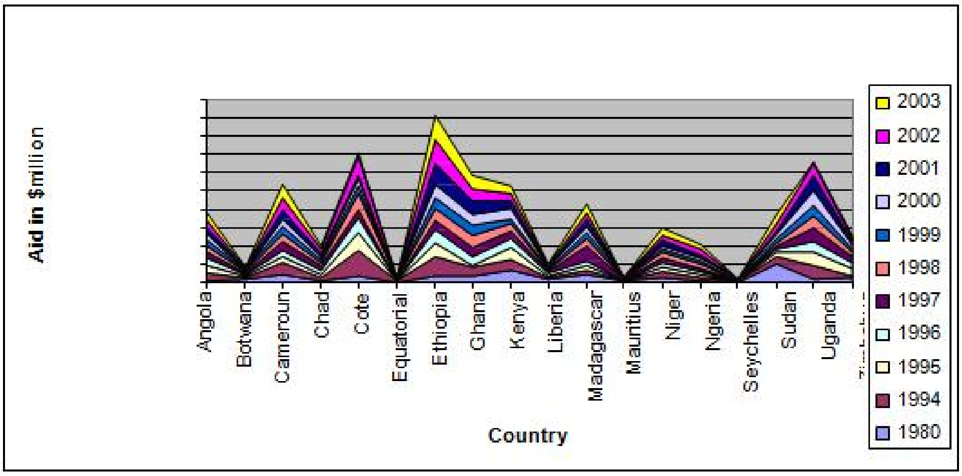


**Figure 5. Net aid flow to selected Sub-Saharan Africa countries**
Source: Author, using World Bank, 2005

*"The gains from debt relief which will be spread over 40 years are a fraction of what the country needs putting a $6bn price tag on the cost of developing the country's infrastructure" (Ghana's Finance Minister-Kwadwo Baah Wiredu, 2006, as quoted by BBC News, 15/06/2006).*

The economy of Ghana receives aid in various forms, including general budgetary support, sector budget support (mainly health and education) and project aid. Harrigan and Younger (2000, p.191) asserts that until the mid-1960s, aid flows were relatively unimportant in Ghana because the Nkrumah government was highly suspicious of the major donors, i.e., Britain and the USA which did not help the already poor state of affairs. But more particularly, the economy, as it emerged from colonial rule (Killick, 1978; Brownbridge, 1994; Quartey 2002) had inherited substantial foreign exchange reserves, little debt, and a small public sector. Very little foreign exchange and budgetary support were needed until the 1961 balance of payments crisis (Killick, 1978; Harrigan and Younger, 2000; Quartey, 2002, as quoted by Quartey, 2005, p.2).

After 1961, there was more interest on the part of Ghana in attracting foreign aid, but by that time, Nkrumah's increasingly criticism of Britain and the USA, the two major western donors, made them less good sources of assistance. Nkrumah did succeed in getting help from the eastern bloc, but the relationship worsened early in the programme and this severely affected disbursement[7]. However, aid flows increased in the second half of the 1960s. In the mid 1960s, aid inflows as a share of GDP increased from 0.002 per cent in 1960 to 0.22 per cent in 1965. This is due to the fact that the National Liberation Council (NLC) government, which ousted the Nkrumah administration in 1966 was more favourable to foreign interests (Harrigan and Younger, 2000, p.191). In 1972, the government of the National Redemption Council (NRC), which succeeded the NLC government, renounced 35 million pounds of Nkrumah's debt and this brought a sharp response from commercial donors in 1973 and 1974 (Brownbridge, 1994; Quartey, 2002). However, in 1975 Ghana agreed to reschedule 100 million pounds of its external debts and this resulted in the country's inclusion in the global flows of aid to Africa. Moreover, the early 1980s was associated with a gradual reduction in aid flows to developing countries and Africa and this change was much more highlighted in Ghana. The nationalism and the revolutionary tendencies of the Rawlings administration worsened the poor state of affairs[8]. The economic woes at the time caused donors to lose hope in Ghana, but soon potential donors were willing to influence the country's policymakers for a radical shake-up of its economic policies. The Rawlings government abandoned its socialist beliefs, put aside the 1981 and 1982 annual budgets and instead fashioned out an economic recovery programme (ERP) in 1983, which got the approval of the IMF and the World Bank.

Aid flows had increased considerably by the end of the 1980s and Ghana was receiving more foreign aid per capita than the average for the entire Africa and other developing countries. Nixson, Asante and Tsikata (2000, p.247) conclude that "The launching of the Economic Recovery Programme in April 1983 changed the macroeconomic and incentive framework within which industry has to operate". The late 1990s and early 2000s marked a new era in Ghana's economic destiny with the adoption of the HIPC initiative. Figure 6 depicts the trend of Official Development Assistance inflows to Ghana from 1970 to 2004. The trend is similar to that of Sub-Saharan Africa. The economic reform in the 1980s and 1990s came with substantial aid inflows.

[7] The only exception to this general pattern was the Volta River Project partly funded by the World Bank, Britain and the US with $US 75 million in aid flows, the principal product of which was the dam on the Volta River at Akosombo. The Project was profitable (Killick, 1978) but it was an enclave project.

[8] The gravity of economic and social collapse and the inability of the public sector to perform even its most basic functions made it seem like any money spent in Ghana would be wasted.

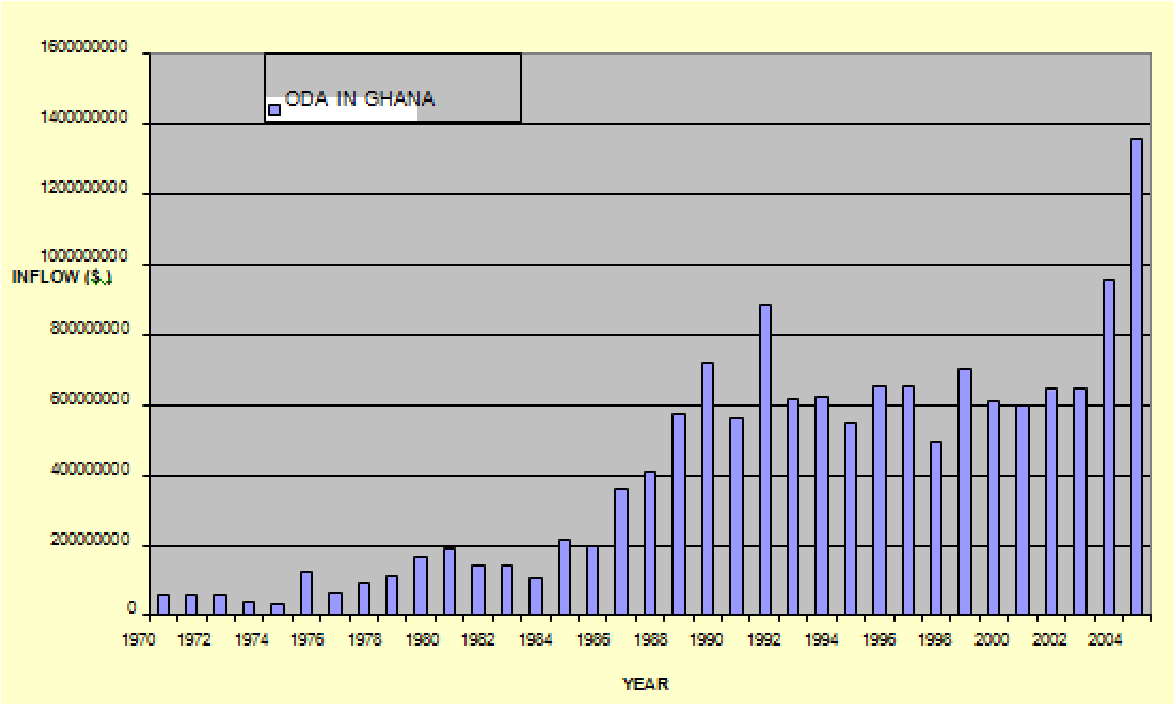


**Figure 6. Overseas development assistant to Ghana**
Source: Author, Using World Development Indicators, 2006

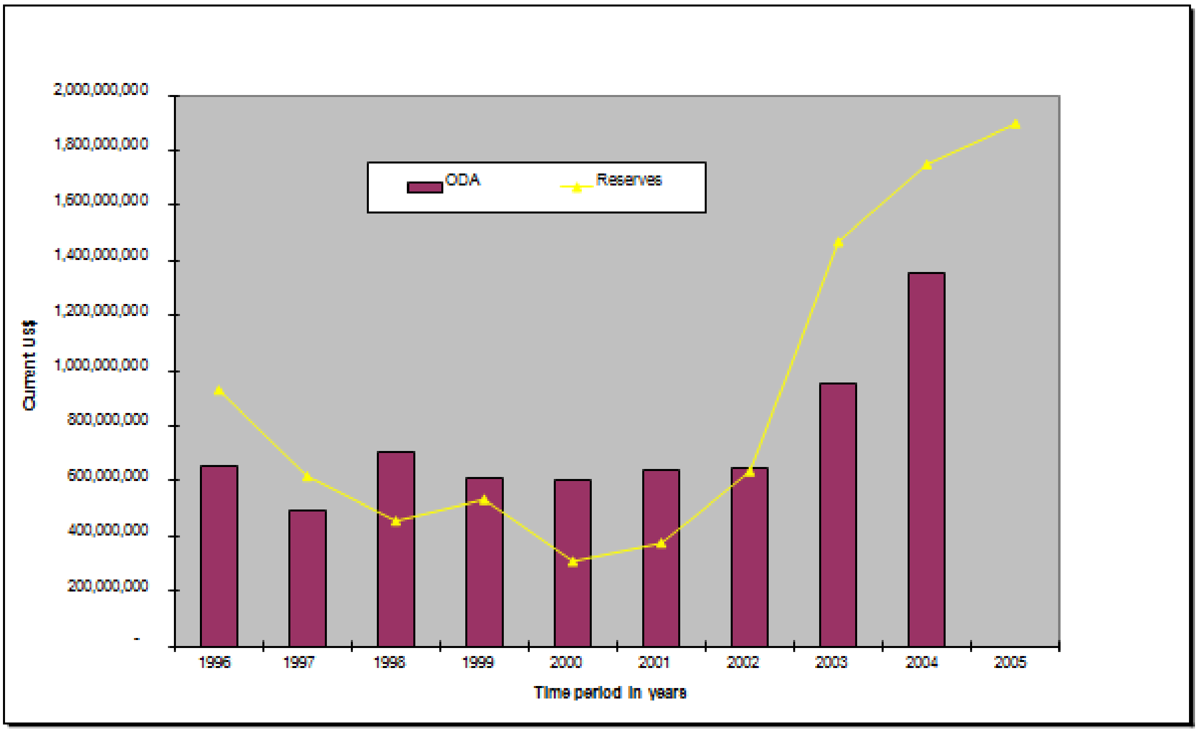


**Figure 7. Overseas development assistant and reserves**
Source: Author, using World Bank (2006)

The sharp decline in international aid from 1990 to 1997 was followed by the growth of ODA inflows in 1997–2004. This was the response of donors to major terms of trade shocks which resulted from falls in price of two main Ghana export items - cocoa and Gold. Figure 7 shows that aid and reserves are positively related.

## Analysis of aid and selected macroeconomic variables in Ghana

The results from Figure 8 and Table 3 suggest that aid is positively related with the GDP per capita growth. The correlation coefficient of aid and GDP per capita growth before entering the Heavily Indebted Poor Countries (HIPC)

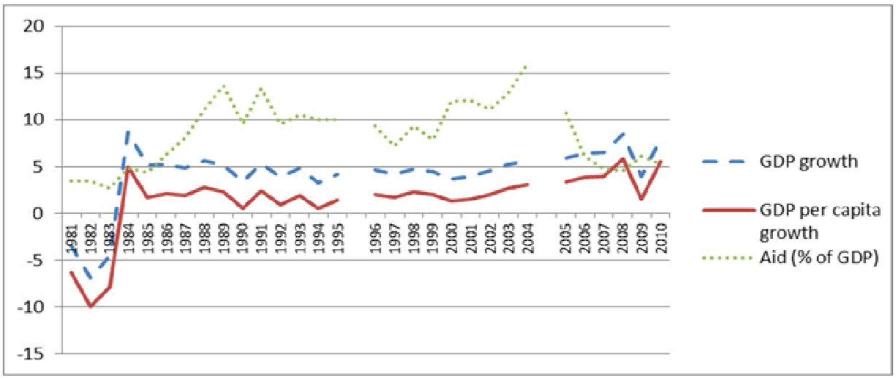


**Figure 8. Aid and GDP trends in Ghana (1981-2010) Source: Author, using World Development Indicators, 2006**

**Table 3. The results of pairwise correlation analysis between aid (% of GDP) and selected macroeconomic variables in Ghana**

| Variables | Pre-HIPC Period 1982-1995 (SAP period) | Post-HIPC Period 1996-2004 | Whole Period 1982-2004 |
|---|---|---|---|
| Exports of goods and services (% of GDP) | 0.800*** (0.000) | 0.436* (0.090) | 0.61*** (0.001)) |
| Imports of goods and services (% of GDP) | 0.809*** (0.000) | 0.394 (0.123) | 0.638*** (0.000) |
| Investment (% of GDP) | 0.777*** (0.001) | 0.534* (0.053) | 0.687*** (0.000) |
| Gross savings (% of GDP) | 0.663*** (0.005) | 0.869*** (0.001) | 0.650*** (0.000) |
| Real effective exchange rate index (2000 = 100) | -0.704*** (0.003) | -0.795*** (0.004) | -0.68*** (0.000) |
| General government final consumption expenditure (% of GDP) | 0.570** (0.019) | 0.258 (0.227) | 0.503*** (0.007) |
| GDP (current US$) | 0.766*** (0.001) | 0.112 (0.373) | 0.561*** (0.002) |
| GDP per capita growth (annual %) | 0.563** (0.020) | 0.492* 0.070) | 0.570*** (0.002) |
| Debt as a % of GDP | 0.808*** (0.000) | 0.335 (0.163) | 0.609*** (0.001) |
| Real exchange rate index (% change) | 0.659*** (0.006) | -0.154 (0.328) | 0.368** (0.041) |

** p < 0.10, ** p < 0.05, *** p < 0.01 (P-values are in parenthesis)*

** indicates significance at 10%; ** indicates significance at 5%; *** indicates significance at 1%.*

initiative (0.563 at 5% significant level)[9] is greater than the HIPC period (0.492 at 10% significant level).[10] Figure 9 demonstrates trends of aid and exports, imports, gross capital formation and savings in Ghana for the period 1982-2004.

As we can observe the flows of aid were accompanied by higher increases in domestic savings. This suggests that policies implemented by the government had a positive effect on savings. The high saving rates helped to recover the economy in December 1996 but a large fiscal slippage happened in late 1999 beginning 2000 when terms of trade shock occurred. Exports, imports and gross fixed capital formation also move in tandem with aid. The correlation analysis suggests that there is positive and significant correlation between aid and investment in the pre-HIPC, HIPC period and the whole period from 1982–2004. This trend can be explained by increased savings which are overall positive and significantly correlated with aid. Higher domestic savings theoretically can lead to a higher rate of domestic investment, what actually happened in Ghana. Another explanation might be the successful liberalization programme implemented under the IMF and the World Bank Structural Adjustment Programme. The major trade liberalization reforms such as the adoption of a new investment Code of 1985, lowering initial required investment capital, encouraged more companies to invest in the economy as depicted by Figure 10.

[9] Out of 29 countries that qualified for the relief, 19 have reached completion point including Ghana. Ghana opted to seek debt relief under the Heavily Indebted Poor Country (HIPC) program in March 2001 and reached decision point in February 2002 (GOG, 2004). Ghana, the International Monetary Fund (IMF), and the World Bank Group's International Development Association (IDA) agreed in February 2002 to support a comprehensive debt reduction package for Ghana under the enhanced HIPC Initiative. Ghana reached HIPC completion point in July 2004 and total relief from all of Ghana’s creditors was approximately $3.5 billion over 20 years (US Bureaux of African Affairs, May 2007).

[10] Analysis here is simple Pair-wise correlation to re-enforce the qualitative analysis. The result is indicative rather than definite.

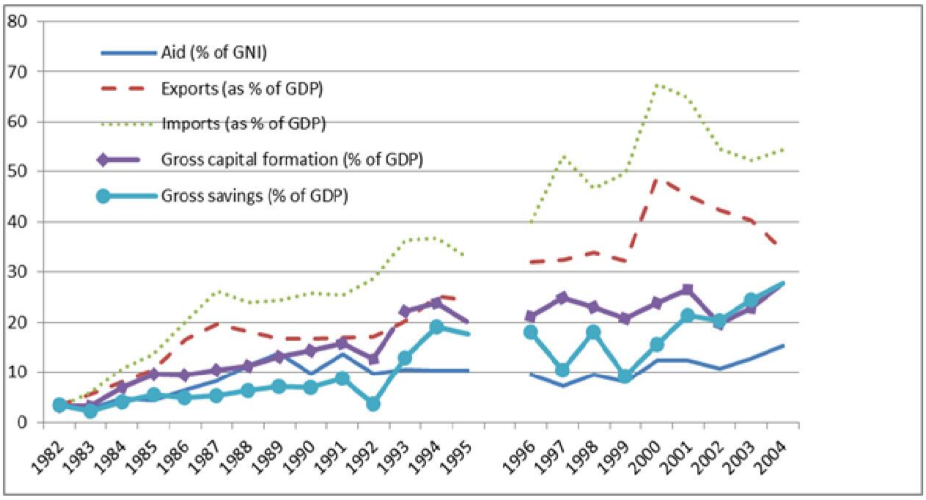


**Figure 9. Aid vs. exports, imports, gross capital formation and savings (1982-2004)**
Source: Author, using World Development Indicators, 2006

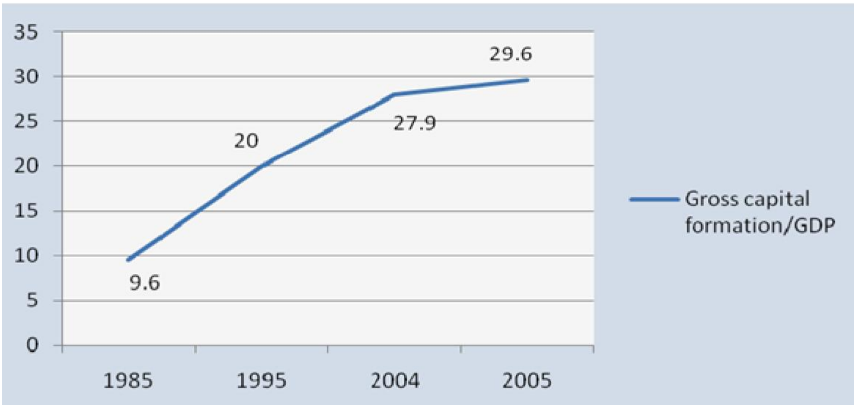


**Figure 10. The ratio of gross capital formation to GDP (1985-2005)**
Source: Author, using World Bank, 2006

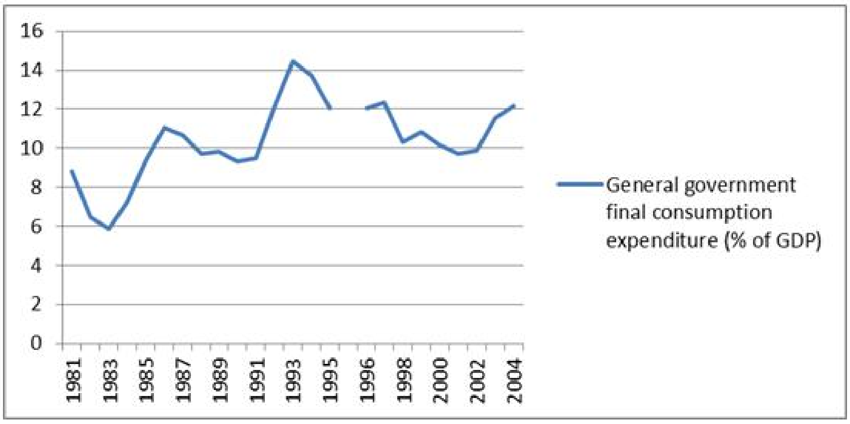


**Figure 11. General government final consumption expenditure (% of GDP)**
Source: Author, using World Bank, 2006

The relationship between aid and the export of goods is positive but more significant in the structural adjustment period (before 1996) than the HIPC period (1996-2004). The correlation analysis demonstrates a significant positive relationship between aid and government expenditure. As we can observe from Figure 11, the level of expenditure has a decreasing trend.

The decreases in government expenditure can be logically explained by privatization[11] decreasing the fiscal burden of

[11] It is general knowledge that one of the conditions attached to IMF and the World Bank loans is conducting privatization.

Government[12]. Furthermore, an increase in aid is positively correlated with higher debt service payments as indicated by the results in Table 3. The correlation coefficient of debt service payment in the Pre-HIPC period is higher than that of the whole HIPC period is higher than that of the HIPC period because of the gains from the HIPC initiative. Figure 12 depicts a decline in real effective exchange rate which stabilized over time.

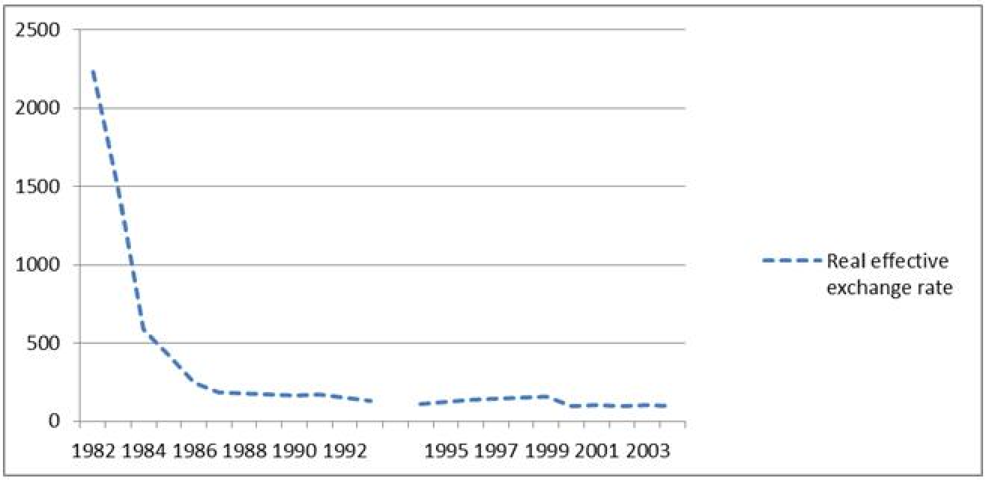


**Figure 12. Real effective exchange rate**
Source: Author, using World Bank, 2006

**Lessons and Conclusions**

In Ghana foreign aid inflows have been crucial for purposes of economic decision making and efficient policy management. An increase in aid had a positive correlation with economic growth, exports, government expenditure, investment, and debt service payments and aid did not displace savings. The negative impact of aid was the real exchange rate appreciation but this was restrained as it had a small impact on export performance. The also the results for other countries might not support the hypothesis that aid is beneficial to economic growth and in some cases it is difficult to disentangle the effect of aid from internal and external shocks and also the policy framework. Sustained growth and poverty reduction in Ghana depend on both aid and on the policies of the country. This is an important collaboration which cannot be overemphasized. It is a collaboration in which aid should be a junior partner. The Government of Ghana still has some work to do to re-establish its credibility as an effective development partner (and to shake off the image of "reform fatigue") and to demonstrate that it has the ability to implement the wide range of policy reforms and programmes set out in the Ghana poverty reduction Strategy. The Ghanaian economy must avoid over-dependence on foreign aid. It has been argued that the donors sometimes pushed more financing than the limited absorptive capacity could manage efficiently. In light of this any future plan should aimed at reducing this dependency.

Thus, There is the need for the Government of Ghana to institute measures to reduce corruption, improve revenue generation and to provide enough counterpart funding for poverty interventions instead of depending solely on foreign aid or putting all blame of economic woes on outside forces.

"*A big obstacle to economic growth in Africa is the tendency to put all blame, failures and shortcomings on outside forces. Progress might have been achieved if we had always tried first to remove the mote in our own eyes*."[13] (Akobeng, 1996, p.2. Tony Yengeni, chief whip of the African National Congress (ANC) of South Africa, chipped in:

"*The turmoil in Africa today – famine, military coups and so on – is partly the result of African leaders who fought for independence but then enjoyed the fruits of their power and forgot about the people.*[14]

The Former U.N. Secretary-General, Kofi Annan added:

"*Billions of dollars of public funds continue to be stashed away by some African leaders – even while roads are crumbling, health systems have failed, school children have neither books nor desks nor teachers and phones do not work*[15]

[12] Privatization of 255 state owned enterprises (SOEs) (or parts of SOEs) had been authorized by the end of 2000; state enterprise law enacted and performance contracting initiated in 1992; accelerated divestiture program launched in 1995 targeting economically significant SOEs including Ghana Ports and Harbors Authority and Ashanti Goldfields ((IMF, 2002, p.12).

[13] Free Press, 29 March - 11 April 1996, p. 2.

[14] The Washington Times, May 6, 1999, A14

[15] The African-American Observer, April 25 – May 1, 2000;

The Post Express provides that late Nigerian dictator General Sani Abacha

"*is believed to have siphoned more than $8 billion of Nigeria's foreign exchange into fictitious accounts in Europe, Asia, America, Caribbean and Arab countries*."[16]

Thus, if the leaders in Africa remain in corruption both foreign aid and internal resources cannot have the expected maximum impact on the poor. As Jesus Christ (Mathew 15:14) asserts

*"Leave them; they are blind guides. If a blind man leads a blind man, both will fall into a pit".*

Ghana is implementing the Ghana Poverty Reduction Strategy. A reduction in poverty will require an improvement in productivity and yields in agriculture in particular where many of those in extreme poverty are to be found. The impediments to improved incomes in agriculture are to be addressed. Of critical importance is the poorly developed rural infrastructure that imposes high transaction costs on rural economies. Specifically, the government should endeavor to commit more resources to the development of Rural Savannah where more than half of the population is extremely poor. Facilities such as portable drinking water, more schools, primary health care and small-scale irrigation schemes should be provided. There should be conscious effort on the part of the government to improve the economic and social infrastructure in this part of the country. Specific programmes to ensure more widespread benefits of growth especially through higher rural productivity should be encouraged. This will increase assets of the poor and improve welfare.

Government spending programmes must be designed to achieve the medium term objective of developing the country's human capital. Export diversification and manufacturing will not be successful Bank, 2006 if the skills of the workforce are not upgraded to compete successfully in the highly competitive and technology based world economy. Government of Ghana should strengthen the National Statistical System and pay particular attention to improving the statistical framework of poverty monitoring. Much of the policy issues relating to foreign aid and reform are unknown and will become better understood if future policy-led research investigates the long run return of foreign aid at the decentralized levels in Ghana and evaluate the beneficiary's involvement in the utilization of such funds. A special study will be needed to determine the exact extent to which the number of people living in poverty has increased or fallen at the household level.

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p.10.

[16] The Post Express, July 10, 2000, p. 26.

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