# Comparative Studies of the Impact of US Foreign Aid on Economic Development in the Global South: The Middle East and North Africa vs. sub-Saharan Africa

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## ABSTRACT

The debate on the impact of foreign aid on developing countries is surrounded by diverging views. While some scholars advocate for foreign aid to create a virtuous cycle of growth in recipient countries, others condemn the provision of aid due to its perceived negative effect on development outcomes in the recipient countries. This paper compares the impact of U.S. foreign aid on economic development in two regions of the Global South: the Middle East and North Africa and sub-Saharan Africa. The paper then investigates whether different aid categories affect economic development in these two regions differently. After using panel data from publicly available datasets, the findings indicate that as an aggregate, US foreign aid has a relatively small positive impact on economic development in sub-Saharan Africa and the Middle East and North Africa when controlling for other factors. Moreover, compared to the Middle East and North Africa, its impact in sub-Saharan Africa tends to be higher. However, when aid is disaggregated, the aid for education has a negative effect on economic development. In contrast, aid for governance positively impacts economic development, as measured by both the Human Development Index and the GDP per capita growth. These findings indicate a need for a reevaluation of the current foreign aid programs and consideration of other factors that prevent its greater impact on recipient countries.

## I.INTRODUCTION

Foreign aid is an important component of US foreign policy, acting as the primary means by which the United States attempts to contribute to economic development in developing countries. While foreign aid can be traced back to the nineteenth century, the contemporary U.S. foreign aid to the Global South, as argued by Mosley (1987), started in the early 1950s, with aid provided to South-East Asia developing countries on the communist periphery, such as South Korea, South Vietnam, and Taiwan, in much the same way as was done in Europe with the Marshall Plan.[1] The US goal was to demonstrate that the capitalist economic system worked better in those countries than a centrally planned economy. In the later 1950s and early 1960s, as African colonies of both Britain and France became independent, the United States, competing with the Soviet Union, began providing aid to these newly independent nations, notably Ghana, Nigeria, Kenya, and Zambia. With the expansion of other countries' aid programs in the 1960s, the United States announced its intention to give aid to Third World countries "not in order to contain the spread of communism, not because other nations are doing it, but because it is right" (Mosley, 1987). As indicated in the Foreign Assistance Act of

*I am grateful to God for leading my steps in my academic journey. I am thankful to Professor Julia Zhu, Professor Samuel Bird, and Professor Amanda Lindsay for their valuable guidance throughout different phases of this paper. I am also thankful to Professors Jacqueline Brux and Georgios Koimisis for their comments on my paper at the Midwest Economic Association Annual Conference. I would also like to thank the Global Association of Master's in Development Practice and the Sustainable Development Solutions Network for the opportunity to share my paper with a broad academic audience. I am also thankful to my parents, Alírio and Santa, my grandmother, Maria, my sisters Luzia and Cesaltina, and my niece Daniela for their unconditional support throughout the development of this paper.

[1]The Marshall Plan, or officially the European Recovery Program, was a US-led economic plan aiming to revitalize the rich but war-damaged countries of Europe between 1948 and 1953, following the aftermath of World War Two. Capital transfers were complemented with technical assistance to raise productivity in local industry. Cited in Janvry& Sadoulet ( 2016).

1961, the ultimate goal of US foreign aid became the support of the people of developing countries to acquire the resources essential to improving the quality of their lives.

After over 60 years of provision of foreign aid to the Global South, the impact of US foreign aid is questioned and seen as controversial (Goldwin, 1963). While there are some examples of successful aid recipients, there is also a perceived lack of progress in many countries that have been aid recipients for decades (Hudson, 2010). This ongoing debate has been led by a diverse group of economists such as Jeffrey Sachs, William Easterly, Paul Collier, Dambisa Moyo, Aneel Karnani, Angus Deaton, and more recently by Esther Duflo, Abhijit Banerjee, and Michael Kremer. Presenting diverging positions, some advocate for aid, arguing that it is a key tool to kick-starting a virtuous development cycle by helping developing countries tackle their critical problems (Sachs, 2005). On the other hand, some argue against aid, stating that it has been an unmitigated political, economic, and humanitarian disaster, making millions of people in most parts of the developing world poorer and fragilizing these countries' social and political institutions (Moyo, 2010).

The objective of this paper is to empirically compare the effect of US foreign aid on economic development in two regions of the Global South: the Middle East and North Africa and sub-Saharan Africa, in order to answer the following research question: Does US foreign aid have a greater impact on the economic development of sub-Saharan Africa in comparison to the Middle East and North Africa? More specifically, this paper considers the effect of different aid categories on economic development in both regions.

## II.LITERATURE REVIEW

Recent studies have posed important questions regarding the impact of aid in recipient nations. While some have focused on economic development broadly, others have pursued a more specialized inquiry, looking at aid's effect on aspects such as investments and governance. As questioned by Deaton (2010), “does aid increase investment, does aid crowd out domestic investment, is aid stolen, does aid create rent-seeking, or does aid undermine the institutions required for growth?”

As suggested by Simplice Asonge and Jacinta Nwachukwu (2014), the substantial literature on the interconnectedness of institutions and development indicates that Africa is deprived due to its poor institutions, including dictatorship, lack of property rights, weak courts and contract enforcement, high corruption levels, political instability, violence and hostile regulatory environments for private business.” In their paper “Foreign aid and governance in Africa,” Asonge and Nwachukwu investigate the effect of foreign aid on governance. Aiming to extend the debate on foreign aid and to verify common positions from Moyo’s ‘Dead Aid,’ Collier’s ‘Bottom Billion,’ and Eubank’s ‘Somaliland,’ they relied on data from 52 African countries for the period 1996–2010. After employing an endogeneity robust instrumental variable Two-Stage-Least Squares empirical strategy, their findings revealed that development aid deteriorates economic governance, including aspects such as regulation quality and government effectiveness, institutional corruption-control, and the rule of law. However, it has an insignificant effect on political governance, including political stability, voice, and accountability.

Similar to Asonge and Nwachukwu’s paper, Lauren Lopez (2015) researched her paper on the relationship between donor governments’ official development assistance (ODA) decisions and corruption in recipient countries over the period 1999- 2010. In Lopez’s paper, poor governance is the limiting factor to aid impact. Using panel data, Lopez estimates the effect of corruption on aid using donor-recipient fixed effects and desegregating aid into sectors that may vary in sensitivity to corruption. The analysis controls for recipient needs and donor interest variables. Overall, the results suggest that countries with higher levels of corruption receive less ODA. Disaggregating ODA, more corrupt countries receive less production sector and social infrastructure aid but more humanitarian assistance. Further, high levels of corruption are associated with recipients receiving a higher percentage of their total ODA as humanitarian assistance from a given country in a given year.

Asonge and Jacinta Nwachukwu, as well as Lopez's findings, show the importance of disaggregating aid into sectors and considering governmental quality aspects when assessing the impact of aid. Aid disaggregation and control for the effect of corruption are two major improvements in this research paper.

## III.METHODOLOGY

To compare the effect of US foreign aid on economic development in the Middle East and North Africa versus Sub-Saharan Africa, the following models are specified:

(1)

$$ED_{ct} = \beta_0 + \delta_0 SSA_c + \beta_1 TAid_{ct-1} + \beta_2 SSA_c * TAid_{ct-1} + \beta_3 Co_{Ct-1} + \beta_4 Tr_{ct-1} + \beta_5 Inf_{ct-1}$$

$$\beta_6 Pop_{ct-1} + \beta_7 Un_{ct-1} + \lambda_t + \mu_{ct-1}$$

where $ED$ is the measure of economic development, $SSA$ is the dummy variable sub-Saharan Africa, $TAid$ is the total aid amount, $Co$ is the Corruption Perception Index, $Tr$ is the Trade, $Inf$ is the inflation rate, $Pop$ is the annual population growth, $Un$ is the unemployment rate, $\lambda$ is the time fixed effect, $\mu$ is the error term, $c$ is the country and $t$ is the year.

(2)

$$ED_{ct} = \beta_0 + \delta_0 SS + \delta_0 SSA_c + \beta_1 AdAid_{ct-1} + \beta_2 AgAid_{ct-1} + \beta_3 EcAid_{ct-1} + \beta_4 EdAid_{ct-1} +$$
$$\beta_5 GoAid_{ct-1} + \beta_6 HeAid_{ct-1} + \beta_7 HuAid_{ct-1} + \beta_8 InAid_{ct-1} + \beta_9 OtAid_{ct-1} + \beta_{10} SSA_c * AdAid_{ct-1} +$$
$$\beta_{11} SSA_c * AgAid_{ct-1} + \beta_{12} SSA_c * EcAid_{ct-1} + \beta_{13} SSA_c * EdAid_{ct-1} + \beta_{14} SSA_c * GoAid_{ct-1} +$$
$$\beta_{15} SSA_c * HeAid_{ct-1} + \beta_{16} SSA_c * HuAid_{ct-1} + \beta_{17} SSA_c * InAid_{ct-1} + \beta_{18} SSA_c * OtAid_{ct-1} +$$
$$\beta_{19} Co_{Ct-1} + \beta_{20} Tr_{ct-1} + \beta_{21} Inf_{ct-1} + \beta_{22} Pop_{ct-1} + \beta_{23} Un_{ct-1} + \lambda_t + \mu_{ct-1}$$

where $AdAid$ is aid for administrative costs, $AgAid$ is aid for agriculture, $EcAid$ is aid for economic growth, $GoAid$ is aid for governance, $HeAid$ is aid for health and population, $HuAid$ is humanitarian aid and $OtAid$ is aid for Other purposes. Other variables are as defined in equation 1.

Given the research question, the explanatory variables of interest include the interaction terms between sub-Saharan Africa and aid amount, as an aggregate and disaggregate. The hypothesis is that the aid effect on economic development is greater in sub-Saharan Africa than in the Middle East and North Africa, given the most frequent aid categories and the amount of aid such categories receive in each region.

## IV.DATA DESCRIPTION

The data used in this research come from publicly-available datasets from the US Agency for International Development (USAID), the World Bank, Transparency International, and Our World in Data. The time frame is 12 years, from 2006 to 2017, and the sample consists of data from 55 countries. The data set has country-year observations, thus resulting in a total of 526 observations included in the estimates.

Economic development is measured by the Human Development Index (HDI) and GDP per capita growth. HDI is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable, and having a decent standard of living. It is measured by life expectancy at birth, mean years of schooling and expected years of schooling, and the GNI per capita (in PPP adjusted international-$). On the other side, the GDP per capita is gross domestic product divided by the midyear population. It is an annual percentage growth rate based on constant local currency. While the HDI allows us to measure economic development by focusing on human development and quality of life, the GDP per capita growth allows for the impact of production capacity to be emphasized.

*Sub-Saharan Africa* is the dummy variable. It takes on the value of 1 if referring to Sub-Saharan Africa and 0 if referring to the Middle East and North Africa. The *total aid*

variable comes from the complete US foreign aid budget data, including the President's Budget Request and initial and final allocations. The different aid categories are the *ForeignAssistance.gov* aggregates of foreign assistance into international sectors, which are within broader areas: Administrative Costs, Agriculture, Economic Growth, Education, Governance, Health and Population, Humanitarian, Infrastructure, and Other. Such sector categories are divided into sectors which are further divided into purposes. For this research, only the sector categories are accounted for.

The control variables are corruption, trade, inflation, total population, and unemployment. The Corruption Perception Index measures perceived levels of public sector corruption and gives results on a scale of 0 (highly corrupt) to 100 (very clean). Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product. The inflation rate, measured by the consumer price index, reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that is fixed. Total population is based on the de facto definition of population, which counts all residents regardless of legal status or citizenship. The values shown are midyear estimates. Unemployment refers to the share of the labor force without work available for and seeking employment. It is modeled based on internationally comparable labor statistics.

As observed in table 1, the mean value of the HDI is 0.555. Keeping in mind that the HDI is ranked from 0 to 1, the 0.555 value suggests that, on average, countries in these two regions have medium[2] human development score. For the total aid amount, the mean value is approximately $479 million. The sector category with the highest mean was governance with $239 million, while the sector category with the lowest mean was administrative costs with $40.9 thousand.

Also important to mention is that from 2006 to 2017, the US government sent approximately $316.5 billion of aid to the 55 countries included in this project. From this value, 51.1% was sent to countries in the Middle East and North Africa compared to the 48.9% sent to sub-Saharan Africa. Nevertheless, the Middle East and North Africa corresponds to only 23.64% of the sample. Furthermore, in regards to the aid distribution by the abovementioned sector categories, while for sub-Saharan Africa, the aid mainly went to health and population (70.8%), governance ( 7.7%), and humanitarian (7.6%), for the Middle East and North Africa, the aid went mostly to governance (90.2%), education (2.6%) and other (2.5%). Such results bring more insights to the earlier assumption that US aid to the Middle East and North Africa concentrated on political and security-related issues. At the same time, sub-Saharan Africa was more evenly split for different purposes. However, according to current results, the aid to sub-Saharan Africa is more concentrated on health and population than on governance-related purposes, thus disregarding the previous assumption.

Table 1. Summary Statistics

| VARIABLE | OBS | MEAN | STD DEV. | MIN | MAX |
|---|---|---|---|---|---|
| Human Development Index | 660 | 0.555 | 0.145 | 0.289 | 0.903 |
| GDP Per Capita Growth | 660 | 1.57 | 4.19 | -36.6 | 18.1 |
| Sub-Saharan Africa | 660 | 0.764 | 0.425 | 0 | 1 |
| Administrative Cost Aid | 660 | 0.000409 | 0.00859 | 0 | 0.219 |
| Agriculture Aid | 660 | 0.0175 | 0.0328 | 0 | 0.224 |
| Economic Growth Aid | 660 | 0.00357 | .0152 | 0 | 0.297 |
| Education Aid | 660 | 0.0147 | 0.0298 | 0 | 0.305 |
| Governance Aid | 660 | 0.239 | 0.928 | 0 | 6.92 |
| Health and Population Aid | 660 | 0.171 | 0.329 | 0 | 2.91 |
| Humanitarian Aid | 660 | 0.0196 | 0.0692 | 0 | 0.819 |
| Infrastructure Aid | 660 | 0.00338 | 0.0221 | 0 | 0.375 |

[2] HDI is divided into four tiers: very high human development (0.8-1.0), high human development (0.7-0.79), medium human development (0.55-.70), and low human development (below 0.55). Source: Human development index (HDI) by country 2022, accessed July 1, 2022, https://worldpopulationreview.com/country-rankings/hdi-by-country.

| | | | | | |
|---|---|---|---|---|---|
| Other Aid | 660 | 0.0105 | 0.0289 | 0 | 0.27 |
| Total Aid | 660 | 0.479 | 0.997 | 0.0000101 | 6.92 |
| Corruption Perception Index | 644 | 40.03 | 5.21 | 0 | 60 |
| Inflation Rate (CPI) | 644 | 6.59 | 6.79 | -10.1 | 53.2 |
| Population growth (%) | 660 | 2.53 | 1.09 | -2.63 | 7.78 |
| Unemployment Rate | 648 | 8.09 | 6.28 | 0.32 | 28.34 |
| Trade | 615 | 77.8 | 44.8 | 1.38 | 322.7 |

Note: Aid is expressed in billions of constant U.S. dollars.

## V. DISCUSSION AND CONCLUSION

Table 2 shows the regression results for equation 1), where the variable of interest is the interaction term between the dummy variable sub-Saharan Africa and the total aid amount. When we measure economic development using the HDI, sub-Saharan Africa, the total aid amount and the interaction term between the two previously mentioned variables are significant at the 1% level. The estimate of -0.190 for the dummy variable Sub-Saharan Africa suggests that the HDI in sub-Saharan Africa is 0.190 smaller than that of the Middle East and North Africa. The estimate of 0.0210 for the total aid suggests that for every billion dollars of aid, the HDI goes up by 0.0210. Finally, the estimate of 0.0266 for the interaction term suggests that every billion dollars of aid that go to sub-Saharan Africa has a greater impact on HDI than that that goes to the Middle East and North Africa by 0.0266, ceteris paribus.

When economic development is measured through the GDP per capita growth, the dummy variable sub-Saharan Africa is only significant at the 10% level, while the total aid amount and the interaction term remain significant at the 1% level. Unlike HDI, there is a positive linear relationship between the dummy variable and the GDP per capita growth. The estimate of 1.128 indicates that the GDP per capita growth rate is 1.128 higher in sub-Saharan Africa than in the Middle East and North Africa. The estimate of 0.407 for the total aid suggests that for every billion dollars of aid, the GDP per capita growth goes up by 0.407. Finally, the estimate of 1.078 for the interaction term suggests that for every billion dollars of aid that goes to sub-Saharan Africa, the GDP per capita growth increases by 1.078 compared to that of the Middle East and North Africa ceteris paribus. The estimates for the total aid amount and the interaction term were relatively higher using the GDP per capita growth as the measure of economic development, as opposed to the HDI.

Table 2. OLS Estimates Result with equation (1)

| | (1) | (2) |
|---|---|---|
| VARIABLES | Human Development Index | GDP Per Capita Growth |
| Sub-Saharan Africa | -0.190*** | 1.128* |
| | (0.0122) | (0.587) |
| Total Aid | 0.0210*** | 0.407*** |
| | (0.00419) | (0.150) |
| SSA*Total Aid | 0.0266*** | 1.078*** |
| | (0.00768) | (0.391) |
| Inflation Rate | -0.000922* | -0.00557 |

| | | |
|---|---|---|
| | (0.000517) | (0.0220) |
| Population Growth | -0.00349 | -0.669*** |
| | (0.00443) | (0.201) |
| Total Unemployment | 0.00599*** | -0.123*** |
| | (0.000541) | (0.0302) |
| Trade (% of GDP) | 0.00112*** | 0.0163*** |
| | (0.000113) | (0.00596) |
| Observations | 526 | 526 |
| R-squared | 0.737 | 0.131 |

Notes: Robust standard errors in parentheses. The model includes year fixed effect and a one-period lag effect. *=Significance at the 10% level, **=Significance at the 5% level, ***=Significance at the 1% level.

Given the significance level of the interaction term between the dummy variable sub-Saharan Africa and the total aid amount, using both HDI and GDP per capita growth as measures of economic development, the assessment of how the different aid categories interact with the dummy variable becomes increasingly important. Table 3 illustrates the regression results of equation 2, where the total aid is disaggregated. The table shows more statistically significant variables when the HDI is used to measure economic development compared to the GDP per capita growth.

In the model with HDI as the response variable, the dummy variable sub-Saharan Africa, the aid for economic growth, education, governance, and humanitarian purposes, as well as the interaction term between the dummy variable and the aid for humanitarian purposes are all significant at the 1% level, ceteris paribus. The coefficient of -0.223 for the dummy variable suggests, as previously, that the HDI is 0.223 lower in sub-Saharan Africa as compared to the Middle East and North Africa. This negative correlation is more negative using the model from equation 2 than from equation 1. There is a positive linear relationship between HDI and the aid to economic growth and governance, which suggests that for each billion of aid that goes to economic growth and governance, the HDI goes up by 0.282 and 0.0264, respectively. Surprisingly, there is a negative correlation between HDI and humanitarian aid. The -2.385 slope suggests that for every billion dollars of aid that goes to humanitarian aid, the HDI goes down by 2.385. However, the interaction term between the dummy variable and the humanitarian aid has a positive relationship with the HDI, suggesting that for every billion dollars of humanitarian aid that goes to sub-Saharan Africa, the HDI goes up by 2.304 relative to the Middle East and North Africa. Other statistically significant variables at the 5% level include the aid for agriculture and the interaction term between the dummy variable and aid for agriculture, education, governance, and infrastructure. While there is a positive linear relationship between the dummy variable and the aid for agriculture, education, and infrastructure, there is a negative relationship between the dummy variable and aid for governance.

When using the GDP per capita growth as the response variable, sub-Saharan Africa is only significant at the 10% level. However, it has a positive linear relationship with the GDP per capita growth, as in equation 1. The only variable statistically significant at the 1% level is the aid for other purposes. The estimate of 25.85 suggests that for every billion dollars of aid that goes to other purposes, the GDP per capita growth of both regions goes up by 25.85, which is a relatively large effect. Other variables significant at

the 5% level include the aid for administrative costs, education, and governance. While the aid for administrative costs and the aid for education has a negative linear relationship with the GDP per capita growth, the aid for governance has a positive linear relationship with the GDP per capita growth. Among the interaction terms, only the one between sub-Saharan Africa and the administrative cost aid is statistically significant and only at the 10% level.

Table 3- OLS Estimates Result with equation (2)

| | (1) | (2) |
|---|---|---|
| VARIABLES | Human Development Index | GDP Per Capita Growth |
| Sub-Saharan Africa | -0.223*** | 0.909* |
| | (0.0129) | (0.482) |
| Administrative Cost Aid | 1.167 | -402.3** |
| | (2.627) | (200.9) |
| Agriculture Aid | -0.707** | 31.90 |
| | (0.279) | (20.75) |
| Economic Growth Aid | 0.282*** | 5.500 |
| | (0.0700) | (4.551) |
| Education Aid | -0.480*** | -19.04** |
| | (0.163) | (8.390) |
| Governance Aid | 0.0264*** | 0.279** |
| | (0.00215) | (0.118) |
| Humanitarian Aid | -2.385*** | -46.82 |
| | (0.883) | (81.78) |
| Other Aid | -0.233 | 25.85*** |
| | (0.155) | (8.046) |
| SSA*Administrative Cost Aid | -1.003 | 396.2* |
| | (2.641) | (202.0) |
| SSA*Agriculture Aid | 0.680** | -15.43 |
| | (0.316) | (22.89) |
| SSA*Education Aid | 0.684** | 28.25 |
| | (0.303) | (18.56) |

| | | |
|---|---|---|
| SSA*Governance Aid | -0.195** | 0.692 |
| | (0.0934) | (6.276) |
| SSA*Infrastructure Aid | 0.594** | -7.825 |
| | (0.264) | (21.78) |
| SSA*Humanitarian Aid | 2.304*** | 49.42 |
| | (0.883) | (82.00) |
| Population Growth | -0.00103 | -0.619*** |
| | (0.00460) | (0.225) |
| Total Unemployment | 0.00668*** | -0.0910*** |
| | (0.000592) | (0.0339) |
| Trade (% of GDP) | 0.000966*** | 0.0164*** |
| | (0.000109) | (0.00586) |
| Observations | 526 | 526 |
| R-squared | 0.778 | 0.165 |

Notes: Robust standard errors in parentheses. The model includes year fixed effect and a one-period lag effect. *=Significance at the 10% level, **=Significance at the 5% level, ***=Significance at the 1% level.

A potential mechanism would be endogeneity concerns, given the possibility of a reversed effect of foreign aid on economic development. Aid from donor agencies and countries is contingent on institutional and developmental characteristics (Asongu and Nwachukwu, 2014). Moreover, the literature on how government quality influences foreign aid is still ambiguous. For instance, in this project, corruption was not a significant variable.

Considering that sub-Saharan Africa has been receiving a significant portion of aid concentrated on health and population, the fact that this variable is not statistically significant raises questions about the effectiveness of aid in contributing to economic development. These results also align with some of the foreign aid's criticisms regarding its delivery system. There is a perceived lack of focus, an excessive number of agencies involved in delivering aid with inadequate coordination or leadership, and a lack of flexibility, responsiveness, and transparency of aid programs (Hudson, 2010).

As time evolves, it is noticeable that the economic development of developing countries has become an increasingly complex issue, from a micro to a macro level. Whether aid is provided for national security, to improve international trade, or for humanitarian reasons, reforms to foreign aid programs will have to address issues of aid effectiveness highlighted by current literature. Asongu and Nwachukwu (2015) argue that it is time for economists and policymakers to rethink the models and theories on foreign aid to influence economic, institutional and political governance in recipient countries. Countries such as the U.S. must engage in foreign aid programs that match the needs of recipient countries in the Global South if this aid is to contribute to their economic performance over time. It is also crucial that all the parties involved act ethically and with accountability to ensure that aid is used effectively and for its intended purposes.

Many elements of the modern U.S. foreign aid delivery system emerged from the success of the Marshall Plan that was implemented between 1948 and 1952 in Europe. The success of

the Marshall Plan gave birth to the idea of using foreign aid as an instrument to help developing countries catch up in development (de Janvry and Sadoulet, 2016). Yet, the Marshall Plan took place when physical capital was seen as the key limiting factor for economic development and the incremental capital-output ratio as a reasonably dependable link between capital investment and growth (Mosley, 1987). Furthermore, aid alone can be only one of several contributing aspects to economic development in developing countries. As such, Sach (2005) argues that a combination of investments well attuned to local needs and conditions can enable African economies to break out of the poverty trap. More specifically, Sach recommended that developing countries have an “Investment Plan, which shows the size, timing, and costs of the required investments” as well as a “Financial Plan to fund the Investment Plan, including the calculation of the Millennium Development Goals Financing Gap, the portion of financial needs the donors will have to fill.” In this post- Millennium Development Goals era, such recommendations remain valid and relevant for developing countries efforts to achieve the Sustainable Development Goals.

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