

**A COMPARATIVE STUDY OF THE EFFECTS OF FOREIGN REMITTANCE
AND FOREIGN AID ON KENYA'S ECONOMIC DEVELOPMENT**

BY

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UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

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**A Report Submitted to the School of Humanities and Social Sciences at the United
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UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

SPRING 2017

STUDENT DECLARATION

I, the undersigned declare that this is my original work and that it has not been submitted to any other College, Institution or University other than the United States International University for academic purposes.

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This project has been presented for examination with my approval as the appointed supervisor.

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DEDICATION

I dedicate this thesis to Lars Videkam. For providing me with unfailing emotional and financial support throughout my years of study. He is the one person who has always had my back and believed in me. This accomplishment would not have been possible without him.

ABSTRACT

Foreign aid (Official Development Assistance) has conventionally been an indispensable source of development resource for Kenya. Consequently, since the country's independence both bilateral and multilateral donors have extended ODA to Kenya in terms of either grants or loans. Nonetheless, these resources have been ineffectual in precipitating real development, besides being highly volatile. In recent years, international remittance inflows have been increasingly considered as imperative source of resources for development. Remittances enhance economic growth by establishing means through which recipient Kenyan households could engage in risky ventures that have high profitability potential.

Not surprisingly, Diaspora remittance is considered central to Kenya's development agenda and Diaspora engagement in Kenya's financial sector and it is one of the hallmarks of the country's development goal under Vision 2030 agenda. Consequently, debates have risen surrounding the issue as to which one between ODA and remittances offer Kenya the most resilient source of development finance. Nonetheless, no definitive study has been conducted to settle the issue.

The purpose of this study is to compare and analyze the effects of foreign remittances and foreign aid on the economic development of the recipient states. The study intends to focus on three research questions, namely; (i) What has been the effect of foreign aid on Kenya's economic development. (ii) What has been the effect of remittances on Kenya's economic development? (iii) How does foreign aid compare with remittances in its effect on Kenya's economic development?

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LIST OF ABBREVIATIONS

FAO	Food and Agricultural Organization
EIB	European Investment Bank
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
IADP	Integrated Agriculture Development Programme
IMF	International Monetary Fund
MDGs	Millennium Development Goals
NSE	Nairobi Securities Exchange
NZODA	New Zealand Official Development Assistance
OECD	Organization for Economic Co-operation and Development
ODA	Official Development Assistance
PEV	Post-Election Violence
SIDA	Swedish International Development Authority
SSA	Sub-Saharan Africa
USAID	United States Agency for International Development
WB	World Bank
WFP	World Food Program

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

In most economies, foreign aid, foreign direct investments (FDIs) and official development assistance (ODA), loans, credits and grants (all considered types of foreign aid) as well as remittances provide the basic sources of development resources and funds (Fatima, 2014). Foreign aid and remittances are considered today, as the most important sources of foreign inflow of finances, which can be used to enhance economic growth and development. Foreign aid is considered vital in the facilitation of economic development in the developing countries (Ekanayake&Chatrna, 2008).

According to Ekanayake and Chatrna (2008), foreign aid has four main mechanisms in which it potentially contributes to development, namely; (i) aid increases investments in the recipient country; (ii) aid increases the local capacity to import capital goods; (iii) aid increases domestic savings; (iv) aid facilitate technology transfer to the local economy. Africa has been the number one recipient of foreign aid in the world with net bilateral ODA from the Development Assistance Committee to the continent in 2008, reaching \$26 billion in 2008 with 86% going to sub-Saharan Africa (OECD, 2009; Hailu, UNDP & Shiferaw, 2012).

In 2006, it was estimated that \$ 103.6 billion worth of foreign aid flowed into the developing countries of the global south. In fact, by 2006, the amount of foreign aid that had flowed into these countries over the last 50 years was estimated at \$ 2.3 trillion (Williamson, 2009).Africa has received up to \$ 568 billion worth of foreign aid over the past 42 years, nevertheless, the per capita growth of the continent's median states remains near the zero mark. Therefore, it is

perceptible why previous studies have yielded mixed results regarding the ability of foreign aid to facilitate economic growth.

For instance, on one hand, Brautigam and Knack (2004), Karras (2006), Dalgaard, Hansen and Tarp (2004) have all concluded that there is a positive correlation between Foreign aid and development. On the other hand, Doucouliagos and Pladam (2010), Jensen and Pladam (2003) as well as Burnside and Dollar (2000) have determined little evidence linking aid to positive economic development. Regardless, of the above difference, foreign aid is aimed at stimulating economic development by supplementing the source of domestic finance including savings and expands capital stock and investment.

Nevertheless, aid has come under intense criticism in its ability to boost economic growth in the developing world, McGilivray, Feeny Hermes and Lensink (2006) have identified four criticisms leveled against foreign aid especially Official Development Assistance. These criticisms are; (i) that aid has diminishing returns; (ii) that the success of aid is contingent on widespread external, climatic conditions; (iii) that aid is vulnerable to internal political conditions; and (iv) that the effectiveness of aid depends on the quality of institutions. Indeed, despite the reverence for ODA as potentially effective in boosting economic development in the developing world, remittances are proving to be a relevant source of finance for development in this part of the world.

Increasingly, remittances are becoming an attractive as sources of external finance for managing economic shocks and for fostering development especially in the developing world. Ahmed and Martinez-Zarzoso (2013) are convinced that both FDI and ODA have been unseated by remittances as the most important sources of economic development in the developing world.

Nwaogu and Ryan (2015) observes that empirical assessment of the effect of foreign aid on economic growth have generated mixed results.

Chenery and Strout (1966) argued, that foreign aid positively impacts the economy as it expands the rate of investment and income levels in the recipient economy by complementing other source of resources. On the contrary, other studies such as that by Ehrenfeld (2004) have put the blame on the donor states regarding aid failure in several receiving states. These criticisms against donors and aid, is that conditionality and aid-tying, results in the redirecting of received aid to the benefit of the donors as opposed to facilitating economic growth in the recipient states.

Not surprisingly, over the years, remittances have proved to be resilient sources of finance for development especially in times of economic downturns as compared to FDI and ODA (Buch&Kuckulenz, 2004). Undeniably, data collected since 2010 reveal the growing importance of remittances as source of finance for development. According to estimates by the World Bank (2016), remittances to developing countries surpassed ODA by more than double to stand at \$431.6 billion in 2015. In Kenya, data collected in 2013 by the Central Bank of Kenya (CBK), remittances stood at \$1.29 billion, this accounts for 2.98% of the GDP. The amount of remittances to the developing countries in 2014 was \$430 billion, an increase of 13% from the \$381 billion that had been recorded in 2011 (Ahmed & Martinez-Zarzoso, 2013; World Bank, 2016).

In Eritrea, remittances are recognized by the government as an important source of development finance. The government has therefore made it mandatory for remittances to be recorded. In line with this, it has created good channels that record all remittances that flow into the country.

These remittances are very vital for the development of the economy as they account for 40-50% of the GDP(Kifle, 2007).

In Africa, increasing remittances have resulted in serious questions being asked about whether foreign aid is the only potentially effective means of facilitating economic development. For instance, Rena (2010) after examining aid inflow to Zambia argues that if Zambia had converted all the aid it received since 1960 to investment and all of that investment to growth; it would have had a per capita GDP of about \$20,000 by the early 1990s. Instead, Zambia's per capita GDP in the early 1990s was lower than it had been in 1960, hovering under \$500. Like the rest of Africa and the developing world, the status of aid effectiveness has been a central concern to Kenya.

Located in Eastern Africa, the country is another example of a country in which foreign aid has not led to economic growth. On the other hand, growing amount of remittances has helped raise important questions about the resilience of remittances to surpass foreign aid as the main contributor to national economic development. In the 1990s, the aid flows increased from \$ 308.85 million to peak at an average of \$ 393.4 million ((Mwega, 2009; Nyamwange& Paterson, 2015).

Since 2002, Kenya has received more aid due to increased government borrowing to augment governments' social sectors and humanitarian response (Mwega, 2009). In 2006, the net official development assistance (ODA) to Kenya stood at \$943 million, which placed the country at number 23 among the 150 states, which were receiving ODA. The levels of the official aid to Kenya in 2006 fell short of historic high of \$1616 realized between 1989 and 1990 (Mwega, 2009). Between 1980 and 2006, Kenya's share of aid among the developing countries was

determined to stand at 1.22%, while in the same period its share of ODA to Africa stood at 3.34%. Between the year 2000 and 2006, Kenya's aid dependency was only 2.18% and was not considered as being a highly dependent aid. Even at its peak between 1989 and 1990, the ODA inflow to Kenya stood at 14.6% (WB, 2014).

Remittances to Africa were estimated to have reached 21 billion in 2008 even though the exact figure remains unknown (Balde, 2010; Nyamwange & Paterson, 2015). In fact, in most African countries, remittances contribute to a huge amount of the Gross Domestic Product (GDP) with countries such as Cape Verde and Lesotho attributing 8% and 24% of their GDP to remittances. The size of remittances to Africa is attributable to increase in African immigrants in the Diaspora over the last two decades (Nyamwange & Paterson, 2015).

1.2 Problem Statement

The potential of foreign aid, especially official development assistance (ODA), foreign direct investment (FDI) and trade to facilitate economic development was first recognized by the United Nations Monetary Report of the International Conference on Financing for Development (Kpodar & Goff, 2011). Following the conference, the amount of aid to the developing countries aimed at boosting the capacity of these countries to attain the Millennium Development Goals (MDGs) increased. However, it is increasingly accepted that ODA has failed to meet expectations and many countries especially those in sub-Saharan Africa (SSA), have not yet overcome the developmental hurdle. In fact, some literature sources including, Doucouliagos and Pladam (2010), Jensen and Pladam (2003) as well as Burnside and Dollar (2000) have indicated that some of the countries that have received the largest foreign aid assistance have either experienced economic stagnation or downturn.

On the other hand, remittances, which barely made it to the agenda of the Monterrey Consensus, have become very important (Kpodar & Goff, 2011). In some developing countries such as Pakistan, remittances outweigh ODA inflows attesting to their increased importance in the developmental agenda. According to World Bank estimates, (2016) remittances currently outweigh ODA by more than double especially in the developing countries where in 2015 it was estimated to reach US\$431.6 billion. Perceptibly, remittances are increasingly being appreciated as providing additional if not the most important source of development financing. As Kpodar and Goff (2011) observe, it is not surprising that development initiatives advocate for the reduction of transfer costs for remittances and the enhancement of their impact on poverty reduction and growth.

Therefore, remittances are proving to be increasingly indispensable as far as debates on the sources of finance for economic development in the developing world is concerned. However, despite its potential and proven ability to facilitate economic development, remittances have received little scholarly attention as far as the development agenda is concerned. Balde (2010), Sander and Aimbo (2003) observe that as opposed to foreign aid which has received much attention at the macroeconomic level, the effect of migrants' remittances on economic growth has attracted limited scholarly interest. He contends that the snubbing of remittances at the macroeconomic level is partly attributable to the proportion of remittances that accrue to the region (about 6% of that going to the developing world in 2008).

Nonetheless, the increasing amount of remittances to Sub-Saharan Africa was estimated at 21 billion in 2008, and was projected to have increased by 25.4% over the five years between 2003 and 2008 making it important and necessary for consideration but that has not been the case

(Balde, 2010). Furthermore, even in instances where remittances and foreign aid have been examined, the two have been assessed independently (Kpodar& Goff, 2011). The two share similar determinant factors including per capita income in the recipient countries and aim at attaining similar development goals such as improving the living standards and well-being of people in the developing countries. Therefore, the most effective way of assessing the two concepts is through a comparative analysis that seeks to explain the reason for the unprecedented increase in importance for remittances and the increasing criticism for foreign aid as sources of developmental finance.

This study therefore aims at conducting a comparative assessment of the importance of remittances and foreign aid in facilitating development. It seeks to contribute to the current literature on the growing importance of remittances to the development agenda and to explain instances where remittances and aid complement each other and specific situations in which either foreign aid or remittances facilitated economic growth and development. As such, the study intends to contribute to the broader issue of economic development.

1.3 Purpose of the Study

The purpose of this study is to compare and analyze the effects of foreign aid and remittances on the economic development of Kenya.

1.4 Research Questions

1.4.1 What has been the effect of foreign aid on Kenya's economic development?

1.4.2 What has been the effect of remittances on Kenya's economic development?

1.4.3 How does foreign aid compare with remittances in its effect on Kenya's economic development?

1.5 Objectives of the Study

The general objective of the study is to compare and analyze the effects of foreign remittances and foreign aid on Kenya's economic development using the data for the period 1966 to 2017.

More precisely, the aim of the study is to achieve the following objectives.

1.5.1 To analyze the effects of foreign aid on Kenya's economic development.

1.5.2 To examine the ramifications of remittances on Kenya's economic development.

1.5.3 To investigate the most effective source of finance between foreign aid and remittances for Kenya's economic development.

1.6 Significance of the Study

The findings of this study will be important to a number of stakeholders.

1.6.1 General Public and the Diaspora

The study takes a comparative assessment of the importance of remittances and foreign aid to economic development. Hence, it will equip the general public with information regarding the role that these two sources of funds play in national development. The Diaspora will also gain knowledge of how their remittances to countries of origin do not only help their kin but also how the remittances contribute to national development. Therefore, the study will act as one of the few sources of information to the public in the developing countries and to the Diaspora on the

volume and relative contribution of remittances and foreign aid to the national development agenda.

1.6.2 Government

The government, which is the main custodian and driver of national development, stands to benefit from this study in several ways. The study will equip government officials and policymakers with information regarding trends in the inflow of the amount of ODA and remittances, which can help in enhancing the national fiscal policy and development policy. The study will form a separate source of information on the amount of ODA and remittance inflow into the country, which can help the government in verifying national data on the same. As such, the study will assist the government and government officials with acquisition of important unbiased information that can facilitate the development policy for regulating and managing remittances and ODA with the goal of enhancing economic growth and development.

1.6.3 The Donor Community

The study will also be important to the donor community in that it will provide information on the comparison between foreign aid and remittances. The information provided concerning foreign aid in particular and the resilience in facilitating economic development in the developing world will be vital in positively influencing how the donor states negotiate and award foreign aid. The information provided would further help the donor community identify and concentrate only on priority areas, which have not been positively affected by remittances.

1.6.4 Future Researchers

The current study ventures into an area that has attained limited scholarly attention. In so doing the study will be important to future researchers as it will help inspire academic attention to the analysis of the growing importance of remittances to economic development. Furthermore, the study will allow future researchers to appreciate the need for aid despite the growth and importance of remittances. The study will also contribute literature on the comparative analysis of relevance of remittances and foreign aid to development, which could form part of the literature review of future studies on the same. By focusing on development, the study will accentuate the need for continued scholarly attention to economic development and factors that contribute to it especially in the developing world.

1.7 Scope of the Study

The focus of the current study is to conduct a comparative assessment of the contributions of foreign aid and remittances to national development. It concentrated on the developing countries by taking a case study of Kenya. In doing so, the study will focus on secondary sources of information to acquire relevant data for the comparative study. The secondary data will be acquired through background study and content analysis of existing sources of information including books, peer reviewed journals and online articles as well as publications by relevant organizations.

The bulk or the greater part of the secondary sources comprised of those produced or published over the last 10 years, however, sources older than 10 years were consulted where necessary for fact checking.

1.8 Definition of Terms

Following are definition of key terms and concepts that were in the course of the study.

1.8.1 Aid

Aid is referred to as a voluntary shift of funds from one side to another, issued at least partly to benefit the receiving side (Feldman, Hadjimichael, Kemey & Lanahan, 2014).

1.8.2 Economic Growth

Growth refers to the aggregate increase in a state's capacity to produce services and goods, this is compared between two periods of time and is measured real or nominal terms with the form often adjusted for inflation (Feldman, *et al*, 2014).

1.8.3 Remittance

Remittance is the money that is sent by migrants to their kin, relatives or other acquaintances in their countries of origin (Ostropolski, 2015).

1.8.4 Aid Effectiveness

The ability of aid to enable countries to reach their own development objectives other than advancing the interests whether economic, political or social of the donor states (OECD, 2005).

1.8.5 Official Development Assistance

Official financing administered with the promotion of the economic development and welfare of developing countries as the main objective and which are concessional in charter (OECD, 2005)

1.9 Chapter Summary and Summary of all Chapters

Chapter One has highlighted on the background of the study and discussed the problem statement. The chapter has further described the purpose of the study and identified the research questions that will guide and direct the study. The significance to various stakeholders including the public, the government of Kenya, the donor community and future research has also been discussed. The scope of the study and the definition of some of the key terms that will be used in the study has also been presented.

Chapter Two will comprise of a review of literature for the study. The Chapter will be divided into five critical parts. The first part is an evaluation of literature relating to the first research question, the second part of the literature review examines existing academic work on the second research question while part three focuses on literature concerning the third research question. The chapter then examines various theoretical perspectives to locate the study within the appropriate theoretical framework. The chapter highlights the conceptual framework for the study before providing the Chapter summary.

Chapter Three of the study will comprise of the identification and explanation of the research methodology. The Chapter will comprise of a discussion and justification of the research design for the study. The data collection methods and research procedure will also be highlighted as well as the data analysis techniques and the ethical issues to be considered in the research.

Chapter Four will provide the results of the research study. The chapter will provide the results pertaining to the contributions of ODA and remittances to Kenya's economic development. Chapter Five, will be the final chapter of the study. It will present the summary of the principal findings of the study and provide a detailed discussion of the findings by relating them to

findings of previous studies. Chapter Five will then provide the conclusion of the study and issue recommendations for policy improvement and for further research.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter presents a literature review on the effects of foreign aid and remittances on economic development, the chapter seeks to assess and examine what existing literature and scholars have said about the nexus or link between foreign aid and remittances on development. Hence, the chapter seeks to determine if there is harmony among scholars and existing literature on the effects of foreign aid and foreign remittances on economic development in the recipient state as well as which of the two can be counted upon as a more reliable source of finances for economic development. Consequently, the chapter presents the gaps in literature, which the current study seeks to abridge in lieu to enhancing the appreciation of remittances as a significant source of developmental finance.

2.2 Empirical Review

2.2.1 ODA Inflows and Economic Development

Official Development Aid (ODA) or foreign aid is an external source of capital, other external sources being Foreign Direct Investment (FDI) and migrant remittances (Makori, Kagiri & Ombul, 2015). ODA comprises of resource transfers to developing countries from developed countries or intergovernmental organizations in terms of loans, concessional financial terms and grants. ODA is grouped into two categories, it can either be loans or grants extended to by a multilateral or a bilateral donor (Ekanayake & Chatrna, 2008). The bilateral aid is extended through agencies of donor states such as the New Zealand Official Development Assistance

(NZODA), the United States Agency for International Development (USAID) or the Swedish International Development Authority (SIDA) among others (Makori, *et al.*, 2015).

The multilateral aid is resource contributions or funds from developed countries, which are administered through international institutions such as the International Monetary Fund (IMF), the United Nations, the World Bank Group (WB) or other specialized agencies such as the Food and Agricultural Organization (FAO) or the World Food Program (WFP) among others (Karras, 2006; OECD, 2012, Jayaraman, Choong& Chand, 2016).Several scholars contend that foreign aid has an effect on economic growth and development (Morrisey, 2001; Fatima, 2014; Ekanayake & Chatrna, 2008).

Mba and Amassoma (2014) contend that aid flows in the form of ODA do play a crucial role in complementing the domestic sources of finance for development. They argue further that ODA can be vital in promoting the domestic business milieu especially for the private sector. Abiola and Olofin (2008) concur and emphasizes that ODA is also a critical tool for augmenting health, education, public infrastructure development, rural development, agriculture and food security. Bakare (2011) explains further that foreign aid is a means of enhancing the available capital for economic growth and investments to eradicate if not reduce the levels of poverty in developing countries such as the countries of sub-Saharan Africa (SSA).

In the developing countries in particular foreign aid plays a crucial role of stimulating economic growth in various ways including supporting the commanding sectors of the economy including agriculture and manufacturing, it also helps in infrastructure development (Fatima, 2014). Other critical sectors in which foreign aid is indispensable are health, education, the development of the political system and environment (OECD, 2009; Jayaraman, *et al.*, 2016).Mba and

Amassoma(2014)explains that ODA enhances economic growth in developing countries by enhancing the efficiency of use of resources, availing the resources for industrialization, generating employment opportunities and enhancing product diversity. Nonetheless, the two scholars are quick to explain that the efficiency of ODA in assisting these developmental milestones is contingent on the presence of regulations regarding the extraction of natural resources, the ability of the relevant officials to enforce such regulations should they exist, increased level of local openness to ODA. Mba and Amassoma (2014) contend further that developing countries' ability to attract and maximize the associated benefits of ODA is contingent on conditionality by which the ODA is awarded and the recipient government's ability to minimize the associated risks.

In a research conducted in Nigeria by Fatima (2014), it was found that aid flowing into the country had a positive correlation with the country's economic growth. Several similar studies have also determined a positive link between ODA and economic growth (Williamson, 2009; Karras, 2006; and Dalgaard, *et al.*, 2004). Ekanayake&Chatrna, (2008) notes that several studies conducted on the relationship between foreign aid and economic development in Africa, have determined that foreign aid not only increases economic growth but it has a reducing effect on poverty levels on the continent. Quattara (2006) examined data on aid inflows and economic growth in Senegal between 1970 and 2000 and found that 41% of the aid went to debt servicing, meaning that foreign aid helps in redirecting the finances that would otherwise go to debt servicing and other areas where the finances are required for development. According to Mba and Amassoma (2014), a research was conducted among some 34 and 51 countries in the 1950s and 1960s respectively, which yielded significant findings regarding the impact of ODA on economic growth of recipient countries. According to the authors, foreign aid, investments and

other flows were investigated to determine their impact on economic growth, it was determined that foreign aid, especially ODA has a substantially significant impact on economic growth in comparison to other variables.

Karras (2006) after examining the correlation between growth in per capita GDP and foreign aid of over 71 aid-receiving countries in the developing world between 1960 and 1997 concluded that the impact of foreign aid on growth was permanent, positive and statistically significant. He went further to calculate that if foreign aid increased by \$20 per person, the result would be an increase in a 0.16% increase in the growth rate of real GDP per capita. Therefore, at least some scholars concur that there is a direct positive impact of foreign aid thus, there seems to be a kind of consensus among scholars that foreign aid has an impact on growth and development. Karras (2006) conducted a study to investigate the correlation between ODA and growth in per capita GDP utilizing yearly data between 1960 and 1997. He samples 71 aid-receiving countries of the developing world and determined a positive effect of ODA on economic growth. He determined that a \$20 increase in ODA per person resulted in a permanent real GDP growth rate of 0.16 per capita. Nonetheless, Mba and Amassoma (2014), criticizes these findings noting these results did not take into considerations the effects of policies.

Fatima (2014) contends that foreign aid has a direct positive impact on the level of investment in the human and physical capital. In a survey conducted by the Organization for Economic Cooperation and Development or OECD (2012), it was determined that in 11 out of some 14 empirical studies, FDI was contributed to economic growth in these countries. Ekanayake and Chatrna (2008) contend that in the developing countries, the foreign direct investments (FDI) is

one of the primary ways in which foreign aid has flowed. Hence, investments can be seen as one of the most significant transmission mechanism of foreign aid in the developing world.

However, other studies have suggested that the effects of FDI are mostly felt in countries with well-developed financial and open markets. Consequently, countries of sub-Saharan Africa (SSA), since they experience low FDI cannot count on it as a source of the much needed development finance. Veiderpass and Anderson (2007), argue that the link between growth and foreign aid goes through investment and that occasionally aid finances investment. Gomanee, Girma and Morrisay (2005) provide a more direct evaluation of the impact of ODA on economic growth. These three researchers utilized a sample of 25 SSA countries over nearly three decades, between 1970 and 1997, and determined that there exists a positive correlation between ODA and economic growth. They also identified FDI as a more significant means of transmitting these forms of assistance.

Scholars have used the so-called Harrod-Domar Model in assessing the link between foreign aid and investment. According to this model, there is a link between aid and savings, which facilitates investment and growth in the recipient countries (Veiderpass & Anderson, 2007; Ndambendia & Njoupouognigni, 2010). In this sense, it is assumed that aid results in the local availability of funds, which can be saved and put in investments. In the developing countries, there exist what has been dubbed the saving gap, that is, the discrepancy or gap between savings and investments.

It is thus proposed that foreign direct investment abridges this gap internally (Jayaraman, *et al.*, 2016). According to Brautigam and Knack (2004), the saving gap can be addressed by encouraging FDI otherwise called foreign capital flow. The underlying argument over the aid-

investment link is therefore that, proper mobilization of domestic savings can encourage an enhancement of the economic activities and thus growth through investment (Balde, 2010)

In a study, Fasanya and Onakoya (2012) examined the impact of ODA on economic growth in Africa, taking Nigeria as a case study. The researcher focused on the period straddling 1970 – 2010 leaning on a neo-classical modeling analytical framework in which he combined several procedures. They established that aid flow to the country facilitated economic growth by increasing domestic investments and savings, freeing resources that enhance domestic investment. In a sense, the finding by Fasanya and Onakoya (2012) confirmed the aid-policy hypothesis that seems to be suggested by several studies as this review has demonstrated.

Mckee and Bells (2013) sampled 30 SSA countries and tested the combined effect of Technical Cooperation Grants (TCG) and ODA on per capita GDP. They found that domestic investment, international trade, domestic investment increased as ODA increased over the 30 years. Furthermore, the two determined a significant correlation between TCG and ODA on economic growth in the sampled countries. Driffiield and Jones (2013) examined the joint effect of ODA, migrant remittances and FDI on economic growth on 20 SSA countries and determined a significant positive correlation ODA, remittances and FDI with economic growth.

Nonetheless, there is an alternative view that perceives the correlation between foreign aid and economic growth as being negative. This body of literature has mainly emerged over the past decade and argues that aid does not necessary precipitate economic growth. This view is often supported by the argument that despite the unprecedented foreign aid inflows especially in the developing countries, these countries remain very poor and face intermittent economic hardships (Fatima, 2014). These contradicting arguments on the effectiveness of foreign aid on economic

growth are assessed further under the comparative assessment of the reliability of foreign aid and remittances as sources of developmental finance.

2.2.2 Remittance Inflow and Macro and Micro Level Development

Loxley and Sackey (2008) in a study to investigate efficacy of aid and the Africa's sources of growth finance sampled 40 SSA African countries astride a 28-year period. They determined that while aid effectively promoted growth in the recipient country, debt-service, aid, domestic savings and worker's remittances were significant source of finances for development for majority of African countries. According to Makori, *et al.*,(2015), remittances can be conceptualized or understood as the money or goods or other resources, which are transmitted to households by migrants outside the country of origin.

Remittances are said to present economic stability in the host countries during recessive phases in the receiving countries. According to Ocharo (2014), the need for filling the foreign exchange and savings gap in the developing countries has made remittances one of the most significant sources of external funds for development. It is assumed that enhanced increase in the inflow of remittances has the ability to offset these gaps and enhance the rate of growth and capital accumulation. For these reason, Ocharo (2014) notes that remittances are currently not only significance as a source of foreign exchange but is an important source of external finance for countries in the global south that are struggling to develop.

Ahmed and Martinez-Zarzoso (2013) contend that in such economic situations, there is a tendency for remittances to rise as migrants send more money to their kin and friends at home. This results in the smoothening of the consumption in the recipient country and assists in the establishment of stability in that economy. This reflects the pure altruism approach to understanding remittances as suggested by Lucas and Stark (1985). According to this perspective, remittances are expected to contribute to economic stabilization of the receiving

country especially in the aftermath of macroeconomic shocks. A similar sentiment is made by Driffield and Jones (2013) arguing that migrant remittances have a strong positive impact on domestic savings, which helps to cushion the economy during periods of global economic instability.

Ahmed and Martinez-Zarzoso(2013) point out that rise in remittances after Indonesian (1997), Argentina (2001) and Ecuador (1999) supports the altruism approach. The World Bank (2006) further supports the view when it observed that there was an increase in remittances in Haiti, Dominican Republic, Honduras and Bangladesh following the natural disasters in these countries.

Empirical studies including those by the World Bank (2006), Solimano, Hysenbegasi and Pozo, (2002) among others have found that the effects of remittances on a country's economic growth are potentially positive.

In the altruistic sense, remittances are considered as vital in boosting economic growth by reducing household poverty levels by increasing recipient family's living standards and income. Ang (2007) studied the impact of remittances on Philippines economic growth over the period 1988-2004 and found that remittance inflows into the country were directly associated with Philippines' economic growth over the studied period.

However, the altruism approach, in which remittances are assumed to increase in the aftermath of macroeconomic shocks, does not follow with the portfolio approach. According to Ratha (2013), there are instances such as that in the Philippines and Turkey in the late 1990s, where remittances to these countries declined in the aftermath of the financial crises in the two

countries. However, it is worth noting that, as compared to other capital inflows to the countries including foreign aid and FDI, the decline was marginal. Still it does not fully follow with the altruism approach and in these instances; it would be hard to argue that remittances contributed to stability. Furthermore, others such as Lueth and Ruiz-Arranz (2006) have actually argued that remittances do not always increase in post-natural disaster periods, further challenging the credibility of the altruism approach.

Aggrwal, *et al.*, (2006) as well as Guiliano and Ruiz-Arranz (2005) confirm this argument in their studies of the effects of remittances on bank deposits and bank credit extensions to the private sector. In this case, remittances are considered as substitute to other forms of financial means such as insurance and credit, which are non-existent in several developing countries. However, Barajas, *et al.*, (2009) sampled 84 recipient countries to determine the association between economic growth and remittance inflows and found that remittances had zero impact on economic growth. Siddique, *et al.*, (2010) when they examined the relationship between remittances and growth in Sri Lanka, Bangladesh and India, made a similar finding. Using the Granger Causality Test of the Vector Auto Regression (VAR), the researchers found zero causality between the two.

According to Ahmed and Martinez-Zarzoso (2013) construe as the portfolio and altruism approach to remittances, the remittances are perceived to stimulate both investment and consumption in the receiving country respectively. In this sense remittances therefore, are considered critical in facilitating the stabilization of the recipient states economy and boost the local economy as well. Furthermore, the remittances could increase the capacity of the local

populace or engage in high-risk but profitable investments. In other words, remittances can facilitate economic growth by enhancing local capacity for investment.

In a recent study, Ratha (2013) found that, remittances could increase financial intermediation and domestic savings, which could precipitate an improvement in the growth prospect of the receiving state. This latter assertion is confirmed by a study conducted by Yasseen (2012) in which he reports a positive correlation between the development of financial systems and remittances especially in the developing countries of the Arab world. However, there is a body of literature that has argued that the positive perception of remittances vis-à-vis economic growth is inconclusive.

For instance, according to Stratan, *et al*, (2013) found that in Moldova, remittances varied by 5.1% (14% to 19.1%) of GDP in five years between 2006 and 2011. Furthermore, remittances are not immune or precluded from the financial developments in the sending countries. Ratha (2013) observes that the recent financial crisis especially in the western developed countries, there was a decrease in remittances from these countries to the developing world. The positive impact of remittances on GDP growth is also found to be contingent on the level of development of the financial markets; hence, it is only positive if the financial markets are comparatively underdeveloped (Guiliano & Ruiz-Arranz, 2005).

Investment is one of the primary areas to which remittances are directed in the recipient countries. This is the view that is dubbed the portfolio approach, and in which remittances are considered to increase especially if their anticipated returns on the recipient countries is also expected to increase (Hysenbegasi & Pozo, 2002). Agunias and Newland (2012) observe that Diaspora large-scale investment in home countries significantly contribute to economic growth

through, employment creation, and the raising of the living standards through associated benefits of investment. Undertaken especially by wealthier immigrants, these kinds of direct Diaspora engagement in local businesses often demand a lot of capital but have huge positive socio-economic effects in the local economy. In fact, as Alvarez-Tinajera (2009) observes, the investments are at times collaboration between the Diaspora and the government such as Cape Verde's Fast Ferry S.A whose owners include Diaspora in the US and the government of Cape Verde.

In other countries, where the Diaspora have not engaged in macro-scale businesses, they have invested their resources in micro-credit institutions. In fact, the Diaspora engagement in small and micro-scale businesses in their home countries is well documented. According to a body of literature that can be categorized as focusing on the portfolio approach of remittances, the remittance inflows are invested by the recipients in business, to expand businesses, to improve agricultural production, or to purchase firm inputs, all of which have potential positive impact on economic development (Agunias & Newland, 2012).

The potential and ability of the Diaspora to play a critical role in mobilizing resources for financial development is well documented (World Bank, 2006; UNCTAD, 2013; Nyamwange & Paterson, 2015). Diaspora bonds are one of the most perceptible means through which this is achieved. According to Ratha (2013), Diaspora bond is a debt instrument that a state, a semi-autonomous state or even private corporation issues, for fundraising from the Diaspora. According to Ratha and Plaza (2011), these bonds tap into the emotional links that the migrant populations have with their home country and their desire to give back to assist in the attainment of a common development goal or agenda.

By issuing these bonds, the Diaspora (both wealthy and poor) are given the opportunity to invest in their home countries. According to Kamuleta (2014), advocates of the Diaspora bonds take the case of India and Israel contends that, these bonds for a viable source of developmental finance can be used to develop national infrastructure. Indeed, in the developing countries, the bonds can be a source for money for the construction of roads, hospitals, schools, water sources and housing among other community needs. Alvarez-Tinajera (2009) observes that countries such as Cape Verde and Ghana have come up with innovative ways that allow the Diaspora to buy bonds in the Stock Exchange and directly finance infrastructure development respectively.

2.2.3 Most Effective Source of Finance between Foreign aid and Remittances

It has been mentioned that some scholars have suggested that remittances may not precipitate a positive outcome for economic growth. Remittances depend on the economic conditions of the sending country and as such may not be reliable source of development finance during periods of financial crisis in the sending states (Rathat, 2013). In several developing countries, foreign sources of funding present the main and sometimes only source of development finance. However, when remittances are considered a permanent source or income, they result in producing negative incentives. In Haiti, for instance, such negative outcomes include labor market participation and working hours (Jadotte, 2009).

This is to say that remittances, affect people's likelihood and resolve to work and increase private consumption. Azam and Gubert (2006) observe that the consumption often involves mostly imported goods instead of improving local saving or enhancing domestic financial investments. Scholars, such as de Haas (2007), Alper and Neyapti (2006) observe that the actual impact of remittances to economic growth can only be realized in the long-term. In other words,

the full impact of remittances can be expected not within the first decade but in the second, in the aftermath of large-scale migration.

In lieu of the sheer amount of remittance inflow into countries and the potential ability of such funds to provide revenues for the government, some countries have proposed taxation of the remittance inflows. Furthermore, with respect to the growing pressure on states finances and economic recession, the taxation of remittances can offer an important source of funds for governments. Two ways in which such a taxation initiative could be implemented exist, these are, taxing when the money is being sent or direct taxation of wages.

According to Kamuleta (2014, p.24), the Omani Government recently proposed such a taxation regime when it suggested the need to tax the colossal amount sent by “foreign workers” in Oman back to their countries annually. The same suggestion was also made by the United Arab Emirates in reaction to the country’s fiscal challenges. The same government also suggested increasing the costs of immigrant or foreign workers in Oman to encourage the hiring of citizens as opposed to migrant workers as a way of addressing the rising unemployment levels in the country (Kamuleta, 2014).

This suggests that remittances can therefore present an unstable source of income for those countries that rely so much on it as a sources of development finance especially since it is very vulnerable to the influence of the foreign (sending) country due to political or economic factors. Furthermore, taxation of remittances is potentially problematic and may result in the burgeoning of transactions costs due to double taxation in the sending country as well as in the recipient country. Apart from discouraging remittances therefore, the taxation may limit the amount

remitted and in so doing prevent the sending or receiving of money that can be of help to the recipient (UNACTD, 2013).

Foreign aid just like remittances has certain drawbacks as a source of foreign finance for development. Fatima (2014) contends that the effectiveness of foreign aid to facilitate economic growth is often limited by the motive and the level of commitment of donors and foreign governments to the development agenda of the recipient country. It is also contingent on a number of domestic factors that all work to determine whether aid inflows actually address the development agenda for which it was intended initially. For instance, Morrisey (2006) contends that there are four disadvantages of foreign aid that makes it unreliable as a source of development finance. These include (i) that it has decreasing returns, (ii) that its effectiveness is dependent on climatic and external conditions, (iii) that political conditions have an effect on aid effectiveness, and (iv) that the effectiveness of aid is dependent on the quality of the institution in place.

The dependence of the effectiveness of foreign aid on the political circumstances and institutional capacity of the recipient countries was well taken up in the Paris Declaration on Aid Effectiveness (OECD, 2008). It was conceived under the declaration that the potential of foreign aid to achieve the intended purpose is dependent on the country-level of effort. These country-level of efforts include political will and commitment as well as institutional capacity to effectively manage aid utilization (Balde, 2010). However, while studies have found a positive aid-economic growth link, there are those studies such as that by Ndambendia and Njoupouognigni (2010) have come out with contradictory results.

Veiderpass and Anderson (2007) contend that the aid-growth links is contingent on several factors relating to governance, domestic policies, historical circumstances and external conditions. This means that for aid to attain its desired purpose, these factors should be favorable, something which is always infeasible. In other words, due to these factors, the suitability of foreign aid as a source of developmental finance is uncertain (Dalgaard, *et al.*, 2004). Proponents of foreign aid propose that it is necessary to help address the saving gap that exists in most developing countries including Kenya. However, while it is intended at improving economic conditions, the volatility of foreign aid can precipitate instability in the macro-economic environment of the recipient state resulting in unintended outcomes (Jayaraman, *et al.*, 2016; Ndambendia & Njoupouognigni, 2010).

2.3 Summary and Gaps to Fill

The review has shown that a lot of scholarly attention has been put to the analysis of the effects of foreign aid and remittances on economic development. However, perceptible in the review is that most of these studies have examined the two concepts separately with very little attempt of comparing how they both affect economic development in terms of their stability as a source of finance for development and also with regard to their ability to provide enough funds. Furthermore, the review also shows that while the literature on foreign aid and economic development have focused on macro-level impacts, not much attention has been accorded to the assessment of the micro-level impacts of the same. However, this is not true for remittances, as scholars have attempted to assess the effects of remittances both at the micro and macro levels.

At the same time, while scholars seem to concur that remittances have both macro and micro-level impacts on the economy of the receiving country, they are divided as to at what point such

effects can be said to occur with some arguing that the effects are only recognizable within two decades and others that the effects are immediate. Furthermore, there is little literature on the effects of remittances at the macro-level. Scholars also seem divided as to which of the two, foreign aid or remittance provides a reliable source of development finance.

These are the gaps that the current study attempts to address by taking a case study of Kenya and assessing three important questions; (i) What has been the effect of foreign aid on Kenya's economic development. (ii) What has been the effect of remittances on Kenya's economic development? (iii) How does foreign aid compare with remittances in its effect on Kenya's economic development?

2.4 Theoretical Framework

Scholars have presented and advanced several theories in an attempt to conceptualize and explain foreign aid and foreign remittance and their links to economic growth in the recipient countries¹. An assessment of selected theoretical and modal perspectives allow for the assessment of the underpinnings of each and the identification of one, which presents the theoretical framework for the current study.

2.4.1 Big Push theory

Paul Rosenstein Rodan proposed the *Big Push theory* or model in 1943 when he argued that a big push or comprehensive investment package could jumpstart economic development (in the developing countries) (Pragyandeepa, 2016). Central argument of the Big Push theory therefore is that there is a certain minimum amount of resources, which must be allocated for development

¹Some of the theories and models that have been proposed include the "big push" theory, the Two-Gap Model, the endogenous growth theory and the economic theory of foreign aid to mention but a few.

programs if the development process is to progress smoothly (Burnside&Dollar, 2000). The idea of the Big Push model derives from an old idea of external economies in which a foreign engagement in a local economy was perceived as capable of facilitating economic takeoff in the latter (Pragyandeepa, 2016).

Furthermore, the Big Push model assumes that no economy can advance towards economic development through the allocation of small resources to the process. Hence, it proposes that specific amounts of investments must be allocated to the development process to facilitate growth. The Big Push model proposes that such allocations can be done in three interdependent ways; firstly, that there has to be massive investments in the local economy. The massive investments, according to the theory, are a prerequisite for the process of economic growth.

Secondly, the investments must go to the different sectors of the economy for it to take effect. According to Pragyandeepa (2016), investments should be done across different channels such that each channel sustains the growth through the provision of a demand-base. Thirdly, the Big Push theory suggests that the investments should be done in tandem with planned industrialization. It stresses the need for such an organized form of industrialization in which the agriculture, the main stay of the economies of the developing world is faced off by systematic industrialization process.

However, the Big Push theory has not gone without criticism. In fact, it is apparent that the model does not specifically address the issue of remittances. Hence, it becomes inappropriate as a theory for the assessment of the current research problem regarding the impact of remittances and foreign aid on Kenya's development. Furthermore, there is potential inflationary pressure if the model holds; this regards the source of the funds and their intended area of use. That is, if the

finances are obtained through foreign loans, then the threat of inflation in the local economy is almost imminent. The model has also not been derived on a precipice of historical experience thus lack the necessary historical facts or evidence that could accentuate its potential to be an effective approach.

2.4.2 The Two-Gap theory

Another theory, which even though focused on foreign aid can be adopted to the remittance issue, is the two-gap model proposed by Chenrey and Strout in 1966. According to Kalowe (2013), the pertinent issue in the two-gap model is that foreign exchange-gap and savings gap is independent and separate constraints to economic growth. The first gap in the model is that between domestic savings (the saving gap) and the investment needed to achieve a certain growth rate. The second gap is between exports and imports. The gap occurs when there is discrepancy between foreign exchange earnings and imports necessary for a given production level (Kabete, 2008).

The model assumes that capital inflows are necessary to avail the requisite growth for economic take-off in developing countries. This means that development of countries of the developing world is embedded in the ability of these countries to embrace global production web via increased technology transfer, productivity and effective competition that capital flows precipitate. According to Kabete (2008), the argument goes that at any given time, one gap transpires in an aid recipient country (such as Kenya) hence the need for aid to fill the gap. The main critique against the two-gap theory is that foreign aid fills the two gaps only as long as liquidity constraints investments while incentives for investments remain favorable. If the cause of low investment are the poor incentives, then there will be no increase in investment through

aid, as the aid will only go to the financing of consumption. It is also considered that the two-gap model only holds truth if productivity results out of the investments made.

2.5 Chapter Summary

Chapter Two has examined existing literature on the research topic. The chapter reviewed literature on the effects of foreign aid on development as well as the effects of remittances on development. The literature was reviewed with the aim of identifying any discrepancies and harmony among existing literature. The chapter has gone ahead to identify the gaps in literature and it has been pointed out that scholars are divided as to what point such effects can be said to occur with some arguing that the effects are only recognizable within two decades and others that the effects are immediate. Scholars also seem divided as to which of the two, foreign aid or remittance provides a reliable source of development finance. The chapter has concluded by providing theoretical framework for the study. The next chapter, which is Chapter Three, presents the research methodology that was used to obtain information from secondary sources.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

Chapter Three provides the methodology that the research used in the study. The chapter highlights and discusses the methodology for the study, the sources of data, the data collection techniques and methods of data analysis. Also included in the chapter are the ethical considerations for the study, regarding the researcher and the conduct of the research. The chapter also provides a description of the limitations of the study.

3.2 Research Design

The study used a descriptive research design. This approach was especially convenient given that the study dealt with the question relating to *'how'*, *'what'* and *'which'*. The descriptive research design permitted the researcher to highlight and examine the dynamics of remittances and foreign aid to Kenya, and to describe or define how remittances and foreign aid received in the country have influenced economic development. Furthermore, a descriptive approach permitted the researcher to conduct a comparative assessment of the effects of foreign aid and remittances on Kenya's economic growth and to define which one of the two is the most resilient source of developmental finance for the country.

3.3 Sources of Data

The study was primarily a qualitative research; as such, it totally depended on the evaluation of secondary sources of data mostly academic sources on the research problem. The secondary

sources of academic data examined mostly included those that were developed within the last 10 years; however, older sources were also consulted for clarification purposes. Nonetheless, the author endeavored to keep the older sources at the minimum to ensure relevance of the study for current analyses. The sources of literature that were examined included, peer-reviewed journals, books included edited books, e-journals and e-books accessed through the online journal services available in USIU library.

The choice for the use of a secondary approach was informed by several crucial factors. One, is that it was infeasible for the researcher to amass all the financial resources needed to conduct the research as the potential respondents are widespread in Kenya and foreign countries. Secondly, the researcher's ability to collect the primary data was limited by the time constraints of the study that required the researcher to collect the primary data within weeks if not months after the approval of the research proposal by the review committee.

Primary data was not possible because; most of the targeted respondents were unresponsive, and the ones available did not constitute sufficient number for a viable sample of the total population hence the choice of secondary data. However, the researcher deemed that an approach that would encompass detailing the scholars' opinions and findings of previous studies on the research problem would provide more comprehensive understanding of the problem by allowing analyses of several perspectives.

The use of peer review sources was deemed appropriate as it includes a panel of experts in this field as they explain the two concepts better than having to do primary research.

3.4 Data Collection Techniques

The methods of data collection are diverse. However, in a qualitative study such as the current one, data collection is done through an examination or analysis of existing materials. In this study, the researcher employed a historical or background study. The researcher conducted a background study of existing material and collected only that information that was deemed relevant for the study. As such, the research conducted a background of academic materials relating to; how remittances and foreign aid received in the country have influenced economic development as well as an assessment of which one of the two is a more resilient source of development funds for Kenya.

3.5 Data Analysis Methods

The methods, techniques and procedures of data analysis are aimed at increasing the translation and the making of informed inferences from the collected data or information. In this study, the researcher used a mix of content and logical analysis method used in qualitative study. The content and logical approach permitted an examination of existing secondary sources and the determination of information that is relevant and necessary for the realization of the research objectives. Logical analysis incorporates a logical or rational reasoning process that shadows a constant and systematic assessment of literature concerning historical events and happenings and people's reactions to this.

3.6 Ethical Issues

3.6.1 Ethical Issues Regarding the Researcher

The researcher engaged in doing the research to serve a social purpose. The research was aimed at accomplishing more than just helping the researcher realize the partial fulfilment of the degree program. The study was meant to be a vital spectrum of stakeholders including the citizens of Kenya, the Kenyan Diaspora community, the government of Kenya, other researchers and other stakeholders. Personal gain was not the primary motivation for the study but rather the provision of or contribution to literature relating to the research problem. Therefore, the fulfilment of a social good was a fundamental ethical consideration for the entire study by the researcher.

3.6.2 Ethical Issues Regarding the Research Process

The researcher considered plagiarism and fraud as critical ethical issues in research. Acknowledging that these acts are legally indictable, the research took necessary measures to ensure that the research was novel and authentic and that all sources used and information borrowed were properly cited. Furthermore, the researcher ensured that professionalism backed by informed personal perspectives were applied to ensure integrity of the research process and findings.

3.7 Study Limitation

Three principle issues limit the efficacy of the study. One of the primary limitations of the study is with regard to objectivity. Complete objectivity will be hard to realize because the literature reveals that academicians and researchers present conflicting evidence, In other words, biases in designs and theoretical approaches among scholar's led to differences and biases in the interpretation of results. Hence, since this study has centered on the use of qualitative approaches

comprising of collection of information from existing information from secondary sources, it is at the risk of replicating the subjective leanings of previous scholars. As such, objectivity in analyses and interpretation of the obtained information is not completely feasible.

The second limiting factor is the study's exclusive reliance on secondary literature. The qualitative approach implies that the study fully centers on previous rather than current data and interpretation of the information would mostly make sense if the study were conducted at the time when information in the secondary sources were collected. A primary research would have generated current information that provides answers to the research questions at present.

The third limiting factor is that there is no correct estimate of remittance inflow into the country. Most of the available data comes from Central Bank of Kenya. The bank gets the reports from formal channels; therefore, it fails to capture the remittance inflow from Informal channels and other money transfer operators. Because of the underestimated figure, the data available is incomplete and inconsistent.

3.8 Chapter Summary

Chapter Three has described the research methodology that was employed in the study. The chapter has outlined the methodology that the researcher used to realize the study's objectives, presented a description of the research design, the sources of data and the techniques for data collection and analysis. The chapter has also highlighted the ethical consideration for the study.

The next chapter, Chapter Four provides the research findings as per every research question of the study and present a platform for the discussion of the major findings in Chapter Five. Chapter Five commences with a summary of the key findings of the study then proceeds to provide a discussion of the major findings in relation to the literature review and the theoretical

framework. Chapter Five also provides the conclusion of the study and suggest alternatives for improvement and for future research.

CHAPTER FOUR

4.1 Introduction

Several scholars contend that foreign aid has an effect on economic growth and development (Morrisey, 2001; Fatima, 2014; Ekanayake & Chatrna, 2008). Others have found that remittances contribute to economic development and facilitate economic stabilization in the receiving country especially in the aftermath of macroeconomic shocks (Makori, *et al.*, 2015; Ahmed & Martinez-Zarzoso, 2013). The review of literature showed that a lot of scholarly attention has been paid to the analysis of the effects of foreign aid and remittances on economic development. However, perceptible in the review was that most of these studies have examined the two concepts separately with very little attempt of comparing how they both affect economic development.

Chapter Four provides the research findings as per every research question of the study. Hence, the chapter presents the findings of the study regarding; the effects of foreign aid in the facilitation of Kenya's economic development, the effects of remittances in the facilitation of Kenya's economic development as well as study findings regarding the comparison of reliability of ODA and remittances for Kenya's economic development.

4.2 Foreign Aid and Facilitation of Kenya's Economic Development

4.2.1 ODA Inflows to Kenya

Kenya has been greatly dependent on Official Development Assistance (ODA) ever since it became independent in 1963. The significant proportion of ODA inflows into the country has been augmented with a substantial inflow of private resources (such as net inflows of FDI, private non-guaranteed longstanding debt, equity/portfolio investment and remittances from the

Diaspora) as well as other loans (Ojiambo, Oduor, Mburu&Wawire, 2015). However, in 1991, both multilateral and bilateral donors such as the World Bank (WB), the International Monetary Fund (IMF), the US, Britain and others suspended ODA inflows to the country citing Moi governments' refusal to abide by donor conditionalities imposed by these development partners as epitomized in the Structural Adjustment Programs (SAPs) (Mwega, 2009). Consequently, the World Bank, reneged on releasing some \$50 million in 1982 because Kenya had refused or failed to implement policy reforms conceived under the SAPs (Ojiambo, *et al.*, 2015).

However, after embarking on daring economic reforms from early 1990s, with the return of multiparty politics, Kenya revitalized donor trust. It is reported that from 1993, the country again realized substantial aid inflows (Mwega, 2009). Nonetheless, by 1997, donor trusts had again dissipated when the international financial institutions (IFIs) suspended aid to Kenya alleging rampant public sector corruption and wide scale misappropriation of funds by public authorities. Despite establishing the anti-corruption authority in 1999 to encourage donor trust and enhance public sector transparency and accountability, it was not until 2002 that the country initiated promising reforms. Upon ascending power, the Kibaki regime initiated reforms of the public finance, created the financial management systems (FMSs), automated payroll for civil servants and enhanced the audit techniques. After the 2002 elections, ODA inflows to Kenya quickly recovered and its significance for economic growth was again evident (Ojiambo, *et al.*, 2015).

ODA inflows into Kenya have generally been in an upward trend with respect to amount amid brief periods of decline. ODA inflows increased from independence up to the early 1990s; by 1999, it had declined to record low of \$310.47 million (Mwega, 2009). Between independence and early 1990s, the country experienced an increase in nominal aid inflows, from \$55.6 million

recorded in 1963 to \$ 1.2 billion recorded in 1990s just before the suspension by bilateral and multilateral flows. By 1999, the amount had decreased to stand at between \$309.9million and \$310.47 million (Ojiambo, *et al.*, 2015; Mwega, 2009). It has been argued that the decline was because of ODA suspension by multilateral and bilateral donors between 1991 and 1997 due to Kenya's rampant corruption and lack of economic and political reforms as demanded for by the bilateral development partners and the international financial institutions. That is, Kenya's failure to comply with the SAPs had been imposed by the development partners upon the developing countries from late 1980s (World Bank, 2014; Hailu, *et al.*, 2012).

Nonetheless, recovery was realized after 2002 with the initiation of economic reforms by the National Rainbow Coalition (NARC) government headed by President Kibaki. Invariably, after the 2002 elections, the number of ODA donors to Kenya, both bilateral and multilateral increased to 34 in 2008 from 17 in the 1990s. At the same time the amount of bilateral aid increased to \$1087 million in 2008 from \$ 293 million recorded in 2002 (Colclough & Webb, 2010). Currently, Kenya's total aid inflows comprises of 70% and 30% from bilateral and multilateral donors respectively. According to Mwega (2009), the key bilateral donors to the country include the United Kingdom, Japan, Germany, the US and the European Union (EU) in general, with EU countries such as Sweden, France, The Netherlands, Norway and Denmark playing particularly important role in extending bilateral aid to Kenya. The key multilateral donors to Kenya include the WB, UN agencies and the IMF among others including the African Development Bank (ADB).

The World Bank (2014) posits that Kenya's aid dependency has subsided markedly over the years. As of 1993, the country's maximum aid as a percentage of Gross Domestic Product (GDP) stood at 15.9% while in 1999 it was a minimum of 2.3% of the GDP. Transitioning from aid dependency necessitates that inflows is accompanied with capital accumulation. Hailu, *et al.*, (2012) argues that exiting aid probability significantly increases with the rate of expansion and investment in the manufacturing sector. Therefore, policies and institutions that promote public and private investments are critical in enhancing economic growth and enabling transition from aid dependency to a more economically independent predisposition.

The effects of ODA on Kenya's economic development can be examined through a historical review. It is estimated that between 1970 and 1980, Kenya's average real growth rate stood at 7%. The period extending from 1980 to 2002, had a negative growth in real GDP, which can be linked to several factors including the drought of 1983 – 1984 and that of 1991 – 1992, military coup attempt and more so aid suspension or embargoes realized especially between 1991 and 1997. Several analysis including Mwege (2009), Nyamwange and Paterson (2015) among others have contended that the 0.5% and 6.9% increase in GDP growth rate realized in 2002 and 2007 respectively can be greatly attributed to resumption of ODA inflows into the country.

4.2.2. Contributions of foreign aid to Kenya's Economic Growth

Several scholars contend that foreign aid has an effect on economic growth and development (Morrisey, 2001; Fatima, 2014; Ekanayake&Chatrna, 2008). ODA plays a crucial role in stimulating economic growth in various ways including supporting the commanding sectors of the economy such as agriculture and manufacturing. Furthermore, it also helps in infrastructure development, health care provision, education, the development of the political system and

infrastructure; as well as environment protection and improvement(OECD, 2009; Jayaraman, Choong& Chand, 2016).

In Kenya, especially at the macro-level, ODA has been associated with the strong economic performance realized between 1963 and 1980 (Mwega, 2009;Nyamwange& Paterson, 2015). The period between 1980 and 2002, ODA inflows were interrupted by donor ODA suspensions,it is considered as the period in which Kenya made limited economic progress. In fact, between 1980 and 2002, Kenya experienced negative and sometimes slow economic growth, significantly missed opportunities in social welfare, particularly rising poverty levels and major macro-economic imbalances (Mwega, 2009; Ojiambo, *et al.*, 2015).In struck contrast between the periods 1980 – 2002, and 2003– 2011, Kenya made huge strides in economic development (Mwega, 2009; Hailu, *et al.*, 2012). In addition, during this periods donor trust and commitment to Kenya increased due to the reality of the Cold war and limited reforms, initiated by the Kibaki regime.

Kenya's real GDP has been increasing between 1971 and 2013 (Ojiambo, *et al.*, 2015;Hailu, *et al.*, 2012). This increase can be attributed to gradual improvement in Kenya's economic performance especially between 1970 and 1990, as well as between 2003 and 2013. During this period, ODA inflows to Kenya also increased significantly despite a dry spell of 1990 – 1999 when ODA was mostly suspended (Makori, *et al.*, 2015). In this case, it could be argued that there is a link between ODA inflows into Kenya and Kenya's macro-economic development in terms of real GDP growth. However, a decline was realized around 2008 probably due to the post-election violence (PEV) that rocked the country earlier that year, and left an approximated number of 1,000 people dead, this brought the country to an economic standstill (Mwega, 2009).

Several cases can be pointed out which demonstrate the actual ODA contributions to development. In May 2009, the Kenyan government reached a deal with the IMF for a loan worth \$209 million, a loan that was to be channeled through the institutions Exogenous Shocks Facility (ESF)(Makori, *et al.*, 2015). The loan was intended to help the Government of Kenya (GoK) plug budgetary holes emanating from declining revenues as well as increases in commodity prices especially the prices of fuel, food and fertilizer (CEGAA, 2010). This loan facility was therefore important in helping the country wade off the macro economic and fiscal instability that the budgetary holes would have precipitated.

Furthermore, the loan facility would help Kenya cut inflation levels to below 5% and limit deficit spending to 3% (WB, 2014). Therefore, on face value, the IMF loan had a direct impact on Kenya's economic standing. Nevertheless, the facility was debunked as having the potential to undercut Kenya's ability of effectively responding to the financial crises, that is, it would limit the country's options for stimulus (CEGAA, 2010).

The contributions of ODA to Kenya's macro-economic development can be conceived further through the activities of bilateral players of which the US and China are highly significant. The US has been a crucial development partner to Kenya, extending financial assistance through the United States Agency for International Development (USAID) program to facilitate Kenya's economic growth. The USAID funds flow to Kenya goes back to 1976 when the US funded the WB's Integrated Agriculture Development Programme (IADP) (Klein-Baer, 2014). This US agency is said to provide a huge amount of \$10 billion in foreign assistance to the rest of the world annually and manage more than 12,000 projects in over 100 countries annually (USOLG, 2011). Kenya stands at position 6 of the largest recipients of USAID program funds and was

estimated to have received over \$350 million in 2016 from the USAID (USAID, 2017). According to Klein-Baer (2014), USAID assistance to Kenya is allocated to financing healthcare programs, education, civil society empowerment, infrastructure development and defense.

In 1980, USAID started delivering large fertilizer shipments as component of various assistance packages to Kenyan farmers (Klein-Baer, 2014). In the late 1980s, just before international aid suspensions to the Moi regime, the US through the USAID disbursed \$2 billion to the country in development assistance (USAID, 2014; Onjala, 2008). In 1998 shortly after the US embassy attack in Nairobi, USAID extended a grant of \$36.6 million to Kenya, some of which were allocated to the repair of damaged infrastructure and facilitation of provision of health services (Klein-Baer, 2014). In fact, in recent years, there has been contention that the bulk of USAID funds are given to enhance security rather than to facilitate economic development in Kenya. The 1998 incident notwithstanding, a lot of USAID resources have been allocated to the training of Kenyan military personnel and the strengthening of the police force, areas which have limited significance to economic development (Onjala, 2008; Klein-Baer, 2014).

Besides the US and the countries of the European Union (EU), China has emerged as a leading and an important bilateral development partner in Kenya's development agenda especially since 2002 (Ardovino, 2010). In 2005 and 2006, the People's Republic of China (PRC) provided about \$56 million for construction projects in Kenya with another \$10 million being given as a grant for economic development and \$44 million for rural power distribution project and the modernization of telecommunications (Onjala, 2008). This was followed in 2006 with another loan worth \$6 million for the construction and rehabilitation of Kenyan roads. This loan included \$3 million for Gambogi Road Project and another \$3 million for the Kipsigak-Shamkhokho Road

Project. Moreover, in 2007, the PRC provided \$88 million in both loans and grants for the maintenance of the Kasarani Sports Grounds, rehabilitation of Nairobi Roads as well as Street Lighting Project (Ardovino, 2010).

However, while not being tied, as is the case with the ODA from the WB, Western countries, and the IMF, China's development assistance to Kenya as is the case with other countries to which the PRC assists, has an investment twist to it (Onjala, 2008; Ardovino, 2010). It is alleged that having financed the construction of a 528-room enterprise in Nairobi, dubbed the 'Great Wall of China Apartment Complex', the Chinese were to run the facility and were to sell units at about \$50,000 each. Therefore, the actual extent to which Chinese development assistance in Kenya helps the country or facilitates China's economic and political interests can be inferred or debated from this context alone. Nonetheless, Chinese assistance to Kenya has obvious implications for Kenya's economic development.

Even though highly debated ODA has also helped facilitate economic development at the micro-level. Micro-level implies the contributions of ODA at the individual and business levels and involves the impact of ODA on the behavior and well-being of individuals and small and medium level enterprises (SMEs). One such instance is the Integrated Agriculture Development Programme (IADP); this was a WB programme funded by the USAID and one, which was a micro-finance-based undertaking. The IADP aimed at promoting Kenya's agricultural and economic development and involved the provision of low-risk loan facilities to small-scale Kenyan farmers (USAID, 2017; Klein-Baer, 2014).

The IADP initiative was unsuccessful having failed to bring the desired development to Kenya's small-scale farmers but only benefited the US by furthering its geopolitical interests in the

region, interests which were linked to the Cold War (Klein-Baer, 2014). The European Investment Bank (EIB), the lending institution of the EU has been a crucial development partner of Kenya offering ODA to the country. The EIB is the financier of the Lake Turkana Wind Power Project issuing some €225 million for the project. The Bank also finances, the Olkaria I and the IV Geothermal extension offering some € 119 million in funding to the Kenyan government for the project.

The EIB has provided credit lines to private commercial banks to facilitate lending to SMEs in Kenya. For instance, the EIB had issued credit lines to SME project and agro-industry, food processing fishing and small-scale manufacturing, education and healthcare sectors. In 2010, the EIB provided some €50 million to Equity Bank to facilitate the bank's onward lending to SMEs in Kenya.

4.3 Remittances and Facilitation of Kenya's Economic Development

4.3.1 Remittance Inflows to Kenya

Since independence, the inflow or migrant remittances to Kenya from the Diaspora has grown substantially and has become among the top-four leading sources of Kenya's foreign exchange (Makori, *et al.*, 2015). This has been greatly attributed to the surge in the numbers of Kenyans living in the Diaspora (Ngugi, 2015). From the mid-1980s when Kenya began to experience economic downturn and political instability, a significant number of Kenyans started leaving for the Diaspora (Ochara, 2014; Makori, *et al.*, 2015). They moved to countries where political and economic climates were favorable and promising, these migrants became the initial remitters of funds to Kenya from their destination countries. In fact, even as far back as the immediate post-

independent period, Kenya started experiencing gradual increase in remittances (Ochara, 2014;Ngugi, 2015).

For instance, remittances increased from \$7.26 million recorded in 1970, to \$ 89.1 million in 1989 to stand at \$609.1 million in 2010, a substantial increase by any proportion (Central Bank of Kenya, 2011). It is no doubt therefore, why the country accounted for 10.7% of total remittance inflow into sub-Saharan Africa in 2014 (Aboullezz, 2015). Nonetheless, Kenya recorded a drop in the volume of remittance inflows between 2008 and 2009. This drop can be attributed to the PEV that disrupted financial activities in Kenya and to the global financial crisis experienced during that period (Ochara, 2014;Ngugi, 2015).

In 2010, the inflows of remittances to Kenya had reached 5.4% of the country's GDP, in 2013 and 2014, remittances stood at \$1.3 billion and \$1.4 billion respectively (Aboullezz, 2015). The 11% increase realized between 2013 and 2014 can be attributed to increase in the number of Kenyan's in the Diaspora and political stability in the country after the 2013 elections (Ngugi, 2015). The aura of stability among Kenyans in the Diaspora following the much-hyped election, allowed for more remittances to flow into the country as more Kenyan migrants to the developed countries remained hopeful for their country's economic growth, hence an increased desire among them to invest home.

The inflow of remittances to Kenya is recorded by the Central Bank of Kenya (CBK) (Makori, et al., 2015). The CBK records remittance inflows by examining the formal channels including forex bureaus, commercial banks as well as other international authorized providers of remittance services in Kenya. According to the records by the CBK North America forms the bulk of Kenya's remittance inflow source, these accounts for close to half the remittance inflows

in 2015 with the rest of the world including Europe accounting for the rest (Makori, *et al.*, 2015). North American and Europe remittances are estimated at 51% and 28% of total remittance inflows to Kenya (Ochara, 2014). The Kenyan Embassy in Washington D.C revealed in 2011 that there were about half a million Kenyans in the US and that about 3 million Kenyans were living in Diaspora at the time (Aboullezz, 2015). This is indicative of a continued rise in the Kenyan Diaspora community, which further indicates a mounting positive trend for remittance inflows to Kenya.

The CBK observes that the majority of the remittances are used at both the macro-level and micro-level with individual recipients using the money to invest in various sectors especially in the Real Estate Sector, to purchase commodities and to buy corporate bonds and government securities (World Bank, 2014). Diaspora remittances are so central to Kenya's development agenda that it is harnessing its flagship project under the financial sector in the country's Vision 2030 agenda (Ngugi, 2015). The new Constitution promulgated in 2010 provided an opportunity for engaging the Diaspora in the development agenda. One of the giveaways of the Constitution is that it permits dual citizenships allowing Kenyans who desire to invest in both countries to do so hence increasing remittances. Coupled with the aggressive drive by the successive government of retired President Mwai Kibaki and the incumbent President Uhuru Kenyatta to involve the Diaspora in the country's development agenda, it is easy to perceive why such trends have been witness (Ochara, 2014).

Therefore, over the last one-decade and a half, that is, between 2003 and 2015 remittance inflows have become a major source of foreign exchange and indispensable implication for economic growth. According to Ahmed and Martinez-Zarzoso(2013), remittances are expected to

contribute to economic stabilization of the receiving country especially in the aftermath of macroeconomic shocks. The economic development importance of remittances seems to be the drive of the Kenyan governments since 2002 to capture the Diaspora's in the country's development agenda. It is considered that remittances can help bridge the savings-investments gap in the country, taking into account that the country's gross domestic savings to gross capital formation ratio stood at 1.5 in 2014 (WB, 2014).

4.3.2 Contributions of Remittances to Kenya's Economic Growth

Several scholars have argued for the substantive link between the migrant or Diaspora and their countries of origin, often contending that these migrant populations can facilitate the political and socioeconomic development of their countries of origin (Kamuleta, 2014; Ratha, 2013; Nyamwange & Paterson, 2015). The domestic government can engage its Diaspora in facilitating economic development mainly in three ways, exploiting the monetary or the skills resources that they possess, creating opportunities for them to invest in the economic activities in their home countries and engaging them in the government's own development projects (Ratha, 2013; Nyamwange & Paterson, 2015).

In fact, according to several scholars including McGilivray, *et al.*, (2006), Karras (2006), Kanayake and Chatrna (2008), can be included in the economic processes of their home countries. Kamuleta (2014) argues that the Diaspora can be engaged in the economic processes in their home country by creating opportunities for them to invest in the stock markets by trading in bonds, or by creating conditions that allow the Diaspora to engage in businesses back in their home countries.

The contributions of remittances to Kenya's economic development are increasingly being appreciated even by the banks in the country. Chase Bank is just one of the banking institutions that has sought to harness the significance of remittances to economic development. Through its subsidiary, Genghis Capital, the bank is supporting the Kenyan Diaspora to invest in Kenya's Nairobi Securities Exchange (NSE) (Ngugi, 2015). In this way, the remittances contribute to economic development both directly and indirectly. Directly, the remittances facilitate job creation in the NSE, with stockbrokers having the opportunity to intermediate for the investors. Indirectly, the remittances facilitate the realization of revenues for the government, as the government is able to trade its treasury bonds, the migrants in the Diaspora can buy through remittance (Ochara, 2014).

The effects of remittances on investments have also been recorded. Investment is one of the primary areas in which remittances are directed in the recipient countries. This is the view that is conceived under the portfolio approach, and in which remittances are considered to increase especially if their anticipated returns to the remitter is also expected to increase (Hysenbegasi & Pozo, 2002). It is no doubt therefore why Kenyan citizens living in the Diaspora have invested hugely in the Real Estate Sector since this is considered one of the rapidly growing sectors, which have huge returns on investment (Ngugi, 2015; Ochara, 2014).

Makori, *et al.*, (2015) and Mwege (2009) observe that Diaspora large-scale investment in Kenya has contributed significantly to economic growth through, employment creation, and the raising of the living standards through associated benefits of investment.

In 2014 alone, it was estimated that the Kenya Diaspora would invest Sh. 6 billion in the property markets in Kenya. These investments include both the top-notch high-end properties

and the middle-level property developments. The impact of these investments in terms of employment creation and associated benefits to the national economy are both direct and indirect (Aboullezz, 2015; Makori, *et al.*, 2015).

One such area where the effect of remittances on economic development has been direct is at the individual or household level, where it has led to poverty reduction (Nyamwange & Paterson, 2015). Studies comparing poverty levels between Kenyan households that have no remittances and those that receive remittances have recorded higher poverty levels in the former than in the latter (Aboullezz, 2015; Makori, *et al.*, 2015). Undeniably, analysts have posited that remittances do facilitate household incomes and are efficient anti-poverty forces in poor or developing countries such as Kenya (Kamuleta, 2014; Ochara, 2014; Nyamwange & Paterson, 2015). Indeed, recipients of remittances are able to identify and utilize the remittances to meet their most pressing poverty needs.

Studies conducted around Kenya on the well-being of households receiving remittances and those that do not receive remittances reveal that the households that receive the remittances are better off financially than those that do not receive the funds (Kamuleta, 2014; Ochara, 2014; Nyamwange & Paterson, 2015). The reason for this is that the recipient households are able to invest the remittances income generating activities, which result in the reduction of their poverty standing and improvement of their living standards while the non-remittance receiving households have no funds to invest (Ochara, 2014). Furthermore, studies carried out across Kenya indicate that remittance-receiving households experience higher income levels and have a higher purchasing power than the non-remittance-receiving households (Aboullezz, 2015; Ngugi, 2015; Ochara, 2014).

Indirect results of remittances for economic growth include job creation, development of housing, and creation of enterprises. Thus, remittances have the ability to reduce poverty indirectly by availing funds for establishment of assets and creating other facilities such as medical centers and schools that benefit the entire local community (Ratha, 2013; Kamuleta, 2014). Therefore, remittances have a potential for facilitating economic development by raising the living standards of the recipient households and by creating job opportunities for the local community.

4.4 Most Effective Source of Finance between Foreign aid and Remittances

4.4.1 The Volatility of ODA versus Diminutive Remittances

ODA effectiveness in Kenya is undercut or hampered by misappropriation, volatility and uncertainty. The degree of unpredictability of aid inflow in Kenya is suggested by the fact that disbursements are often lower than commitments by bilateral and multilateral donors (Ojiambo, *et al.*, 2015). This was the case in the period 1968 to 1970, 1992 and 1995 when the oil shocks and advent of the Structural Adjustment Programs (SAPs) disrupted the flow of ODA into Kenya (Ojiambo, *et al.*, 2015; Mwega, 2009)

The ineffectiveness of ODA can be attributed to its volatility in terms of inflow to Kenya (Odipo, *et al.*, 2015). Studies such as the one conducted by Mwega (2009) determined that aid inflow to Kenya is highly volatile at a rate of 24.1%, which is worrying when compared to other developing counties where volatility rate stands at 13.3%. Aid volatility in Kenya is further demonstrated by the fact that studies have revealed that 3 out of 4 projects initiated with the funding of ODA often turn into white elephant projects (Ojiambo, *et al.*, 2015; Mwega, 2009).

Most of these projects either are abandoned or take a long time to complete due to uncertainties that are associated with ODA under the underlying political interests of donors.

ODA projects are abandoned or discontinued, for instance in the case of the Nairobi Water Supply Project (Odipo, *et al.*, 2015). Other ODA Projects deviate from the original plan, as was with the case of the Bura Irrigation and Settlement Scheme or results in an under provision of services as realized with the Tana Delta Irrigation Projects (Mwega, 2009). The propensity of misdirection of ODA funds from projects that they were actually meant for is a problem even in a country with relative stable macroeconomic policies as Kenya. In several instances akin to the case of the Bura Settlement and Irrigation Scheme, the government shifts to consumption activities from original investment projects. In fact, this was evident in the secondary allocation of funds to eradicate the effects of drought realized in 1983 – 1984 and 1991 – 1992.

This misappropriation of ODA funds to projects and uses not initially intended is further evident when successive Kenyan governments, mostly due to lack of fiscal discipline, utilize the resources from ODA to contain national expenditures (Odipo, *et al.*, 2015). That is to say, that the government of Kenya has often used ODA funds to augment the national budget when there is a deficit. Instances, where ODA is reallocated to finance pro-poor social sector projects for political advantages are widespread. Both the Moi and the Kibaki regimes were found to have been notorious in utilizing the funds for pro-poor social sector expenditures including education and health sectors (CEGAA, 2010; Ojiambo, *et al.*, 2015; Mwega, 2009).

While these sectors are important as far as economic development is concerned, the problem is that they are sometimes not the primary recipient of the resources and do not result in immediate development benefits as had been initially intended. Others have argued that the sectors

contribute to welfare development rather than real economic growth and are also short-term in terms of their impact in social welfare. In fact, it is noted that when aid surged in Kenya between 2000 and 2004, the country was able spend only 22% of the aid and at the same time only 33% was absorbed (CEGAA, 2010).

Remittances are said to present economic stability in the host countries during recessive phases in the receiving countries. Ahmed and Martinez-Zarzoso (2013) contend that in such economic situations, there is a tendency for remittances to rise as migrants send more money to their kin and friends at home. This results in the smoothening of the consumption in the recipient country and assists in the establishment of stability in that economy (Kamuleta, 2014). This reflects the pure altruism approach to understanding remittances as suggested by Lucas and Stark (1985).

Both the World Bank and the International Monetary Fund (IMF) acknowledge remittances as a reliable countercyclical source of foreign finance when determining how much debt poor countries can manage. If states are able to borrow more money when they are getting large remittances, they could use the borrowing power to finance their investments, which may then lead to national economic growth (Kamuleta, 2014). In some recipient countries, remittances are currently taxed to obtain revenues by the government. Kamuleta (2014) observes that this however does indirectly affect remittances. Such as when they need the recipients of remittances to convert the remittances into local currency usually at uncompetitive official exchange rates.

For instance, Ethiopia, Kenya, South Africa among others are just some of the countries that indirectly tax remittances (Mohapatra, 2010; Nyamwange & Paterson, 2015). However, the indirect taxes are usually just a fraction of the whole amount that is remitted and as such does not act as a very important source for development finance for the government. Furthermore, the

taxation of remittances may also have a negative impact in that it results in the raising of the transaction costs and discourage migrants from remitting money to households that so need it (UNACTD, 2013).

Remittances on the other hand do not experience the nature of volatility and misappropriation of funds in the levels found with the ODA. However, remittances are minuscule or diminutive in comparison to ODA. According to Ochara (2014), remittances contribute only 3% of Kenya's GDP. Nonetheless, this figure is still significant in comparison to the 1.08% that Kenya earns from its mining sector. The remittances are therefore unable to fund any real public project and at the same time unlike ODA is not accessible to all needy populations in Kenya. The only people that can receive remittances are people with kin and relatives or acquaintances living abroad. Remittances, unlike public funded ODA have the potential to precipitate household poverty reduction as recipients have the power to utilize the remittances to meet their own specific needs (Hailu, *et al.*, 2012).

4.4.2 Conditional ODA versus Free Flow Remittance

According the IMF, WB and other donor's, ODA extension to Kenya is contingent on Kenya's meeting the standards established under the SAPs (Ahmed & Martinez-Zarzoso, 2013; World Bank, 2016). According to the SAPs Kenya should implement a spectrum of macro-economic reforms including, cut deficit spending, reduce access to domestic credit, cut inflation in all lower national budget (CEGAA, 2010). However, it can be argued that certain conditionalities especially those pertaining to welfare spending have a grave and negative impact on social development and by extension economic development.

Furthermore, whether the conditioned ODA has the potential to precipitate economic development is a matter of intense debate among scholars and economic analysis (Mwega, 2009; Ojiambo, *et al.*, 2015; Hailu, *et al.*, 2012). It is recorded that after adopting the SAPs and borrowing heavily from the WB and the IMF, Kenya's external debt burden more than doubled and rose from \$3.4 billion to \$7.5 billion in a decade between 1980 and 1990, this was despite a debt forgiveness of about \$ 700 million (Colclough & Webb, 2010). Currently, Kenya's external debt is estimated at over \$17 billion (World Bank, 2016).

In fact, in terms of development, bilateral assistance seemed to have only served the interest of the donors. It has been seen that China's and US bilateral assistance to Kenya have been mainly aimed at achieving the political, economic and security interest of the donors (Kamuleta, 2014). In fact, a securitization of ODA can be perceived in USAID engagement in Kenya especially in the US response to the 1998 US embassy attacks in Kenya, which left 224 people dead, 12 of which were Americans. In the aftermath of the 1998 attacks, USAID allocated \$36.9 million to Kenya to facilitate recovery efforts and security (Klein-Baer, 2014). Indeed, covert intentions often underscore ODA as the intentions of the donors are in most circumstances, to facilitate their own interests.

For instance, despite the US extending large consignment of fertilizers to Kenyan farmers in the 1980s through the USAID, the country had covert interests of achieving an economic objective. According to Klein-Baer (2014), the US intended to break the influence of the then dominant Kenya Farmers Association (KFA), which had monopolized the fertilizer market in Kenya. In so doing, the US aimed to liberalize the market for private sector investment. The contingency measures employed by the USAID resulted in the delay of fertilizer delivery to most farmers

thus hampered the development of the agricultural sector that was the backbone of Kenya's economy at the time (Kleain-Baer, 2014).

Remittances in comparison are not vulnerable to conditionalities, political machinations and manipulations inherent in ODA. However, there are certain intrinsic features of remittances inflows to Kenya that hamper their potential for economic development. In Kenya, like elsewhere in the world remittances are transferred through either formal or informal systems(Ochara, 2014;Ngugi, 2015). The formal mechanisms include remittance service providers (RSPs) of which Western Union and MoneyGram are popular, financial institutions commercial banks and microfinance institutions (MFIs) or post offices. Other formal means of transferring remittances in Kenya include, Mobile Network Operators (MNOs) such as Safaricom, Airtel or Orange Network as a well as New Transaction Technology (NTT) (Mwangi & Mwenda, 2015).

These formal mechanisms allow the CBK to determine what amount of money is coming into the country and from whom the money is coming,which is important not only for security purposes but to serve as entry point for financial inclusion in the national economy. The formal mechanisms can expand and facilitate access to associated financial services and products in Kenya as well as the country from which the fund is emanating (Ochara, 2014;Mwangi & Mwenda, 2015).However, the same is not the case for informal mechanisms as the infamous *Hawala* system in Kenya

According to Mwangi and Mwenda (2015), the *Hawala* is the most widespread means of transferring money unofficially. In this system, the remitter pays (on several occasions with a small fee) the first transfer person who is in the country that is sending, the person then informs

the second transfer who is in the recipient country, who then releases the money. In this way, remittances channeled through the informal system is not reflected in the national economy in the manner in which those transferred formally are reflected. Hence, it has zero significance, at least directly at the macro-economic level.

4.4.3 Reflection on the Most Reliable Source of Development Finance

Remittances are in every sense countercyclical financial flows. Remittances increase in circumstances in which financial markets are in decline. Remittances in Kenya seem to rise during economic downturns, civil and political crises as well as during natural disasters. In this sense, remittances are vital in dealing with the severity of financial crises in the short-run but are rather incapable of precipitating real development in the long run (Mwangi & Mwenda, 2015). In fact, in terms of poverty reduction, remittances in actual sense do affect the severity of poverty rather than the scale of poverty, that is, the total number of people living in poverty. During such crises, migrants in the Diaspora seems to send more money to cushion their kin and relatives from the shocks associated with the political and economic turmoil as well as the natural disasters (Ochara, 2014;Ngugi, 2015).

ODA is capable of precipitating macro-level economic development that trickle down to the individuals citizens if well managed. Unlike remittances, every citizen regardless of whether they are recipient or not of remittances can enjoy ODA. Aboullezz (2015) and Ratha (2013) explain, regarding ODA, that not all poor households are recipients of remittances; the worst of these often experience shortage of capital needed to even migrate and as such do not enjoy remittance-financed benefits. In other words the, efficacy of remittances on Kenya's economic development

is hampered by remittances inherently discriminative nature where only people with a kin abroad enjoy remittance-financed benefits.

Nonetheless, ODA has diminishing returns, that is, ODA is only positively related to economic growth up to a certain level relative to GDP of the recipient country after which it has a negative impact on growth (Aboullezz, 2015). This means that if ODA surpasses the GDP, its effects on economic growth begin to be negative. For instance, it causes over reliance on foreign assistance, something that has been termed as the dependency syndrome. It is estimated that when aid reaches between 15% and 45% of the recipients GDP then it results in negative outcome. This is however not an issue of worry for Kenya as studies indicate that Kenya's aid dependency has been declining over the years and currently it is estimated at about 2% (WB, 2014). Notwithstanding Kenya's current declining aid dependency, the propensity of ODA to bring about diminishing returns has been a problem for Kenya going back to the 1980s and 1990s (Mwega, 2009).

Another issue that also works to debunk beliefs that ODA is a resilient source of development finance for Kenya is related to the fact that the success of aid is contingent on widespread external, climatic conditions(Ojiambo, *et al.*, 2015). A historical review of Kenya's experience with ODA reveals that ODA is quite a volatile source of development finance for Kenya. The periods between 1990 and 2002 reveal that ODA was subject to external conditions, especially the political machinations of donors. Furthermore, the decline in ODA between 2007 and 2009, due to the global financial crisis revealed that ODA was a volatile and perhaps an unreliable source or development funding for Kenya.

Lastly, the efficacy of ODA to development is contingent on the effectiveness and quality of institutions that are directly or indirectly concerned with the utilization of resources. Indeed, corruption and misappropriation of funds by public officials in Kenya has been noted as an undermining factor as far as the realization of full impact of ODA in the developmental agenda is concerned (Hailu, *et al.*, 2012). The worrying fact is that institutions that are in place and which are mandated to ensure effective use of the ODA funds are weak and politically compromised. The Kenyan courts have failed to indict key government officials that have colluded to use ODA funds intended for development projects, the law enforcement authorities including the Kenya police and the Kenyan Anti-Corruption and Ethics Commission are too weak to intervene (Ojiambo, *et al.*, 2015; Ochara, 2014).

4.5 Chapter Summary

This chapter has provided the results pertaining to the contributions of Foreign aid and Remittances to Kenya's economic development. It has found that Kenya has conventionally relied on ODA but is increasingly appreciating the significance of remittances in the country's development agenda. It has found that ODA has mainly been important in facilitating Kenya's development at the macro-economic level and less at the micro level while remittances have been crucial at micro-level and less at the macro-level of economic development. However, the study has found that the greatest challenges to the use of ODA has been its vulnerability to misappropriation and secondary use for purposes not initially intended.

It has found that while being intrinsically immune to some of the vulnerabilities of the ODA, remittances are also vulnerable to economic instabilities such as financial crises; it is also vulnerable to political instabilities that disrupt the operations of the financial sector. Besides, the

funds that are channeled through remittances while significant in terms general quantity are intended for individuals in most instances and as such are diminutive to be invested in projects of developmental significance. Furthermore, the existence of informal mechanisms means that the remittances cannot be captured by the formal institutions hence their significance for macro-level development cannot be ascertained. The next chapter, Chapter 5 presents the study's concluding chapter. It provides the summary of the major findings, the conclusion and the recommendations.

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

Chapter Five is the end chapter of the study. The chapter provides a recap of the study by highlighting the summary of the major findings of the study as per the research objectives. It highlights the defining outcome of the study with the aim of reiterating their importance and implications for policy. The chapter also presents the concluding remarks drawing from the study findings and major postulations made in the study. The conclusion is followed by the provision of recommendations both for improvement and for further research.

5.2 Summary of Major Findings

The purpose of this study was to compare and analyze the effects of foreign aid and remittances on the economic development of the recipient states. The study intended to focus on three research questions, namely; (i) What has been the effect of foreign aid on Kenya's economic development? (ii) What has been the effect of remittances on Kenya's economic development? (iii) How does foreign aid compare with remittances in its effect on Kenya's economic development? Some of the key findings of the study as per these research questions are stated below.

5.2.1 Foreign Aid and Facilitation of Kenya's Economic Development

The study determined that Kenya had been greatly dependent on ODA ever since it became independent in 1963 however, in the recent years its dependence on ODA has continued to decrease. It found that ODA inflow into Kenya increased from independence up to the early

1990s and declined to record low of \$ 310.47 million recorded in 1999. The study found that the reason for the decline in this period was the aid suspension leveled against the Moi administration. The donors demanded that the government implement certain political and economic reforms as per SAPs and aid to Kenya was conditioned on Kenya's compliance with the donor conditionality request.

The study further established that between the late 1990s and early 2000s, Kenya experienced economic decline. The economic decline could be associated with the economic sanctions even though other political and economic factors can help account for the decline. However, after 2002 and with the ascension of power of President Kibaki, the amount of ODA to Kenya increased. The study found that the increase could be associated with the implementation of economic reforms by the NARC government that boosted donor trust. From 2002, ODA inflows to Kenya have remained stable despite having declined around 2007 and 2008 due to the global economic crisis.

In terms of development, the study has found that ODA has been an important source of development finance. The study has found that ODA has been crucial facilitator of development by supporting the commanding sectors of the economy including agriculture and manufacturing, telecommunications, education and health sectors. The study found that funds from development partners in bilateral and multilateral partners have been crucial in facilitating economic development in Kenya. However, the study has found that ODA is volatile and vulnerable to political machinations. It has found that ODA resources are often extended with underlying and political or economic interests. US and China have been found to extend ODA to Kenya with a motive of realizing economic, political or security interests.

5.2.2 Remittances and Facilitation of Kenya's Economic Development

The study has found that since independence, the inflow or migrant remittances to Kenya from the Diaspora has grown substantially and has become among the top-four leading sources of Kenya's foreign exchange. It has found that remittances increased from \$7.26 million recorded in 1970, to \$ 89.1 million in 1989 to stand at \$609.1 million in 2010. The study has found that remittance inflows to Kenya had reached 5.4% of the country's GDP, in 2013 and 2014, remittances stood at \$1.3 billion and \$1.4 billion respectively. It has determined that the reason for the surge in remittance inflow to Kenya is the increase in the number of Kenyan migrants to North America and Europe.

The study has established the US and EU account for the bulk of remittance inflows to Kenya, with 51% and 28% of total remittances respectively. The study has also established that remittances have facilitated economic growth in Kenya. .

5.2.3 Most Effective Source of Finance between Foreign aid and Remittances

The study has found that both remittance and foreign aid are vital for Kenya's economic development. It has established that remittances are important at facilitating growth at the household or individual level while ODA are vital at national-development level. The study has however found that ODA effectiveness in Kenya is hampered by misappropriation, volatility and uncertainty. It has established that such volatility as experienced in the period 1968 to 1970, 1992 and 1995 could be associated to a little extent with the oil shocks that rocked the western countries in the mid-1990s and largely to the advent of the Structural Adjustment Programs

(SAPs).It has also found that it was during this time that Kenya stagnated greatly in terms of economic growth.

The study has found that while not vulnerable to political and economic machinations that is associated with ODA, remittances are vulnerable to economic conditions in the sending countries and as well as the level of development of financial institutions in the receiving country. It has found that remittances do rise with the onset of economic and political crises in Kenya as migrants send more money to their kin and friends at home to cushion them from shocks. It established that during economic hardships, remittances are vital in cushioning recipient households in Kenya. The study found that the economic growth value of remittances is experienced at the individual or household level while that of ODA is capable of being experienced at national levels.

The study has established that Remittances and Foreign aid are both important sources of development finance. The two are critical in Kenya's economic growth and are mutually reinforcing. While ODA is crucial for facilitating economic growth in Kenya during times of global financial stability, remittances are significant in cushioning the recipients from the financial shocks associated with civil and political strife as well as national financial crises. Therefore, it is improper to argue for one and leave the other, in fact both these source of development finance are critical in serving two aspects of economic development.

5.3 Conclusion

5.3.1 Foreign aid and Facilitation of Kenya's Economic Development

ODA has the potential to contribute positively to economic growth in Kenya. In terms of quantity the resource available in ODA are able to precipitate real economic growth at the

national level. ODA contributes directly to economic growth by facilitating development in the various sectors of the economy. Such crucial areas where ODA is crucial include manufacturing, agriculture industry, education and health. As such, ODA in Kenya facilitated growth in terms of social welfare development and real economic development.

Nonetheless, the effectiveness of ODA to facilitate growth is contingent on several factors, which work against it. In Kenya, like elsewhere, ODA is vulnerable to political manipulation by donors, who may direct it to sectors that have no economic growth value with covert political and economic motives. ODA is also vulnerable to international financial crises and that ODA inflow declines with the global financial instability. Furthermore, ODA's efficacy is also affected by the domestic factors such as the integrity of public officials put in charge of it, strength of the relevant institutions including the law enforcement, judiciary and the executive; it is vulnerable to domestic politics and prevailing domestic financial and climatic conditions. Therefore, it can be argued that while being potentially effective in term of its ability to facilitate economic development both at the household and the national level, ODA's effectiveness is dependent on a multiplicity of factors including, the level of corruption, stability of the global economy, allocation for intended purposes and the recipient government's financial discipline.

5.3.2 Remittances and Facilitation of Kenya's Economic Development

Remittance has grown to become a significant source of development funding in Kenya over the past few decades. International remittances in Kenya have surpassed FDI as a source of external capital. Therefore, it is an important consideration in Kenya's Vision 2030 development agenda. The impact of remittances in economic growth terms is mostly realized at the micro or individual level. Remittances cushion the recipients from the effects of poverty and help uplift households

out of poverty. In other words, remittances facilitate economic growth by reducing poverty levels. It also facilitates investments and helps bridge the savings gap in the Kenyan economy. Furthermore, remittances enhance job creation by facilitating establishment of enterprises that employ people from the local community.

However, several issues work to undercut the development potential of remittances. Informally transferred remittance are not captured straight away from the national economy hence do not precipitate all the benefits associated with formally transferred remittance. Besides, remittances are inherently discriminative in that only recipient households realize their economic benefits while other neighboring households continues to experience poverty. The amounts remitted are also too diminutive to be invested in real national development projects and remittances are vulnerable to economic shock and financial downturns in the sending countries.

5.3.3 Most Effective Source of Finance between Foreign aid and Remittances

Remittances and ODA are both important sources of development finances. The two are critical in Kenya's economic growth and are mutually reinforcing. While ODA is crucial for facilitating economic growth in Kenya during times of global financial stability, remittances are significant in cushioning the recipients from the financial shocks associated with civil and political strife as well as national financial crises. Therefore, it is improper to argue for one and leave the other, in fact both these source of development finance are critical in serving two aspects of economic development.

The ODA is important in national-level economic development since the quantity and volume of funds it avails can be invested in various sectors of the economy to facilitate economic

development. The majority also enjoys the benefits of ODA rather than a few numbers of individuals. On the other hand, remittances are crucial for facilitating development at the individual or community level. Other than having the direct impact of lifting recipients from abject poverty, remittances result in direct job creation for the recipients who use the funds to venture into business and the community members who get employed in the businesses set up through remittances.

5.4 Recommendation

The study makes the following recommendations for improvement and for further research concerning the findings made.

5.4.1 Recommendations for Improvement

5.4.1.1 Foreign aid and Facilitation of Kenya's Economic Development

The Kenyan government, and private stakeholders should work together to establish and strengthen public institutions that deal with ODA related issues. The government and the donor community should ensure that ODA funds are only used for the intended development projects. The donors should demand dire sanctions on secondary use of ODA for purposes not originally intended. The GoK should uphold the provisions of the Constitution of Kenya 2010 regarding access to public information and respect the Freedom of Information Act 2015 to ensure that the public have access to information regarding the source, intended purpose and actual use of ODA. The public through their representatives to the National Assembly and the media should follow up and challenge the government and national authorities on issues regarding the progress and completion of ODA-funded projects.

5.4.1.2 Remittances and Facilitation of Kenya's Economic Development

The GoK should create and enable economic environment and work towards encouraging the Diaspora to engage actively in the country's development agenda. The Ministry of Foreign Affairs (MoFA) should establish in every embassy, a Diaspora Office. The Diaspora Office should exclusively promote investment opportunities for the Kenyan Diaspora that are available in the home country and give those who want to invest assistance on how to do so. The MoFA should manage the Diaspora Office and should liaise with the Ministry of Finance (MoF), the Interior Ministry and the Ministry of Coordination of National Government to minimize the bottlenecks that the potential Diaspora investors may encounter. Furthermore, the government through the relevant ministries should establish institutions to assist remittance recipients utilize the funds in ventures that are potentially sustainable and that generate income.

In addressing the Hawala problem, Kenya should strengthen its collaboration with other governments, non-bank FIs and Banks to make the transfer of money through official channels cheap. Such an arrangement should involve the levying of transfer charges during sending. Furthermore, such collaboration should aim at increasing the speed of transferring money from the sender to the receiver. The government should also encourage mobile banking service providers such as Safaricom to engage in international money transfers and provide them with incentive to encourage them to charge cheaper amounts for transfers. Additionally, the government of Kenya including the Kenya Revenue Authority, the Kenya Commercial Banks should adopt better monitoring, regulation and transparency in the detection of remittance

inflows. The government should improve its technology to ensure more effective monitoring of remittance inflows.

5.4.1.3 Most Effective Source of Finance between Foreign aid and Remittances

The government needs to recognize that the ODA and remittances are mutually reinforcing and that none is substitute for the other. The government should bring the Diaspora funded development projects and the ODA-funded projects under one institution in order to facilitate data monitoring regarding the two. The government should encourage Diaspora participation in certain public project and forego acquiring ODA funds for the same to reduce the debt burden. In fact, the GoK should always weigh between using the Diaspora or the ODA to fund a public project in order to ensure the realization of the project's objective while also ensuring its sustainability.

5.4.1.4 Suggestions for Future Research

Research is needed that would explain theoretical linkage between ODA and development and the practical disjoint between the two. Why does practical outcomes of ODA with regard to economic development not conform to actual results? Future researchers or studies should examine the reason for the resilience of ODA despite its ineffectiveness to precipitate economic development. Such studies should examine the underlying reasons why bilateral and multilateral donors are willing to extend loans and grants despite such finances inability to bring about sustainable development. There is also need for further studies into why developing countries are willing to receive ODA especially loans regardless of the accompanying conditionality, associated debt burden and ineffectiveness of such loans to precipitate economic development.

Furthermore, more research; particularly primary research should be conducted at the macro-economic level to facilitate understanding and appreciation of the contribution of remittances to economic development. There is little understanding of the effects of remittances on economic development in Kenya especially at the micro-economic levels. Hence, further study need to be conducted in the subject that will permit effective policy formulation to ensure that household remittances facilitate the development agenda.

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