AID IMPACT ON ECONOMIC GROWTH:
DONOR POLICY AND INDUSTIRALIZATION AS DECISIVE FACTORS

Comparative analysis of Japan and Ghana

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List of Acronyms

DAC	Development Assistance Committee
EOI	Export-Oriented Industrialization
GDP	Gross Domestic Product
GNI	Gross National Income
MCA	Millennium Challenge Account
MVA	Monitoring Value Added
IMF	International Monetary Fund
ISI	Import-Substitutive Industrialization
NEPAD	New Partnership for African Development
ODA	Official Development Assistance
OECD	Organization of Economic Co-operation and Development
OECF	Overseas Economic Cooperation Fund
SSA	Sub-Saharan Africa
UN	United Nations
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
US	The United States of America
USAID	United States Agency for International Development

Abstract

This study examines the link between official development assistance (ODA) and economic growth with particular reference to donor policy and industrial policies of aid recipient countries. It first outlines the historical basis of economic growth in the post-Second World War period in Japan and adopts a strategy of comparison of economic development strategies and patterns of two countries – Japan, as one of the first aid recipients and a prominent example of a late-industrialized country with a 'miracle' economic growth, and Ghana, as a country with one of the highest levels of aid inflows from one side and economic stagnation from another. The research analyses the necessary conditions for assuring long-term economic growth for aid recipient countries. And finally it concludes that for aid to be effective for economic growth, a proper donor policy and industrial policies have a considerable role to play. In particular, crucial structural changes in economy which emphasize growth of manufactural production along with the increasing rate of manufactured exports are very likely to help the economy to grow. In a word, it is the appropriate donor policy which will assure the necessary level of independence for aid recipient countries to choose the export-led industrialization route that would help aid to be effective for long-term economic growth.

Keywords

Official Development Assistance, Economic growth, Donor policy, Export-Led Industrialization, Manufactured exports, Japan, Ghana.

Chapter 1 Introduction

> "Give a man a fish; you have fed him for today. Teach a man to fish; and you have fed him for a lifetime."
>
> – Chinese Proverb

For decades foreign aid has been considered as one of the most important and feasible solutions for poverty alleviation and development. However, after many years of experience with foreign assistance the debate on whether aid could be considered as an effective tool to foster growth and eliminate poverty is still alive and creates increasing tension and disagreement. As Paldam (2009) points out, the countries like China and India are experiencing a tremendous economic growth whereas these countries had never received aid, while the poverty level in the most active aid recipient countries is surprisingly steady.

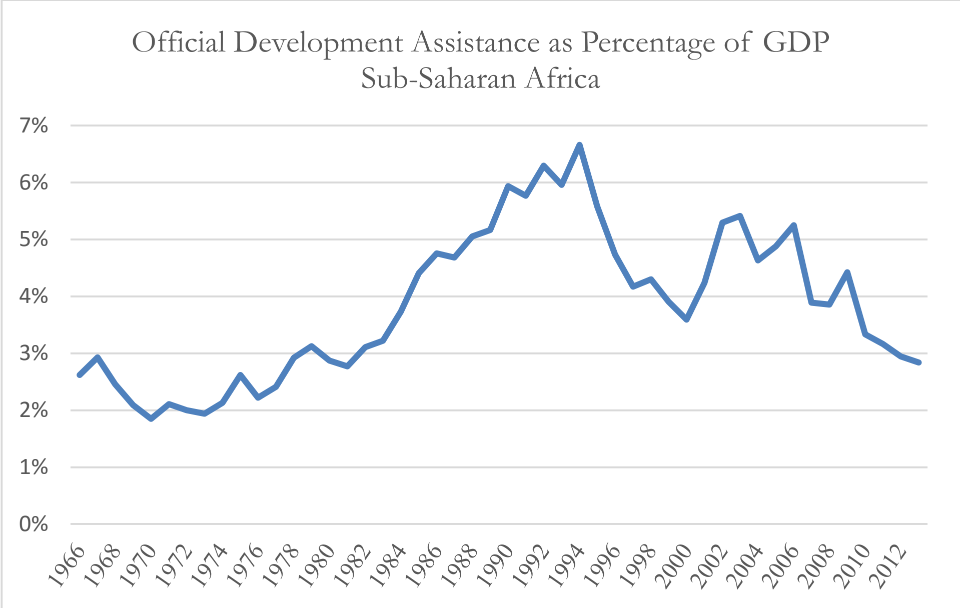
> "Foreign Assistance is not an end in itself. The purpose of aid must be to create the conditions where it is no longer needed."
>
> – The US President Barack Obama

The question of the impact of aid on growth has been extensively studied in recent years (Boone 1995; Burnside and Dollar 1997; Durbarry *et al.* 1998; Dalgaard and Hansen 2000; Burand 2001; Adams 2002; Burnside and Dollar 2000; Easterly *et al.* 2004; Hulten and Isaksson 2007). Many studies have focused on recipient countries government's policies and considered them as one of the main reasons why aid does not work (Burnside and Dollar 1997; 2000; Whitaker 2006; Sundberg and Gelb 2006). As a result, over the past decade Western governments are more and more intensely propagating developing countries to improve their governance, social and fiscal policies (Dalgaard and Hansen 2000; irvonen 2005). As an obvious example of such approach can serve the establishment of the Millennium Challenge Account (MCA) at the Monterrey Summit in 2002, which was supposed to provide development assistance to only cautiously selected countries that would meet the requirements set by the US. The necessary criteria included civil liberty, rule of law, management of corruption, openness to international trade, new government regulations for successive investment, social expenditures, etc. (Hirvonen 2005). The key goal of the established criteria was to 'measure policies that are necessary conditions for a country to achieve broad-based long-term economic growth', as Hirvonen (2005) points out there is no universal development model and it is almost impossible to measure good governance, civil liberties and economic freedom which subject to political pressure.

Development economics has acknowledged deficiency of capital accumulation as the main problem of most developing countries. As a result, foreign aid is considered to play a vigorous role in forming of capital in aid recipients countries, particularly, in the least developed countries with sizable amount of debt experiencing economic stagnation, such countries in sub-Saharan Africa (SSA) - at least 80 percent of them (Bakare 2011) - and is crucial for their economic development. During the 1980s, annual average per capita income of sub-Saharan Africa has dropped considerably to 2.2 percent, per capita consumption decreased by approximately 15 percent, whereas annual volumes of imports increased up to 4.3 percent (Ogundipe *et al.* 2014). Moreover, the growth rate of GDP per capita experienced a continuous decrease and even turned negative in the early 1990s (WB 1981; Aklilu 2009; Ogundipe *et al.* 2014).

As a consequence, sub-Saharan African countries, being considered as the countries that are of great need of foreign aid have received a substantial amount of official development assistance (ODA) during the last 50 years – overall about $1 trillion: $80 billion in 2008, which increased in 2010 reaching $125 billion and is very likely to continue to rise (Ogundipe *et al.* 2014). What is of great concern is the fact that those countries, despite the huge amount of financial inflow have had no any noteworthy economic growth and do not look like having it in the future.

Figure 1. Official Development Assistance as Percentage of GDP, SSA, 1966-2014



Source: World Bank, World Development Indicators 2015.

ODA is considered to be one of the most significant sources of financial inflows for most of sub-Saharan African economies (Sundberg and Gelb 2007). As countries of the world's 'bottom billion'[1] (IDR 2009:1) they have attracted a considerable amount of ODA which was 10 and 15 times as much as the ones directed to other developing countries in 1990 and in 2010 correspondingly (Ogundipe *et al.* 2014).During the period of 1960-2000 more than $500 billion ODA was directed to Africa – an amount that is four times as much as the Marshal Aid Plans. Share of sub-Saharan Africa's ODA compared to the world total has been increasing for about 50 years, from approximately 20 percent in the 1960s to over 75 percent in 2007. And during the period of 2001-2005 sub-Saharan African countries were receiving the most amount of ODA - 38 percent, with South and Central Asia - 15 percent, the Middle East and North Africa -14 percent, and Far East Asia - 11 percent. In spite of that,

[1] Collier (2007:3) defines the "bottom billion" as a group of about 60 countries (concentrated in Africa and Central Asia) which has an overall population of approximately one billion and had deviated economically from the rest of the 'increasingly sophisticated world economy' at the yearly rate of five percent during the period from the end of Cold War till 9/11. Those are the countries which were unable to develop economically and escape economic glut.

these countries have experienced economic stagnation and increasing aid dependence – for instance, 50 percent of national budget in Ghana is depending on aid (Ogundipe *et al.* 2014).

At the same time, even though starting from 2012 bilateral ODA directed to the least developed countries increased overall by 12.3% to $30 billion, bilateral aid to sub-Saharan Africa was estimated to be $26.2 billion – what is 4% less than the one from 2012 (Sundberg and Gelb 2006). Moreover, while global ODA may rise in 2014, a decreasing tendency of foreign aid provided to the sub-Saharan African countries – which are in the most need of it – is very likely to persist. Hence, it becomes of more and more acute importance to understand the reasons for sub-Saharan African countries for not being able to use the foreign financial inflows in a way that would assure long-term economic growth and stop the vicious cycle of poverty.

According to DFID (?), the past 50 years of research on development showed that economic growth can be considered as the most intensive tool for poverty reduction in developing countries since it might deliver wider opportunities for better standard of living. DFID (?) brings an example of China where the fast economic growth between 1985 and 2001 helped to achieve a huge decline in poverty - more than 450 million people were lifted out of poverty since 1979.

Adams (2002) suggests that economic growth may reduce poverty in developing countries since it results in proportionate increase in income of the poor along with the rest of the population. Analysis of the 50 countries showed that with economic growth income inequality increases on average less than 1% per year (Adams 2002). Finally, based on cross-country studies the author discovered that a 10% increase in a country average income is very likely to decrease the poverty level by 20-30% (number of people living with 1$ per person per day). As the author points out, current rates of economic growth in developing countries are plainly too low to produce significant changes in poverty levels. Moreover, he concludes that more research should be done on discovering the essentials for attaining high rates of long-term economic growth and poverty reduction in certain regions, for example in East Asia, and applying their experience in export-led industrialization to assure long-term growth.

> Industrialization is integral to economic development. Scarcely any countries have developed without industrializing, and rapidly growing economies tend to have rapidly growing manufacturing sectors.
>
> IDR (2009)

Long-term fast economic growth explicitly helps to decrease poverty and, contrariwise, poverty alleviation is almost impossible in conditions of economic stagnation (IDR 2009). As UN Department of Economic and Social Affairs documented,

> 'Industrial development is not the only possible route to a developed country standard of living, but it is a well-proven one. It is for this reason that industrial development remains a high policy priority of governments in the developing world. While less vital to maintaining high incomes in developed countries, industry remains an important source of well-paying jobs, especially for those workers with less than a college education'.
>
> United Nations, Department of Economic and Social Affairs (2007)

At the same time, it is worth mentioning that industrial growth based on resource extraction and manufacturing may influence poverty levels in a completely different ways. Resource-based industrial development and sometimes also agriculture are very likely to result in uneven income distribution – because of inequality of resource- and land possessions (IDR 2009). A labour-intensive manufacturing, in contrast, may help to create jobs. And if in the past there might have been problems related to the saturation of domestic market with manufactured products, nowadays, with the production and trade globalization, export-oriented production may help to overcome those limitations. Hence, the progress of manufacturing jobs may be outstanding – more people involved in wage employment, more security with formal jobs, increasing wages and improved skills. Resource extractive industries, at the same time, even though they might create jobs (for instance, if it boosts the development of upstream industries or construction), they do not have the capability of influencing labour market and cannot result in automatic wage increase (Lewis 1954; IDR 2009).

According to IDR (2009), the 'bottom billion' countries are relatively small economies and for them international trade is much more vital than for larger economies. IDR (2009) and Fisher (2009) showed that a feasible export rather import strategy could help those countries to successfully incorporate into global economy. Moreover, among different export possibilities, it is the manufacturing exports that may pave the way to economic growth (Bisten *et al.* 2000; IDR 2009). However, most 'bottom billion' countries currently rely on agricultural exports or natural resource extraction which are considered to be extremely tricky ways of development – they might result in resource curse (through undermining other sectors of economy) and expose economy to shocks because of higher price volatility of commodities compared to those of manufactures (IDR 2009). Manufactured exports, hence, are more likely to assure long-term economic growth in small 'bottom billion' countries than agricultural exports and resource extraction.

As Berthlemy and Soderling (1999), IDR (2009) and Fischer (2009) showed, there is a positive correlation between the manufacturing growth and growth of GDP. Besides, the noticeable role that technology plays in manufacturing exports implies that growth in production is very possible to be determined by growth in manufacturing but not the opposite. Moreover, a particular topic that was historically considered as an important but is currently being missed in economic development debate and that could provide an answer to the issue of economic stagnation is the idea of structural change. Structural change, which is defined by IDR (2009) as 'the shift of capital and labour from low-productivity to high-productivity sectors', can be considered both as a reason and a result of long-term growth.

As a prominent example of importance of manufacturing and structural change in growth can be the experience of East Asian countries (Boltho 1975; Pilat 1994; Forsberg 2000). The share of manufacturing in GDP of East Asia and Latin America were both accounting for about 25 percent of GDP in 1965, whereas now it accounts about 30 percent in East Asia but in Latin America it fell considerably up to 18 percent in 2000-2005 (IDR 2009). Similarly, in sub-Saharan Africa – the region with the lowest growth rate – manufacturing accounts and has not ever surpassed 12 percent, whereas, for instance, Japan, as an example of East Asian countries with a rapid economic growth currently has a share of manufacturing in GDP that is higher than global average (IDR 2009). It is very likely, hence, that it is the divergence in economic structure that decides the different levels of development between East Asia and the rest of late-industrializing countries. In a word, development economics seems to revive the historically known notion which says that "what you make matters for growth" (IDR 2009).

Overall, the research on foreign aid tends to focus on aid ineffectiveness for poverty alleviation and growth from the point of view donor agencies and international financial institutions, rather than from the perspective of recipient countries. Particularly, the studies have emphasized the problems with governance, corruption, institutional and economic system in developing countries that negatively influence their growth. Whereas, a comprehensive research that would address the importance of donor policies and enlighten their existing imperfections, as well as would recognize and highlight the prominence of fast industrialization along with proper industrial policies which would be directed to the growth in production and manufactured exports and would assure the developing countries integration into the arena of international trade, could serve as a necessary contribution to the field of foreign assistance and help late-industrializing countries get out of the vicious cycle of poverty. The purpose of this research is to increase insight into the link between foreign aid, donor policy, industrialization and growth. The study will be designed to show the importance of donor policy in assuring aid effectiveness for economic growth and will try to evaluate the necessary conditions for foreign aid to help to achieve long-term development.

1.1. Research questions

The research will be based on deductive analysis which will include exploration of the relationships between foreign aid characteristics and economic growth. It will aim to answer the following research questions:

Research Question:

Under which circumstances foreign aid helps to achieve long-term economic growth?

Research Sub-questions:

- What are the necessary conditions for donor policy to assure aid effectiveness for growth?
- To what extent industrial policies (export-led industrialization) influence economic growth?

More precisely, the study will provide information to support two main ideas. First, it will try to show that for foreign assistance to be effective for growth, one of the important and key conditions is the proper donor policy - it is the donor policy that decides aid effectiveness for growth. And second, the study will investigate essential conditions for long-term economic growth and increase understanding of importance of industrial policies (in particular, export-oriented industrialization) in achieving it. On the example of an 'Asian tiger' – Japan– and the patterns and strategies of its development, as well as using a country analysis of a sub-Saharan country – Ghana, this research will contribute to the advancement of theoretical thinking about the aid characteristics (donor policy and industrial policies) and related long-term economic growth. The hypothesis is that official development assistance, provided that it is used to foster industrialization and boost of manufacturing exports, ensuring by this the country's intrusion in the global trade market, may help to achieve long-term economic growth. The initial hypothesis of this study is that donor policy and industrial policies of the recipient country are crucial for aid having a positive impact on economic growth.

1.2 Method of approach

The data in this research paper is both qualitative and quantitative; therefore the analysis employs mixed methods. The data has been collected from various secondary sources, such as academic literature, books, websites, journal articles and official reports. Wide range of quantitative data has been obtained from World Bank database (World Development Indicators, Africa Development Indicators), IMF and its World Economic Outlook, OECD, United Nation Statistics Division, etc. These data are used in empirical research and analysis in order to sustain and strengthen arguments. Comparative analysis of Japan and Ghana are performed in this research. Individual case study of Japan has been conducted for specific analysis to show how donor policy and proper industrial policies of recipient countries can help official development assistance to be effective for long-term economic growth. The same data and analysis of Ghana helped compare with those of Japan and to strengthen my arguments. In particular, growth rates and export levels have been assessed for the period of during and after (in case of Japan) receiving of aid. In view of that, the following variables have been analysed: GDP and manufacturing growth rates, export (manufactured export) growth rates, the amount of aid received and the GDP compositional shifts.

1.3 The scope and limitations

Since the study includes historical analysis of economic growth, manufacturing and exports of Japan, the data collected will include the period starting from the end of the Second World War, when the country experienced economic downturn and was highly dependent on official development assistance for economic recovery, up to the years when it started to be economically self-dependent, transformed from aid-recipient to aid-donor and experienced unprecedented economic growth, i.e. the period from 1946 till 1970s. Thus a methodological challenge was to find the necessary data for the mentioned periods of time what might also influence the comprehensiveness and strength of the arguments. The same issue is related to Ghana that has limited data on manufacturing growth and exports; the time frame covers the period of 1966-2014.

The research will solely focus on official development assistance[2] (ODA) and exclude other forms of international assistance such as emergency aid and humanitarian aid. According to DFID (?), there are eight important conditions for long-term economic growth: *physical capital* (investment in machinery, raw materials, etc), *human capital* (investment in education and skills), the rule of law, competitive markets, macroeconomic stability, *and infrastructure*, *openness to trade and investment (good markets and input markets)* and *increased agricultural productivity*. This research will be particularly concentrated on the importance of physical capital with particular reference to industrialization and manufacturing, as well as importance of integration to global market and the role of agriculture in assuring capital accumulation and long-term growth.

The paper is structured as follows. Following the Introduction Chapter 1, Chapter 2 involves a critical review of academic literature with special focus on two strands of literature on aid-growth nexus – claiming that aid might and might not have an impact on growth, as well as reviews the historical global conditions of aid provision and related aid dependency in the changing global system. Chapter 3 briefly explains the nature and history of aid evolution, highlights the changing motivations of donors, as well as reviews the forms of aid provision and the main aid recipients to explain the origins and relevance of this study. In Chapter 4 – analytical part – the aid and growth-nexus is analyzed on the examples of Japan and Ghana with the aim of making critical comparisons of those countries strategies on the way to their development and

[2] Official development assistance is defined as those flows to countries and territories on the DAC (Development Cooperation Directorate – DCD DAC) List of ODA Recipients-
http://www.oecd.org/dac/stats/documentupload/DAC%20List%20of%20ODA%20Recipients%202014%20final.pdf- and to multilateral development institutions which are: provided by official agencies, including state and local governments, or by their executive agencies; and each transaction of which: a) is administered with the promotion of the economic development and welfare of developing countries as its main objective; and b) is concessional in character and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent) (OECD 2008).

strengthen our arguments on importance of proper economic strategies and appropriate industrial policies in assuring long-term economic growth. Finally, Chapter 5 includes concluding remarks and further recommendations for developing countries and donors on how to proceed with aid provision and to successfully use it on the way to their long-term economic growth.

Chapter 2 Literature review

This section will focus on the literature that concentrates on the link between aid and growth, and in the context of this link - the motivations of the donors. While discussing the literature on the aid-growth nexus, it will centralize the debate between those who say that aid does not help growth and may even hinder it, and those who say aid may help the growth process. Moreover, it will try to consider the historical developments of aid recipient countries which experienced economic boom (Japan, South Korea) as well as touch interesting patters of developing economies which have been deprived of growth opportunities because of wrong development strategies or colonial dependancy (India, Latin America).

There have been variety of discussions and views about the effect of aid on development. There is a strand of literature which claims that the relation between aid and growth is more likely to be negative than positive (Graffin and Enos 1970, Mosley 1980, Mosley et al. 1991, Okon 2012, Bauer 1972, Knack 2001, Djankov *et al.* 2006), whereas another strand states that aid may have a positive impact on economic performance (Burnside and Dollar 2000; Whitaker 2006; Stoneman 1975; McGowan and Smith 1978; Sundberg and Gelb 2006; Storm 2013).

The conventional point of view that aid speeds up growth has been challenged for a long time. There is a mass of literature which is arguing that in certain conditions aid could have an undesirable impact on growth – reduce the rate of growth; moreover, there are no trusty reasons to expect that development assistance might have any kind of impact on growth – be it positive or negative (Graffin and Enos 1970, Mosley 1980, Mosley et al. 1991, Okon 2012). Graffin and Enos (1970), based on the data available from 1960s have concluded that the correlation between capital inflows and GNP growth was roughly zero for 15 African and Asian countries and negative for 12 Latin American countries. Likewise, Mosley (1980), after conducting econometrical studies of 83 developing countries for the period of 1969-1977, discovered that there is 'a weak and insignificant but negative correlation between aid and growth'. The same conclusion was made by Mosley et al. (1991) based on econometrical research of data from 1960-1983, who concluded that 'aid in the aggregate has no demonstrable effect on growth…. the apparent inability of development aid over more than twenty years to provide a net increment to overall growth in the Third World must give the donor community, as it gives us, cause for grave concern'. Similarly, Boone (1995) revealed that during the period from 1970 to 1980 African countries, in spite of increasing aid inflows (as a percentage of GDP) have not undergone any economic growth.

The literature has also claimed that rising amount of foreign aid is very likely to create corruption, inspire rent-seeking performance and destroy bureaucratic system (Knack 2001). Djankov *et al.* (2006) also finds that financial inflows to recipient countries is very likely to encourage rent-seeking strategies. Likewise, Okon (2012) argues that the analysis of the data available from 1960 to 2010 show that foreign aid has hindered human development in Nigeria.

There was also an opinion among aid efficiency critiques that the government misuses the provided aid by not directing it to the initially targeted sectors (Bauer 1971). Bauer (1971) even goes further arguing that if a nation is not capable to develop without aid, it would not be able to develop also with the aid. To further support his opinion, the author brings the example of Marshal Aid; according to him even though the latter could be considered as an example of aid effectiveness for growth, it would not work for developing countries, who unlike Western Europe do not have 'attitudes, motivations and favorable institutions' - 'the economies of Western Europe had to be *restored*, while those of the present recipients have to be developed (Bauer 1972).

At the same time, according to Burnside and Dollar (1997; 2000), Whitaker (2006) foreign aid might help to foster economic growth in the existence of good policy environment. In their research which involves the studies of aid from the period of 1970 till 1993, Burnside and Dollar (2000) conclude that foreign assistance cannot have a continuous and efficient effect on financial policies that influence economic development. Rather, they argue that if there is a good policy environment, aid is very likely to have a visible impact on economic growth, since it would not be wasted by un-efficient government expenditures. The authors even blame donors for chasing different interests and failing to pay larger attention to economic policies of recipient countries. Burnside and Dollar (1997) find that donor interest has a much bigger role in the distribution of aid and suggest that aid allocation based on good policy of recipient country but not on the donors' interests would increase the growth rate in poor countries from 1.10% to 1.44% without even necessity to increase the overall amount of aid.

Even in the conditions of worsening economy in Africa, despite the increasing aid, the study of Burnside and Dollar (1997) gave great relaxation to politicians who started to claim that the recovering of Africa is 'just around the corner':

> 'Policy action and foreign assistance… will surely work together to build a continent that shows real gains in both development and income in the near future'.
>
> WB, 1981
>
> 'This optimism can be justified by recent experience in Africa… some countries are introducing policy and institutional reforms'.
>
> WB 1984
>
> 'Since the mid-1980s Africa has seen important changes in policies and in economic performance'.
>
> WB 1989
>
> 'African countries have made great strides in improving policies and restoring growth'.
>
> WB 1994

> ‘Africa’s leaders … have recognized the need to improve their policies, spelled out in the New Partnership for African Development (NEPAD)’.
>
> WB 2002

Hence, there was an optimistic view about the tendency among developing countries to recover their economic policies thus creating better environment for effective aid (Burnside and Dollar 2000; Sundberg and Gelb 2006). Authors bring several reasons to explain such optimistic view. Among them is: aid is currently being allocated only among countries with democratic governance, better policy and civil rights. The aid provided to countries with ‘unlimited executive authority’ decreased two times, down to 18 percent, whereas aid directed to democratic countries has tripled (Burnside and Dollar 2000). The authors also believe that there is a widespread understanding about the necessity to improve the quality of aid and the efforts are being done in the direction of cutting the number of aid providing agencies, abolishing tied aid, and adjusting aid goals with the strategic priorities of the recipient country. Finally, according to Collier, Hoeffler, and Pattillo 2004, as cited in Sundberg and Gelb 2006) there is less need in financial resources for growth in Africa – they explain it by improved political situation, higher growth and increase in income. There are critiques (Dalgaard and Hansen 2000; Easterly *et al.* 2004), however, who re-evaluated the study of Burnside and Dollar (1997) and argued that a positive influence of good policy on economic growth is rather weak than strong.

North and Thomas (1973), Acemoglu and Robinson (2012) claim that well-organized economic structure is crucial for aid to help economic growth. Under well-organized economic structure authors imply the institutional measures and organization of property rights that may help to direct individual economic activities into actions that would assure consistency between private and social benefits and costs. Moreover, Acemoglu and Robinson (2012:73) on the example of economic development of North and South Korea, as well as USA and Latin America claim that the institutional structure in those countries might have played a decisive role in the economic performance. The authors define inclusive[3] and extractive[4] economic institutions to explain how divergent institutional arrangements can influence economic success of different countries and finally conclude that foreign aid and its financial resources are of no use if a country has 'bad' institutions, as it is the case in some African countries.

At the same time, Storm (2013) disclaims the statement of Acemoglu and Robinson (2012) arguing that by admitting such approach the authors just repeat the modern statement of the World Bank that aid is ineffective if there is no democratic government, as well as USAID's current assignment to support in developing democracy. According to Storm (2013), they do not provide any clear explanation rather than the transformation of wealth from dictatorship to an inclusive democratic governance, thus they end up with a primitive conclusion that it is a fight against 'privilege' that would help to achieve proper economic institutions. He also argues that South Korea, for instance, industrialized under non-inclusive political institutions and later built up more inclusive institutions – thus inclusive political institutions are the outcome, but not the reason of the country's economic achievements. Furthermore, Storm (2013) brings also the example of economic development in England, which he calls as an extraordinary. He explains the 'England problem' of Max Weber – industrialization happened in England first, in spite of its weakly established property rights and 'irrational' legal system, but not in Germany, where there was a well-protected private property rights and established rule of law. Storm (2013) goes further by citing Talcott Parsons, who claimed that the key and essential prerequisite of the Industrial Revolution in England was its weak legal system.

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[3] Inclusive economic institutions (that according to authors exist in South Korea and in the US) are institutions that imply and promote involvement of individuals in economic activities, help to take most of their skills and knowledge, and assure productivity growth. The latter requires the establishment of secure property rights, public services and infrastructure (roads).

[4] Extractive economic institutions are created to dig out income and wealth from society for benefit of a third party or parties (Acemoglu and Robinson 2012:76) and according to the authors existed in North Korea and Latin America. The property rights of peoples in such institutions are completely ignored; individuals, being constantly exposed to coercion are unable to make economic choices; no rule of law.

Sundberg and Gelb (2006) also add, that aid was usually consumed by corrupt governments in countries with insufficient civil and political rights, who are not concerned about the nation's economic growth. The reason, according to the authors, is that aid allocation was often based on geopolitical interests and colonial dependence (Jacky, Guillaumont, and Guillaumont-Jeanneney, 2005 as cited in Sundberg and Gelb 2006). During the period 1960-1990 approximately 50 percent of foreign aid was allocated to the countries with 'unlimited executive authority'; only ten percent – to countries with democratic policies (Sundberg and Gelb 2006). A huge amount of aid also went to countries which lack political stability and suffer from civil wars; more than twenty five percent of aid provided to Africa was allocated to conflict prone countries (Sundberg and Gelb 2006; Bakare 2011). Moreover, there are scholars who argue that corruption might be even beneficial and help to accelerate economic growth (Leff 1964; Huntington 1968 as cited in Mauro 1995). They explain this point of view by using two arguments: bribery working methods such as 'speed money' could help people to escape from bureaucratic postponements; and politicians who are permitted to charge bribes might work more effectively, particularly in the case where bribes act as a payment by results.

Hirvonen (2005) claims that it is the donor's policy that might be considered as one of the main reasons why aid cannot deliver the expected poverty eradication. She mentions that 'tied aid, overpriced technical assistance, double counting debt relief as development aid and including immigration-related costs in aid figures' benefit the donor's interests but not help to alleviate poverty. On the example of ActionAid report Hirvonen (2005) highlights that 'if aid currently has a mixed record in terms of its impact on poverty reduction', that is because poverty elimination 'is often not what (aid) is designed to do'. Tendler (1975) also stated that:

> 'A donor organization's sense of mission then, relates not necessarily to economic development but to the commitment of resources, the movement of money… The estimates of total capital needs for development assistance in relation to supply seem to have been the implicit standard by which donor organizations have guided their behaviour and judged their performance… the quantitative measure has gained its supremacy by default. Other defini-

tions of success and failure of development assistance efforts have been hard to come'.

Hirvonen (2005) then adds that many countries see aid recipient countries as a source of direct economic and political interest. They distribute aid based on the geographical closeness and historical colonial ties, as well as national security (Hirvonen 2005; Sundberg and Gelb 2007). Hirnoven (2005) suggests that to fulfil the Millennium Development Goals we should try not only to increase the development assistance funds but we should transform the overall system of foreign aid: in particular, donors should prioritize the requirements of aid recipient countries instead of their own needs (Griffin 1991; Hirvonen 2005).

2.1 Aid conditionality, donor policy and growth

Hayter (1971), Boone (1995), Killick (1997) and Knack (2001) have exposed the contradictions and contradictory incentives of aid policies. According to her, aid has never been an unconditional relocation of funds. Often, the conditions earmarked to the aid are obviously and directly aimed at serving the interests of the donor countries providing it - for instance, donor countries may force recipient countries to purchase products and services from aid provider (Hayter 1971). In general, aid is allocated to countries whose domestic political structure, overseas policy, management of foreign private investment, as well as export strategies are in line with goals of the aid allocating countries or institutions (Hayter 1971; Boone 1995).

Conditionality attached to the aid, according to Hayter (1971), could be explained by the necessity to encourage economic growth in developing countries. The goal of development itself can be explained in a different way - some types and levels of growth in developing countries might be of an advantage for developed countries, or be well-matched with their goals. However, the confusion about objectives of aid is very likely to keep on influencing aid (Hayter 1971; Killick 1997).

Many studies on aid-growth nexus claim that aid is very likely to create dependency (Hayter 1971; Killick 1997; Ellerman 2001). As Hayter (1971) states, aid could be considered as an indulgence by the colonial powers to allow them to keep use of the semi-colonial states: the existence of 'official aid' helps to assure that the politicians of developing countries would accept the regular seeping away of private profits. Aid might also support such governments to find some short-term way out from their economic problems; it might also promote the establishment and existence of a class which would depend on constant aid flows to sustain its existence and hence, become alliance partner of colonialism (Hayter 1971). Indeed, as Storm (2013) argues, imperialism had one main goal which was to assure the outflow surplus of funds from colonized country to the imperialist one. Thus, for instance colonialism in India was necessary to assure capitalist accumulation in Britain, both as a source of financial resources and inexpensive Lancashire cottons. For India, hence, the latter meant a policy of 'export-led exploitation' (but not export-oriented development) (Storm 2013). Furthermore, the same surplus outflow strategy was applied in agriculture by creating highly insecure property rights for indigenous people and creating a decumulation of capital applied to land (Storm 2013). Finally, India was de-industrialized, what was frankly accepted also by British bystanders and the key explanation for it was the strategy of *'one-way free trade'* which obviously privileged the import of British manufactures over Indian goods (Storm 2013).

According to Ellerman (2001), if we consider development as an independent self-development, than there is a clear inconsistency with the whole idea of development assistance. While questioning 'How can an outside party ("helper") assist those attempting to undertake autonomous activities (the "doers") without overriding or undercutting their autonomy?' he sees this issue as an underlying problem of current aid – "helping theory".

By looking at the "helping theory" through a broader perspective of social philosophy, education and management theory, as well as economic growth, Ellerman (2001) comes to a number of commonalities which best describe the necessary conditions for a successful help:

- Help should begin from the current situation of the "doers"

- Helpers should perceive the situation 'through the eyes of the "doers"'
- Help might not be imposed on the "doers" since the latter might directly endanger their autonomy
- Help might not be given as a gift so that not to create "doers"' dependency
- Doers should be 'in the driver's sit' (Ellerman 2001)

Moreover, Ellerman (2001) claims that the decision-making capacity of the doer is undermined by the assumed relationship between the given resources and decisions made, i.e. through providing doers with the necessary resources, helpers impose on them already defined decisions. According to him, the helper intervention might be considered as a 'non-distortionary' (what author sees as an important condition for autonomy-compatibility) when this intervention does not influence the decisions of the doer when he provided with necessary resources. Such kind of approach would help to strengthen the original motivation of the doers without undermining it (Griffin 1991; Ellerman 2001). To further support his ideas, Ellerman (2001) explains that the 'non-distortionary aid might make a worthwhile project possible while distortionary aid aims to make some project "worthwhile"'. Moreover, in case of the distortionary aid, where the self-motivaiton of the doer is the minimum, the doer might have inclination to fail the project to be provided with aid for the second round.

Killick (1997) defines conditionality as 'policy changes stipulated as a prerequisite to the approval of, or continued access to, a grant or loan, or to subsequent assistance', or 'the use of financial leverage to promote donors' objectives'. In addition, Ellerman (2001) claims, that aid conditionality would encourage only 'external' or 'extrinsic' motivation, whereas real development and change require 'intristic motivation and actions – actions implemented by individuals for their own sake' (Acemoglu and Robinson 1960; Ellerman 2001). Hence, he concludes that international development assistance 'to be no harm' and what is more, to be effective, might be 'autonomy-compatible'.

Many studies have endeavoured to emphasize the role of effective state. Jiyoung (2013) tried to understand the historical preconditions for development of developmental or 'capitalist-cohesive state' in South Korea. Even though different studies highlight that the aid worked in South Korea because of a well-established democratic state (which was due to the Japanese rule before 1945 and also internal dynamics) and also because aid was mainly provided in the form of bilateral assistance (USA and Japan), it is clear that the grants that the US gave to Japan up to 1960s and later, helped a lot, also because of the *specific nature of the aid provided* (Jiyoung 2013).

The nature of aid intervention and its organization played a significant role in economic development of South Korea as well, since the aid did not hinder political stability or dangerously deteriorate state capacity and legitimacy in the country (Jiyoung 2013). According to Jiyoung (2013), the aid management and utilization approach applied in South Korea pledged relative autonomy for the government of Korea, thus making aid work ultimately for state transition. Although the content of aid was for the most part determined by the US, the final utilization and beneficiaries as well as distribution were primarily decided within the frames of South Korea state economic policies (Amsden 1989; Jiyoung 2013). In a word, dissimilar from many other aid recipient countries, US donor intervention in South Korea's policy and politics was not so strong and did not confront state legitimacy and superior power of the government (Amsden 1989; Jiyoung 2013). And, even though there were some limitations to use financial aid for only jointly decided purposes, and the US emphasis for development was mainly macroeconomic stability, including the reduction of inflation, government of South Korea did occasionally use funds, in particular, established Counterpart Fund without the US approval for rebuilding infrastructure, what was considered as an essential precondition for economic growth (Jiyoung 2013). To conclude, as Griffin (1991) concluded, a more 'self-reliant strategies' would have been much more favourable for poor countries than conventional aid policies of the donors.

2.2 Industrialization, trade and growth

As Fischer (2009) implies, current debates on foreign assistance ignore the earlier wider debates on aid in 1950s and 1960s, as well as understanding of the early structuralists on aid, who were highlighting the importance of aid in addressing balance of payment problems, in particular in countries undergoing late industrialization and fast urbanization. According to the author, there are external barriers for growth that create chronic trade deficits, which, in the conditions of scarce capital flow may result in chronic shortage of foreign exchange and persistent balance of payment disequilibrium. Thus, effectiveness of aid was determined by its ability to help late industrializing countries to run trade deficits and to help in meeting industrialization needs of those countries on their way to growth (Stoneman 1975; Pack 1993; Fischer 2009). Following the same logic, active industrial policies could be considered as another important prerequisite for aid to be effective for growth (Fischer 2009).

A latest report by United Nations Secretariat on industrial development highlights the importance of industrialization and technology in economic growth of twenty-first century:

> 'Industrialization is proving a potent force for economic growth in countries of Asia, most recently China and India. In the former at least, it has also been an important contributor to poverty reduction. In China, vast numbers of people have left agriculture to work in factories, as – in the past – did rural populations in the now industrialized world'…
>
> 'The past several decades have witnessed a major restructuring of the global economy, one in which more and more industrial output and employment is now located in emerging developing countries, while the developed countries have become ever more service oriented economies. Globalization through increased trade and investment flows is driving this restructuring along with technological and associated organizational change.
>
> United Nations, Department of Economic and Social Affairs (2007)

According to Kay (2009), the industrialist views predominated the early post Second World War period. During the initial phase of import-substituting-industrialisation (ISI), industry grew quite fast thanks to protectionism and supportive measures such as credit and public investments by the government. After few decades of quick industrialisation, several problems came to the surface. Those problems were due the saturation of the domestic market limiting the complete use of their installed capacity, quick diversification of the firms, the inability to exploit economies of scale hindering them to compete in the international market, and shortages of foreign exchange restricting the import of necessary materials (Little, Scitovsky and Scott (1970 as cited in Kay 2009).

The government of South Korea, however, had a dynamic vision of the interface between agriculture and industry; and in that vision the institutional arrangements and innovative technologies had an essential role to play (Kay 2009; Afesorgbor (?)). Government hence guaranteed the necessary conditions for the introduction of new technologies and encouraged changes in production to higher value crops (Oshima 1987 as cited in Kay 2009). As related to industrialisation, the policy makers tried to make sure that the resources relocated to industry be invested in industries with huge growth prospective and for improved in exports (Kay 2009).

Thereagainst, policy makers in Latin America were not so successful in creation of such synergetic interaction; they were not able to transform their land tenure system and modernise agriculture system (Kay 2009). They also could not handle the rising demands from industrialists for protectionism and lacked a strategy for export-oriented industrialisation (EOI) (Ranis and Orrock 1985 as cited in Kay 2009). Their economic development was constantly troubled both by lack of industrial exports and by limits of foreign exchange preventing the import of capital goods. This together affected the investment rate in countries (Jenkins 1991, Kay 2009). The main barrier to Latin America's industrialisation was the insufficiency of foreign exchange than the lack of capital. The absence of agricultural exports together with the delay in acceptance of EOI strategy contributed Latin America to lag behind the newly-industrialized East Asian countries (Kay 2009).

Hayter (1971), Ranis and Orrock (1985 as cited in Kay 2009) also argue that the economic obstacles of Latin-American countries are due to their balance of payments problems, with particular reference to the worsening of the conditions of trade. Foreign exchange is of increasing importance not only for economic growth but also to assure the operation of existing industries - mainly food industries - which are considered to be extremely unproductive and have bigger rather than smaller foreign exchange needs. However, their sustained survival has become a justified interest of local, or foreign, capitalists; plus they offer some employment (Hayter 1971). Besides, as Hayter (1971) states, there are significant obstacles Latin-American countries face when trying to enlarge the inflow of foreign exchange. Main part of their exported products are primary commodities prices of which for the most part may be decided by the policies of other countries, including industrialized ones (Hayter 1971). Moreover, those prices are very likely to rise and fall, and in the long-term they are prone to decrease if compared to the prices of manufactured products (Hayter 1971). At the same time, establishment of exports of manufactured products might require long time. When a country is successful in exporting manufactured goods in large quantities, the likelihood that it may meet the obstacles in the markets of industrialized countries is very high (Hayter 1971; Tybout 1992). Moreover, industrialized countries might exploit their power to defend their agriculture or their industries from, as they call it, 'unfair' rivalry - even oblige developing countries to decrease their exports (Hayter 1971).

2.3 Openness to international trade and productivity growth

There are different discussions about the link between trade policies and productivity growth. However, most of them accept that exposure to global trade system results in increased rivalry among domestic firms, what hinders their ability to embrace rent-seeking[5] strategies (Tybout 1992). According to Pilat (1994), rivalry makes domestic economies to accept innovative technologies, decrease prices and increase their productivity – obtain a so called 'dynamic' gain from trade. 'Static' gain from trade implies that openness to trade may result in enhanced resource allocation (Tybout 1992) but it does not necessarily lead to output growth – it has only a narrow affect (Pilat 1994).

As Pilat (1994) states, there is a strong relationship between growing production and productivity increase, i.e. economies of scale play an important role in improved productivity. Hence, for the countries with limited domestic market,

[5] Rent-seeking – when a company, organization or an individual uses their resources to get economic advantages from others without returning any gains back to society through improved prosperity (Investopedia; URL: http://www.investopedia.com/terms/r/rentseeking.asp).

exports could be considered as an essential tool to increase output and reach the production quantities that would help them to benefit from economies of scale (Pilat 1994). Moreover, export-oriented strategy is very likely to improve capacity utilization; for instance, the main reason for productivity increase in manufacturing sector of South Korea was improved capacity utilization (Pilat 1994).

Exposure to international trade is very likely to create more opportunities for technological advancement – it allows entry of technologies through trade partners (Pilat 1994). Furthermore, Nishimizu and Robinson (1984) offer that whereas import-substitutive development strategy might imply pricey access to intermediate and capital goods (because those products are often hard and very expensive to produce in developing countries), export-oriented economy is very likely to assure supply of necessary financial resources to import those products, hence having a positive impact on cost and productivity of domestic firms.

2.4 Structural changes in economy and growth

According to Pack (1993), IDR (2009), Fischer (2009) industrialization is essential for economic growth. It would be difficult to find a country that experienced economic growth without industrialization; all fast developing economies show promptly rising manufactured production (IDR 2009). And, even though it is not easy to make conclusions on which way the causality runs – from increased manufacturing to higher GDP growth rate or opposite, the noticeable influence of new technologies on manufactured production might help to conclude that GDP growth is, possibly, the result of improved manufacturing, but not the opposite. To explain such conclusion, IDR (2009) refers to the idea of structural change in economy (IDR 2009).

According to Temple and Wössmann (2006), economic growth analysis among countries often ignore the issue of structural composition of economy. The fact is that developing countries show very diverse productivity levels in different sectors of economy (IDR 2009). Structural change, according to IDR (2009) – 'the shift of capital and labour from low-productivity to high-productivity sectors' – might be considered as both a reason and a result of long-term economic growth. Hence, it could be extremely beneficial to move labour from comparatively low-productive sectors to somewhat high-productive sectors. According to Lewis (1954), early economic growth models were built on such kind of strategy – labour transfer from traditional agricultural sector (relatively low-productive) to manufacturing sector (relatively high-productive) has boosted capital accumulation and improved growth.

Structural changes in economy might be not imperative for developed countries which have already reached an important conjunction between output levels of different economic sectors. Conversely, structural dissimilarities between highly industrialized countries, such as the US and countries whose economies still considerably rely on agricultural production, such as sub-Saharan African countries, are of great importance (IDR 2009). The empirical literature has passed over this issue and mainly emphasized the importance of improved institutions, good governance, openness to international trade and increased supply of financial assets in economy. Although those factors are certainly important for economic growth, they are generally lacking the structural content (IDR 2009).

A study conducted by UNIDO showed that a large divergence in development levels of different countries can be explained by the variances in productivity. As Hulten and Isaksson (2007) find, the divergence in production efficiency of countries is the main reason for divergence in development levels. They also mention that the existing discrepancy between affluent and most deprived economies is very possible to continue if usual development patterns (productivity growth rates) persist.

According to IDR (2009), it is a well-known fact that technological innovations in production and exports are very likely to influence the country's development. Under the improved technological sophistication in manufacturing economists usually understand the shift in production from more simple manufacturing production for wider masses (for instance, textile production) to more complicated production (such as electronical industries, chemicals, etc.). Nowadays, an empirical literature shows that there is a close relationship between the ability of grasping innovative technologies and growth. Since technologically innovative industries create increased revenues and possibilities for further knowledge and skills improvement, moving up from primitive technology to a more sophisticated manufactured production is considered as the key driving force for productivity growth.

Chapter 3 Background

This chapter will provide the reader with the information that is important to understand the analytical part of the study explained in the Chapter 4. In particular, in this section I will discuss the nature and historical evolution of aid. The discussion will involve the period starting from the end of Second World War, emphasizing the countries who were the first to receive aid (Japan, South Korea, Taiwan), with a specific emphasis on the historical growth practice of Japan, up to recent past with new aid donors (including both multilateral and bilateral donors) and aid recipients, on the example of a sub-Saharan African country - Ghana.

3.1 Nature and history of aid

Foreign aid has intruded international arena after the Cold War. It was initiated as part of a sociopolitical conflict between two industrial giants – the United States and the Soviet Union, which was recognized as a Cold War and was addressing rather political then economic purposes (Griffin 1991). The beginning of foreign aid could be associated with the necessity to help Western Europe to recover after the end of the Second World War. The initiated political program is known as Marshall Plan which main purpose, according to Griffin (1991), was to stop dispersal of communism in France and Italy, to assure stable conditions in West Germany and to prevent the spread of collectivist policies in the UK. The second phase of the Marshall Plan was meant to assure technical and financial assistance to Greece and Turkey, which were also in danger of spreading communist regimes (Griffin 1991). And the third, final stage of the Plan was a response to the rise of newly independent (from colonial rules) countries in Asia and Africa, being later called the Third World. Foreign assistance, at this stage, seemed to be a very useful tool of Western diplomacy (Griffin 1991).

More difficulties arose after the collapse of Japanese Empire which was in the territories that Japan took possession of before and owned them during the Second World War; it intensified the conflict between the First World and the Second World (Griffin 1991). Japan has been deprived of its political independence by the United States occupation forces and faced restraining trade policies from most European countries (Pilat 1994). At the same time, with the burst of the Cold War, the United States were mainly interested in firming Japanese economy what became more evident in 1948 when many limitations on economic policy of Japan were eliminated and economic strengthening and rebuilding have started (Pilat 1994). During the period of economic stabilization Japan received a significant amount of official aid from the United States which continued up to 1951 (Takagi 1995). Moreover, a vast export market was opened up for Japanese goods, and the United State, being a member of different international organizations (IMF, OECD, World Bank, etc.) established a route for incorporation into the international financial arena (Pilat 1994). An efficient conjunction of improved exports and extra revenue from costs of US armed forces in Japan, resulted in a huge foreign exchange inflows; it was used to import foreign technology and was invested in capital goods (Pilat 1994).

That the foreign aid initially has been driven by political forces could be clearly seen on the examples of Taiwan, South Korea and South Vietnam. In 1949, after the intrusion of communist forces into China, the anti-communist forces which retoured to Taiwan and tried to create a political and economic trials in China were funded by considerable number of foreign aid (Griffin 1991). According to Griffin (1991), in 1950s South Korea (capitalist) won the war with North Korea (socialist) thanks to the huge military assistance from the West; after the war South Korea continued to receive large amounts of foreign aid from the West. Likewise, during the war between North (communist) and South (capitalist) Vietnam, even though it ended up with the victory of North Vietnam in 1975, South Vietnam has received large inflows of military and economic aid (Griffin 1991).

Later foreign aid started to have more regional dimension, like financial assistance of France to Africa, Britain's assistance to Commonwealth countries and Dutch aid to Indonesia. As Griffin (1991) claims, although foreign aid was established based on political reasons, it had always followed economic purposes as well, in particular, it had the goal to introduce and spread capitalist economy. Profit generation rapidly became one of the main reasons for foreign assistance: assuring market safety, encouraging exports, building a favorable environment for foreign funds inflow and investment (Griffin 1991). For sure, there were also aid allocations for humanitarian reasons, for instance in Scandinavia.

3.2 Some facts about Official Development Assistance

The historical development of Official Development Assistance (ODA) can be attributed to the time of imperialism, when the colonial powers were trying to introduce improvements in the colonized territories, as well as organizations and projects for economic cooperation after the World War II sponsored by the UN and financial assistance for economic stabilization in the post-communist countries (Führer 1996). Big and possibly even too much expectations about the forecasts for assisting developing economies through overseas aid, in completely various conditions were generated by the achievements of the Marshall Plan.

The formation of the Development Assistance Committee (DAC) of the OECD was an essential step for the establishment of a system of nationwide and global aid agencies and projects and associated organizations (Führer 1996). Here are some important dates in the establishment of the ODA:

- The formation of the International Bank for Reconstruction and Development (World Bank) and the International Monetary Fund (IMF) can be attributed to the United Nations Monetary and Financial Conference at Bretton Woods in 1944, New Hampshire, USA, assembled by the 44 Joined Nations (Führer 1996).
- In 1969 DAC approved the idea of "Official Development Assistance" and distinguished ODA from "Other Official Flows" (OOF). DAC has classified ODA as official economic transactions the key goal of which is to encourage the economic and social growth in developing countries; the monetary conditions of those transactions are "intended to be concessional in character". The

"grant element" concept is used as a measure of concessionality (meaning further refined in 1972) (Führer 1996).

- In 1972 DAC adopts the stronger definition of ODA, which is still used (Führer 1996):

'ODA consists of flows to developing countries and multilateral institutions provided by official agencies, including state and local governments, or by their executive agencies, each transaction of which meets the following test: a) it is administered with the promotion of the economic development and welfare of developing countries as its main objective, and b) it is concessional in character and contains a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent)'.

- In 1976 DAC admitted and emphasized the issues related to the providing aid to the populations in the more deprived economies (Führer 1996) and in 1977 a 'Statement on Development Co-operation for Economic Growth and Meeting Basic Human Needs' was approved according to which to fulfil the basic human requirements, a more intensive economic development along with the modernization, infrastructure development and industrialization are of great importance. Particular significance, according to the Statement should be given to the policies directed to more effective utilization of resources, with particular reference to labour and productivity growth what, in its turn, would support growth (Führer 1996). Moreover, the DAC emphasized the importance of growing income of the deprived population and a strong foundation for self-producing growth (Führer 1996).
- The year 1978 was announced by the additional solidification of the Recommendation on Terms and Conditions of Aid - the average grant component goal for each ODA Member's project was raised from 84 per cent (defined in 1972) to 86 per cent.
- In 1978-1981 DAC introduced and evaluated policies on official assistance directed to rural development, energy growth and woman rights (Führer 1996)

- The year 1982 is well known as a start year of the debt crisis and stress on Structural Adjustment. According to Führer (1996) poor economies faced significant debt issues because of over-borrowing, unproductive resource exploitation, the double oil shockwaves, as well as a rapid increase in global real interest rates and low export earnings - a result of OECD countries' financial stabilisation policies. Governments, international financial organizations and banks tried to control the financial shock prompted by the Mexico declaration (August, 1982) about incapability of implement debt commitments, which was followed by Brazil and other countries (Führer 1996). This could be considered as a start of attempts for policy improvements and structural adjustment programs by developing countries.
- In 1985, which was announced as the twenty-five years of Development Cooperation, the DAC made a statement on aid efficiency. The statement says: *in spite of the current obstacles in sub-Saharan African countries and some Latin American economies*, many poor countries have shown a significant economic as well as social development over the past 25 years, and the aid along with the increased exports to OECD countries had obviously supported to those developments (Führer 1996). Moreover, according to the statement *even though the official development assistance is mainly directed to the economies which are experiencing the most obstacles and inflexible growth issues, it is also aimed at helping countries in a crisis as a result of natural disasters, refugee inflows or conflict* (to be continued).

Indeed, as Sundberg and Gelb (2007) claim, even though the general understanding on aid is that it aims to support development, considerable quantities of financial assistance is not directed to that goal. He argues, that OECD countries calculate under the name of ODA all financial flows, including for 'special purposes' - projects administration costs, crisis and food aid, technical assistance, as well as debt release. And only the remaining financial assistance is considered as 'non-special-purpose grants' which is usually considered as an aid: aid directed for education improvement, infrastructural development as well as health programs and budget support. Moreover, for a long time this share of official assistance directed to development project support was experiencing a steady decline specifically in 1990s after what is has not been improved (Sundberg and Gelb 2007).

The authors also mention the underlying reasons for decreasing share of aid directed to development projects. According to them, the decrease by as much as 22 percent in the share of development aid in ODA (from 63 to 41 percent) was a result of rising administrative expenses, debt release and emergency aid. In particular, technical assistance – was and is the second biggest constituent of ODA; although the financial flows aimed at trainings, final reports and experts services have been slightly decreased, they are still constitute about 20 percent of ODA ($4.5 billion for Africa in 2004) (Sundberg and Gelb 2007). The share of administrative expenses (bilateral aid) have arisen from approximately 5 per cent to about 8 per cent of ODA; the reason, according to Sundberg and Gelb (2007) is partly the increase in number of donor agencies and countries (there were 2 agencies and 10 countries providing aid to Africa in 1960, whereas by 2004 their number increased to 16 and 31 respectively). As to the emergency and food assistance, their share in ODA has risen since 1980 as much as 2 times – from 7 to 13 percent (Sundberg and Gelb 2007). Such assistance, for sure, is useful but it cannot be considered as a financial support for long-term growth.

Lastly, an additional issue that might decrease the significance of aid for growth is the previously mentioned idea of tied aid (aid tied to donor country exports or companies). According to UN (2005), the value of the tied aid is less by 11-30 percent compared to the value of untied aid since the price that the aid recipient country have to pay to a donor country companies is different from the market prices. During the 1980s, as much as 50 percent of all official aid was considered as tied (Sundberg and Gelb 2007). And even though there are some evidences of slightly decreasing share of tied aid, many donors do not provide any information on the share of tied aid in total aid provided by them; hence the delivery of reliable information on tied aid has become problematic (Sundberg and Gelb 2007). Nevertheless, according to the data provided by the UN, in 2003 tied aid had undervalued bilateral aid directed to Africa by $1.6-2.3 billion out of $17 billion. Overall, little less than 25 percent of overall bilateral and 38 percent of total foreign assistance is delivered in such type of financing that would be possible to use in projects for infrastructural development, education and health improvement (this number does not include debt release) (Sundberg and Gelb 2007). Furthermore, starting from 1977 selectability of both bilateral and multilateral aid was very weak: for donors high poverty levels were not an indicator for large aid provisions (for multilateral donors – it was particularly true during the second half of 1970s, but it has changed in the 1980s) (Arighi 2002). Last but not least, a huge proportion of foreign aid has been directed to economies suffering from political instability or experiencing a civil war: 28 African countries have had about a hundred army takeover starting from 1975 and 22 economies have gone through the conflicts in the last 30 years. About 25 percent of total aid provided to Africa during the years 1980-2002 was aimed at countries passing through a conflict (Sundberg and Gelb 2007). To finalize, development assistance in the common sense is far less than what is being presented as development aid.

- DAC 1985 statement (continuation): Almost all countries have received a considerable assistance to speed up their social development and *to place at least some of the basics for fast economic growth* (Führer 1996). *Sub-Saharan Africa, as a result, was considered by DAC as being of urgent necessity for crucial policy reforms. DAC, hence, had sturdily supported the World Bank in its efforts to introduce the new project with strongly controlled aid provisions for African structural adjustment programs* (Führer 1996).

According to Sundberg and Gelb (2007), starting from 1960 sub-Saharan African countries have received about $650 billion aid from OECD DAC countries. However, a considerable amount of this aid has not been directed to development itself.

Based on their research on 'sustained economic growth' performances in Africa during the period 1960-1996, Berthélemy and Soderling (1999) discovered sixteen successful practices in sub-Saharan Africa and they even compared the success of those remarkable achievements with the growth practices of the 'miracle' East Asian countries. Under the 'sustained economic growth' Berthélemy and Soderling (1999) understand 'an uninterrupted period of 10 years or more, during which time the five-year moving average of annual GDP growth exceeds 3.5 per cent'. The sub-Saharan countries which are among those sixteen have met those requirements for about 15.4 years in average (Arighi 2002) (Table 1).

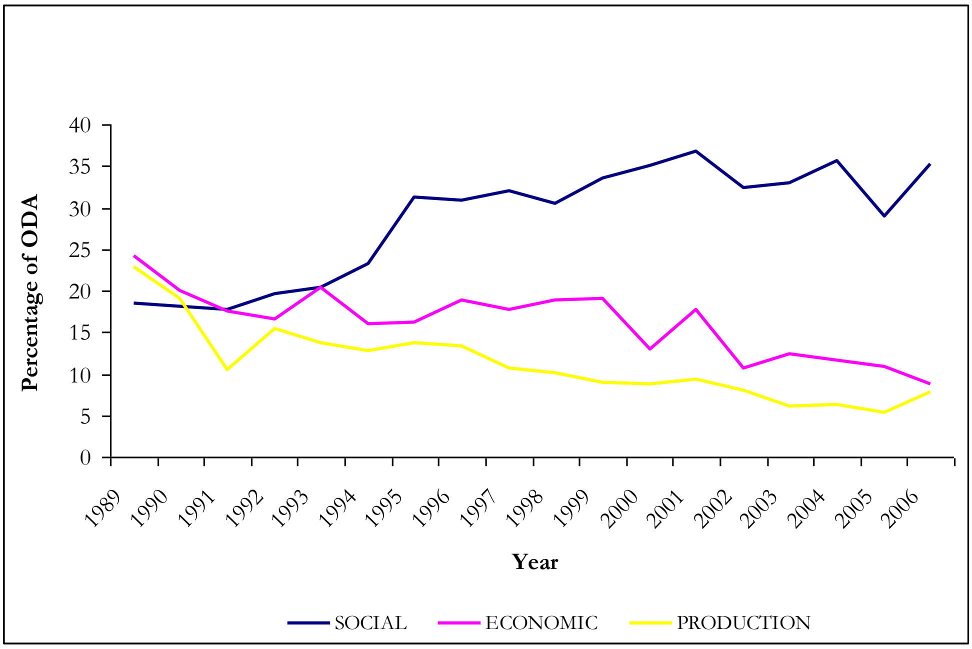
Table 1. GDP Growth Rates, sub-Saharan Africa, 1960-1999 (ten years averages)

Year	GDP growth rate (percentage)
1960-1969	4.33
1970-1979	3.7
1980-1989	1.7
1990-1999	2.35

Source: World Bank 2015, World Development Indicators

What is important to mention here is that during the early years of ODA provision – from mid 1940s up to late 1960s - aid was profoundly directed towards and hence supported to the development of infrastructure and other productive capacities with an obvious ability to increase GDP (Aklilu 2009). During the 1960s spending on agriculture and social issues accounted only 15 and 5 per cent of overall expenses respectively (Aklilu 2009), whereas infrastructural spending was estimated to be as much as 64 per cent of total World Bank loans – up to early 1970s. This was the period of high GDP growth in SSA countries (see Table 1). Afterwards, philosophy of aid had changed and the priority was given to fighting poverty where economic growth was not anymore seen as a sufficient tool to assure increased standards of living. Hence, there was a shift of interest to social sector and the share of ODA directed by the World Bank to social issues has increased up to 40 per cent (Kapur *et al.* 1997 as cited in Aklilu 2009). Starting from 1990s – during the very peak of structural adjustment initiatives in sub-Saharan Africa, the share of ODA directed to production activities has declined (Aklilu 2009) (Figure 2). Moreover, there was a decrease in manufacturing value added (MVA) during the same period (Aklilu 2009; Wolrd Bank 2015). Accordingly, GDP growth after the 1980s was as much as 2 times lower than during the previous two decades (Table 1). The latter helps to conclude, that when ODA is not aimed at productive manufacturing activities, in direct support of ODA for productive manufacturing activities and also on growth.

Figure 2. ODA flows by sector, sub-Saharan Africa, 1989-2006



Source: Aklilu (2009)

3.3 The World Bank and its policy-based lending

The World Bank, according to Mosley *et.al* (1991) has been identified as an organization which could be characterized by prolonged vagueness of its goals and conflicts between its purposes: it seems to continuously shift from one objective to another for a long time. The four main goals of the World Bank, according to Mosley *et.al* (1991), can be defined as follows:

1) monetarist agent between global capital markets and the Bank's debtors – 'the Bank as a bank';
2) a tool for the protection and improvement of the interests of the prospering economies which are the main stockholders of the Bank;
3) an 'evangelist' looking for alterations in the principles and attitudes of emerging economies' governments; and

4) An intermediary for the relocation of capitals from prospering to developing economies (Naim 1994: 194-196 as cited in Mosley *et.al* 1991).

As Mosley *et.al* (1991) explains, during the period of 1966-1991, the Bank has accentuated on the objective (3), i.e. as 'evangelist'. And the launch of policy-based lending could be seen as an endeavor to syndicate the previous main objective of transporting resources to most deprived economies and make a sturdier effort to transformation of the policies of borrowers (Mosley *et.al* 1991). Moreover, the period of 1965-1992 was overall characterized by the decreasing growth rates of all countries worldwide – both developed and developing - with the exception of China and the countries of South and South-East Asia in the 1980s (Mosley *et.al* 1991). Such deceleration in the global economic growth could be explained by the two considerable increases in oil price (in 1973 and 1979-1980) as well as by the following debt crisis started in 1982.

The World Bank initiated structural adjustment program during the period of 1980-1988. Initially, poverty alleviation was not the main goal of those programs (Mosley *et.al* 1991). Hence, the assessment of the programs omitted the poverty alleviation factor as a measure of the achievements of policy-based landing. Moreover, as early as in the late 1980s, most anticipations that the Bank had before launching the program of structural adjustment landing were not met and had to be reviewed. Specifically, it was clear that in many countries, and in particular in sub-Saharan Africa, in order to achieve stabilization and structural adjustment a much longer period than five years would be essential. Understanding of this fact, according to Mosley *et.al* (1991), has challenged a well-known principle that economic restructuring should by highly prioritized over social problems, like poverty reduction. Since both the borrowing countries and donors have hardly agreed on the adjustments which were supposed to take no more than two-three years, the idea of the delay in policy agenda made it more difficult to give unconditional importance to economic reforms (Mosley *et.al* 1991).

Many critics of the structural adjustment program has claimed that adjustment created 'social costs' such as worsening school enrolment, maternal and child nutrition, increasing cases of some diseases (Mosley *et.al* 1991). As

Hayter (1971) also mentioned, stabilization programs also have inclination to decrease employment in public and the private sectors. Activities to overturn the declining living standards, to reduce unemployment, to decrease the huge migrations, and to advance other social conditions were either delayed or ignored (Hayter 1971). Moreover, she argued, that the international agencies, for instance in Latin America, were focussed on policies of financial stability, which often disagree with the aim to advance the living standards of the population. Because of that reason, such projects have hardly ever doing well what is obvious from rising prices, and poorer than anticipated performance of the private sector (Hayter 1971). The international agencies, though, were still thinking that such projects might flourish if they were practised with more determination. UNICEF even started to movement under the name 'adjustment with a human face' according to which a more slow adjustment with a stronger emphasis on the structure of public expenses and with special social-security programs for the most vulnerable and the poor had to be launched (Mosley *et.al* 1991).

For international agencies, financial and monetary stabilization was a prerequisite for aid effectiveness for growth (Hayter 1971). Moreover, development, relocation of income and raise in social expenditures were considered as imperative goals and growth was expected to be an immediate result of stabilization programs (Hayter 1971). At the same time, as Mosley *et.al* (1991) stated that in poor countries the poverty level was too high and it might be impossible to alleviate poverty through relocation of existing resources; hence the economic growth was crucial. Moreover, the growth should have been a labour-intensive in his nature, so that it could generate high labour demand – the most important resource for the poor (Mosley *et.al* 1991). In any case, as Hayter (1971) claimed, goals other than financial stabilization have been forgone and yet stabilization was hardly ever achieved. With a small number of exceptions, stabilization programs carried out by the international agencies have led to low or zero rates of growth; furthermore, they tended to have usually downbeat outcome on production and development (Hayter 1971).

The importance of cutting budget deficits is a widespread requirement from donor agencies (Hayter 1971). The latter implies the limitations and decrease in government expenditures Hayter (1971). This strategy, according to

Hayter (1971) is mainly used for the projects which are regarded as 'non-productive' or having a social direction, for instance, salaries and wages, health programs, education and land reform. Furthermore, since international agencies are mainly concentrated on short-term stability, the idea of land reform to be a precondition for long-term growth have been given modest significance (Hayter 1971). Goals of international agencies in agriculture have involved only elimination of price controls, the diversification of agricultural exports and provision of credits Hayter (1971). Thus, the international agencies' policies, as Hayter (1971) concluded, have therefore added to already existing relentless inequalities in the allocation of income and power in Latin American countries.

Even though there was a lack of a heated debate on development policy of the World Bank, in 1993 Japan's Overseas Economic Cooperation Fund made an attempt to express its disbelief about the Bank's adjustment lending. In contrast to the World Bank's strategy of blanket liberalization, the Japanese government debated about the importance of protecting infant industry and providing credit supports to particular industries with export prospective (Mosley *et.al* 1991). It also suggested and sponsored a research conducted by the Bank on the reasons of the fast economic development in Japan and its bordering countries, published under the name - *The East Asian Miracle* (World Bank, 1993). Japan's main objective was to convince the World Bank that its statement about the state damaging impact economic performance has no any strong basis. The Japanese government wanted to show that the rapid growth Japan, as well as in Taiwan, South Korea and Thailand have performed since the Second World War was thanks to the intervention and strong control of the economy by the state. It explained accurately the approaches of 'performance-contingent state support' acclaimed in the OECF's Occasional Paper (Amsden 1989). Hence, the Japanese government was trying to strongly demonstrate to the public, that the historical experience of the most prosperous late-industrializing economies has nothing in common with the Bank's recommendation to developing countries to stay on the liberalization route (Mosley *et.al* 1991).

The emerged attempt by Japan did not force the World Bank to make visible changes in its strategy on the economic policy development. The published *East Asian Miracle* research recognized choosy state intervention only for export advancement (Mosley *et.al* 1991). The study clearly disputed against the fact that import protection and credit market interference should be introduced in poor countries on the example of East Asia – statements that OECF over again opposed. However, this experience has created additional distrust on the relevance of the Bank's policy recommendation, and of the Washington Consensus which promotes it (Mosley *et.al* 1991). Moreover, the argument that there is only one method of economic development could no longer be strongly advocated.

Nowadays, structuralist ideas seem to exert a little pressure on the international agencies. They are now more alarmed by the problems of supply, revenue side of the budget, and agricultural production (Hayter 1971). But they still fail to act in agreement with the structuralists' opinions on income distribution and the structural reform of the economy with the emphasis on industrial development and exports (Hayter 1971). Moreover, they remain opposed to the structuralist arguments on the balance of payments difficulties in Latin-American countries, and do not except the responsibility of donor countries for those problems (Hayter 1971).

3.4 Changing motivation of the donors and corresponding uses of aid by recipients

The debates and constant doubts about the effectiveness of foreign assistance have resulted in decreasing amounts of foreign aid during the last years. According to Hirvonen (2005), the amount of global development assistance was estimated to be only 0.25% of rich countries' Gross National Income (GNI) in 2004, what is obviously less than the one in 1990 - 0.33%, and the one in 1960 - 0.54%. Thus, rich countries provided less than half the amount the aid they gave in the 1960s when the levels of their affluence were far lower (Hirvonen 2005). Furthermore, Hirvonen (2005) adds that the fact that the official OECD aid statistics are presented in US dollars influences real numbers of aid, particularly the decline in dollar increased the nominal aid form countries which use currencies different from US dollar. Thus, according to OECD statistics, between years 2003 and 2004 the official development assistance increased 12.1% in nominal terms, whereas the real grow was estimated to be only 4.6% (Hirvonen 2005).

Besides, the field of development assistance is marked by ongoing debate about the new model of developmental finance from China. The expansion of China's financial assistance and economic cooperation projects with many developing countries, and its obvious efforts towards economic ascendancy might serve as an incentive for international development assistance to overview its old-fashioned strategies and try to find new ways for making aid work.

China's dominant position in economy implies changes in international economic and trade arena (Zafar 2007). In particular, the country's aid and investment in Africa are very likely to expand during the coming decades because of China's increasing demand for resources (Zafar 2007). According to Zafar (2007), China's contribution in Africa's economic growth is visible. As Senegal's president Abdoulaye Wade stated 'With direct aid, credit lines and reasonable contracts, China has helped African nations build infrastructure projects in record dime – bridges, roads, schools, hospitals, dams, legislative buildings, stadiums and airports. In many African nations, including Senegal, improvements in infrastructure have played important roles in stimulating economic growth' (Financial Times 2008).

Furthermore, as Davies (2010) claims, China applies in Africa the successful industrialization scheme similar to the one that helped growth of many Asian countries over the past forty years - manufacturing and export based economies, which attract investors to establish industrial "clusters" – 'geographical concentrations of interconnected companies and institutions around particular sectors' which constitute global economy (Porter 1998 as cited in Zafar 2007). Accordingly, China is continuously establishing economic cooperation zones in Africa, which seems to be attractive to African countries since it might foster economic growth and help them go beyond the resource extraction strategy (Davies 2010). Last but not least, China's guarantee of non-interference in countries inner affairs and minimum lending conditions on governance and financial regulation inseminated welcoming attitude from several governments in Africa (Zafar 2007).

What calls for a careful consideration is the fact that the increase in China's economic cooperation might have negative effect on the evolution of Western aid and make changes in the arena of development assistance (Zafar 2007). As Abdoulaye Wade also mentioned 'China's approach to our needs is simply better adapted that the slow and sometimes patronising post-colonial approach of European investors, donor organizations and non-governmental organizations' (Financial Times 2008). In fact, new effective procedures and techniques would be necessary to develop between the lenders. In addition, there might be a need for traditional donors and international financial institutions to find ways to bring back China into the vast development arena (Zafar 2007).

Chapter 4 Analytical part

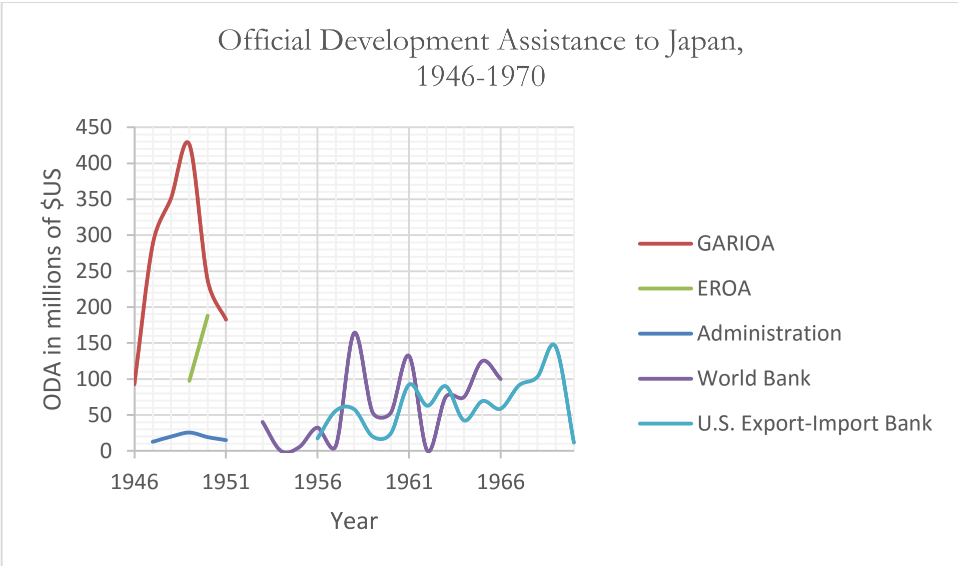
In this chapter I will first consider aid-growth nexus in the context of early aid recipients, such as Japan. Later I will move on to analyze the same relationship in the context of aid in the modern setting of sub-Saharan Africa with an emphasis on Ghana.

4.1 Japan – a "miracle" economy and an early aid recipient

Japan, from a secluded agricultural society has become one of the most powerful industrial countries in the world having experienced extraordinary growth rates for a long period of time. It represents an example of a late-industrialized country (with rapid growth started only after 1950s) and once again highlights the significance of catch up factor in economic growth. According to the catch up theory, economies with low-levels of income is very likely to have a faster growth compared to high-level income countries since they can enjoy technologies already developed by developed economies; moreover, the economic organization of such economies is well suited for structural changes (Pilat 1994). Total ODA that Japan has received after the Second World War till the period when it transformed from aid-recipient to aid donor (1946-1970) was much less than those received by sub-Saharan Africa (as a percentage of the world's total ODA), but it underwent a greater growth what allowed for more structural change.

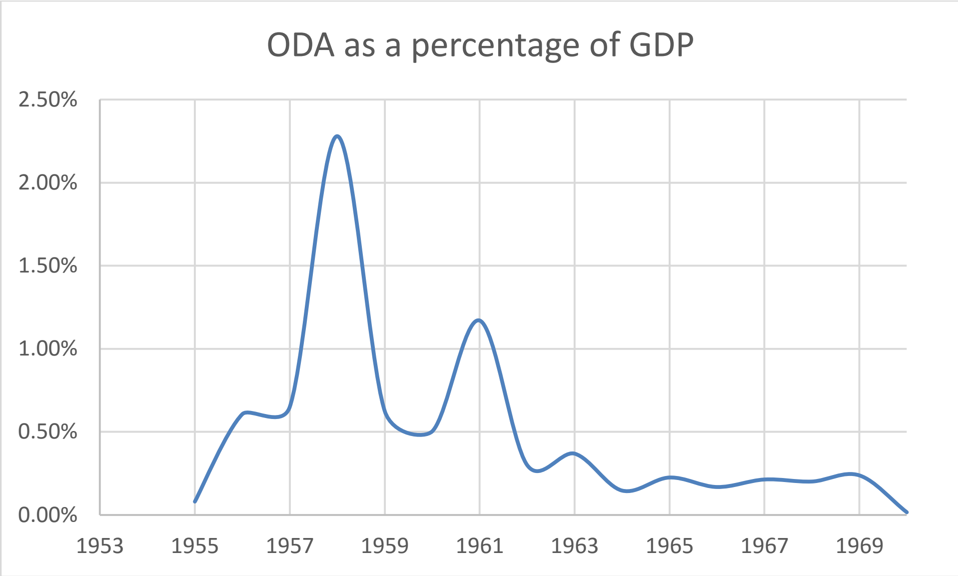
After the Second World War, during the so called rehabilitation period, Japan received considerable amount of aid from the United States. In 1947 the US established the Government and Relief in Occupied Areas (GARIOA) program with the aim of delivering food, fuel, fertilizers and medicine to Japan (Takagi 1995) (see Figure 3). Only from the start of 1949 the program on Economic Rehabilitation in Occupied Areas (EROA) was initiated under which raw materials and machinery were provided to Japan to assure economic recovery (Takagi 1995). US aid to Japan continued until mid-1951 (Takagi 1995). Even though, according to Takagi (1995), it is difficult to estimate the exact amount of aid that Japan received from US during the post-war period (most aid was used by occupational forces), some sources claim this amount to be $3 billion – what is a relatively big number compared to overall $120 billion of foreign assistance that US provided to Japan during the period of 1940-1958 (MOF 1976 as cited in Takagi 1995).

Figure 3. Official Development Assistance to Japan, 1946-1970.



Source: MOF, *Mikaeri Shikin no Kiroku*, 1952; MOF, *Fiscal and Financial Statistics Monthly*, monthly issues; Takagi 1995.

Figure 4. ODA as percentage of GDP, Japan, 1953-1970



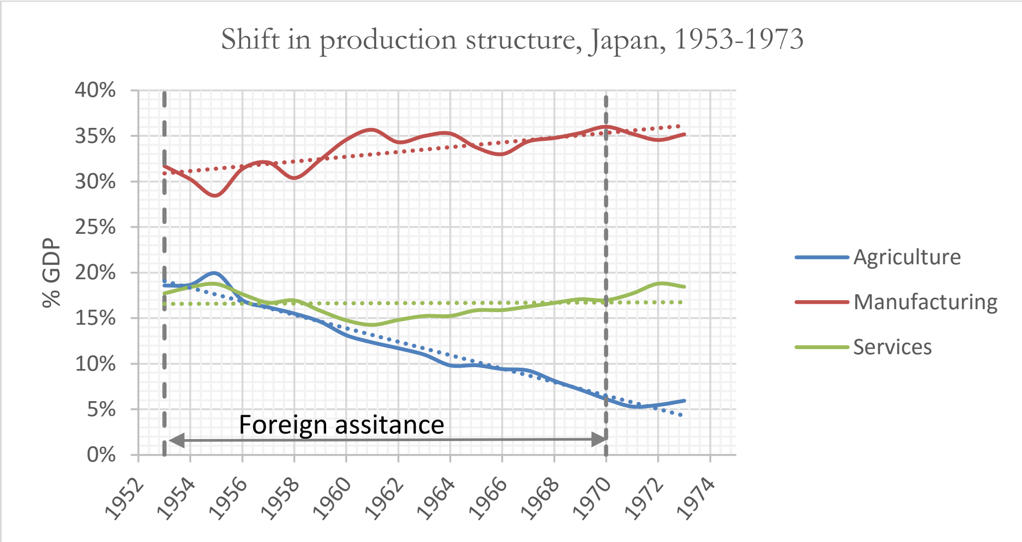
Source: Tagaki 1995; WB 2015.

In 1949 with the launch of Dodge Plan a US Aid Counterpart Fund Special Account was established within the Japanese national budget and all the profits from sales of imports provided with US assistance – overall $845 million during 1949-1952 were directed to this account and then used to finance industrialization projects (MOF 1952 as cited in Takagi 1995).

4.2 Structural change of economy as a basis for growth

Pack (1993) mentioned that the latest literature on growth often overlooks structural change of economy as a basis for growth. Resource allocation is responsible for approximately 7 percent of economic growth in Japan between the period of 1953 and 1990 (Pilat 1994). The Japanese economic structure has experienced significant changes between 1953 and 1990 (Pilat 1994). Figure 4 shows the GDP composition of the economy at current market prices. During the post-war period (from 1953-1970) which was accompanied by the significant amounts of ODA received, agricultural production from has experienced a continuous decline from approximately 19% of GDP to about 6% in 1970 (and later even down to 2.2% in 1990 (Boltho 1975; Pilat 1994). Similarly, slower productivity in services gained more importance in the postwar period - it dropped slowly till 1964 from 18% of GDP to some 15% of GDP; since then its share in GDP slowly increased up to 17% (Pilat 1994).

Figure 5. Shift in production structure, Japan, 1953-1973



Source: Pilat (1994); World Bank 2015, World Development Indicators.

The share of manufacturing in the economy, in the other hand, showed a clearly rising trend during the period of 1953-1970 up to 36% (Figure 4, 5). Starting from 1973, however, manufactured production started to drop gradually turning Japan into a service-driven economy – in 1990 service sector was responsible for more than 24 per cent of GDP (Pilat 1994).

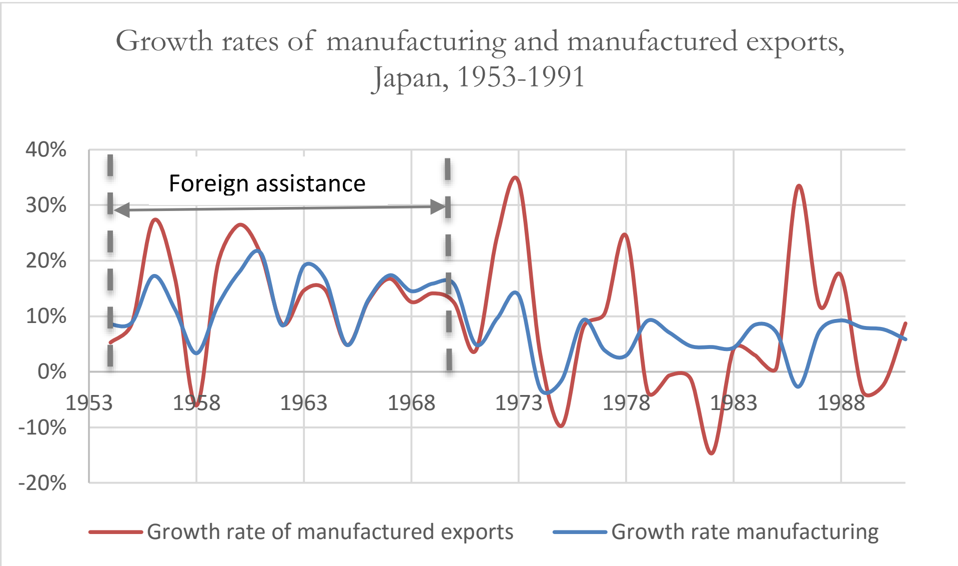
4.3 Productivity growth and exports

The catch up factor may also be considered as an important aspect for growth. According to Pilat (1994), rapid productivity growth may let a country to get advantage of economies of scale, which might be essential for different sectors of economy, and mainly for manufacturing. Moreover, due to the existence of advanced technologies, the revenues from investment in capital stock may be sizable. Technological advancements also help to decrease the price of capital compared to labor price, what is also very likely to increase capital stock. Capital accumulation due to the catch up factor, as Boltho (1975) and Pilat (1994) state, accounts for almost 50 percent of Japanese productivity growth during the postwar period.

At the same time, for a catch up factor to work for fast economic growth, proper industrial policies are of great importance (Pilat 1994). Japan's industrial policy was directed at establishment of a 'long-term dynamic comparative advantage'- instead of 'static comparative advantage' (based on textile production during the early postwar period) the country has shifted to industries with long-term potential and perspectives – machinery, electronical equipment and transport (Boltho 1975; Pilat 1994). Hence, industrial policies in Japan were developed very carefully and technology imports were under serious control.

Furthermore, *there was a solid relation between growing exports and output growth in Japan: sectors of economy with the highest output growth have showed the highest export growth levels as well* (Boltho 1975; Pilat 1994) (see Figure 6). The latter, according to Pilat (1994), speaks about the imperative role of Japan's export-oriented policies in its output catch up with the early-industrialized economies.

Figure 6. Growth rates of manufacturing and manufactured exports, Japan, 1953-1991



Source: Statistics Bureau, Japan Ministry of Internal Affairs and Communication; Pilat 1994.

As ODA has accounted about 3 percent of GDP during the period of receiving aid - 1953-1970 - the average growth rate of total economy has reached about 9% what was twice as much as the one during period when Japan stopped receiving financial assistance – starting from 1970s (Table 2).

Table 2. ODA and manufacturing data, Japan, during (1953-1973) and after (1973-1990) receiving aid

	1953-1973	**1973-1990**

ODA as a percentage of GDP	3%*	0%
Growth rate of total economy	8.63%	3.97%
Growth rate of manufactured exports	18%	5%
Manufacturing as a percentage of GDP	12.7%	5%

Source: Statistics Bureau, Japan Ministry of Foreign Affairs and Communication; Takagi 1995; WB 2015, World Development Indicators. * - 1953-1970.

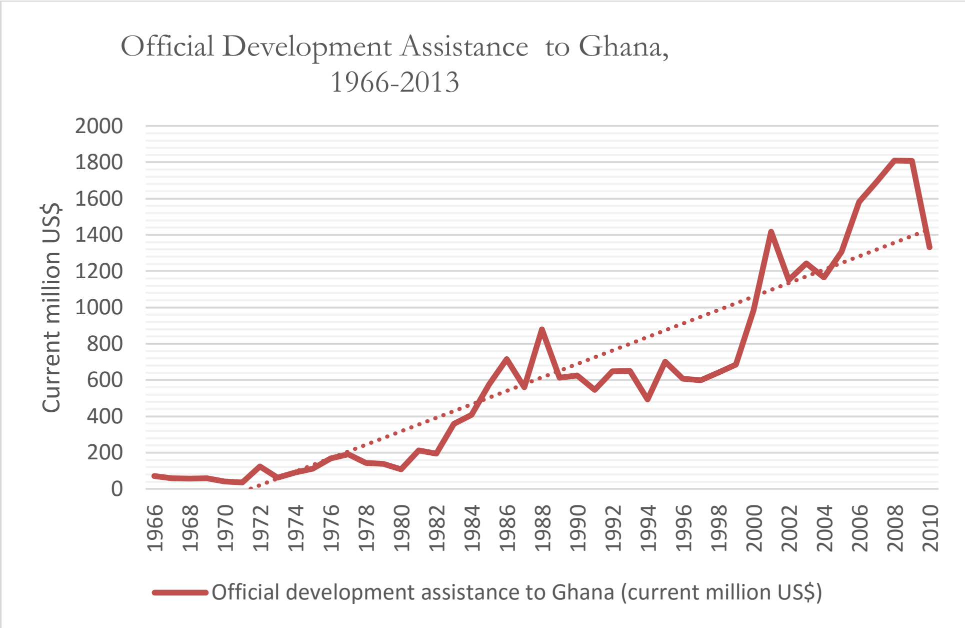
The latter suggests that *as ODA increased, the economic growth rate also reciprocated implying that foreign assistance was effective in achieving economic growth in Japan. At the same time period, share of manufacturing in total economy and growth rate of manufactured exports in Japan were as high as triple and quadruple respectively, compared to those after 1970s* (Table 2), what once again proves the significance of increased production and manufactured exports in accomplishing economic growth.

4.4 Ghana – a contemporary aid recipient

Ghana has always been a focus of donors and their agendas, hence it represents an interesting case for exploring the aid provision and its impact on economic growth. It first attracted worldwide attention in 1957 by being the first country to gain independence in sub-Saharan Africa, but later became an archetype of failure of Africa. The country is also well known among donors as a 'star pupil' of structural adjustment reforms in 1980s (what created aid-dependence because of foreign exchange shortages and increased debt) and which a decade later (mid-1990s) experienced a tremendous economic downfall (Whitfield, 2009).

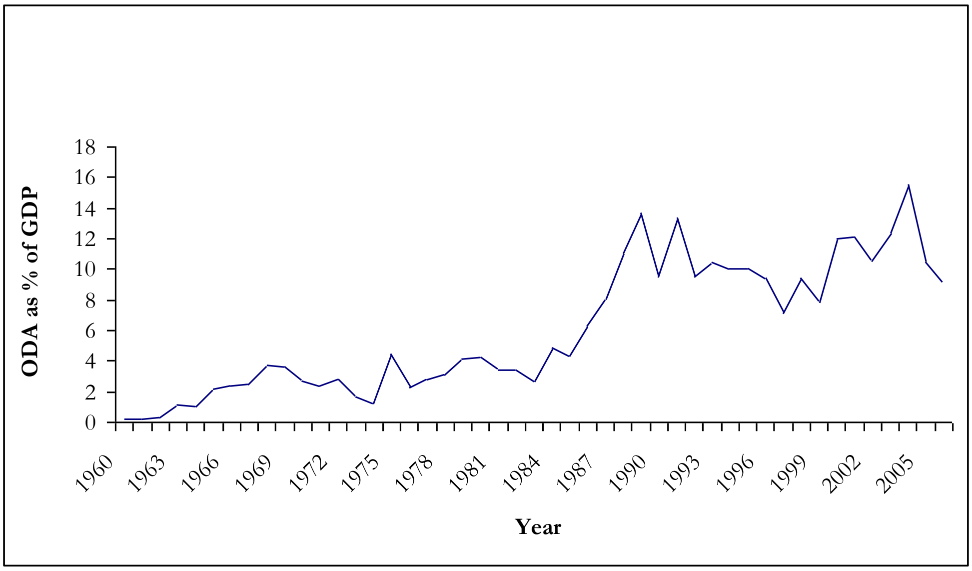
The experience of Ghana seems to be different from the story of Japan. During the long period of receiving ODA – from 1966-2014 – when the share of foreign assistance in overall economy was as high as 6.5 percent with unprecedentedly highest levels in 1989 and 2004 – about 14 and 16 percent correspondingly (Figure 7,8), the average growth rate of economy was has never passed 3.7 percent (Table 3) and as World Bank calculations show was for many years even negative in spite of ODA being continuously pumped to Ghana (Figure 8). This offers a bright picture of the failures of aid impact on growth in Ghana.

Figure 7. Official Development Assistance to Ghana, 1966-2013



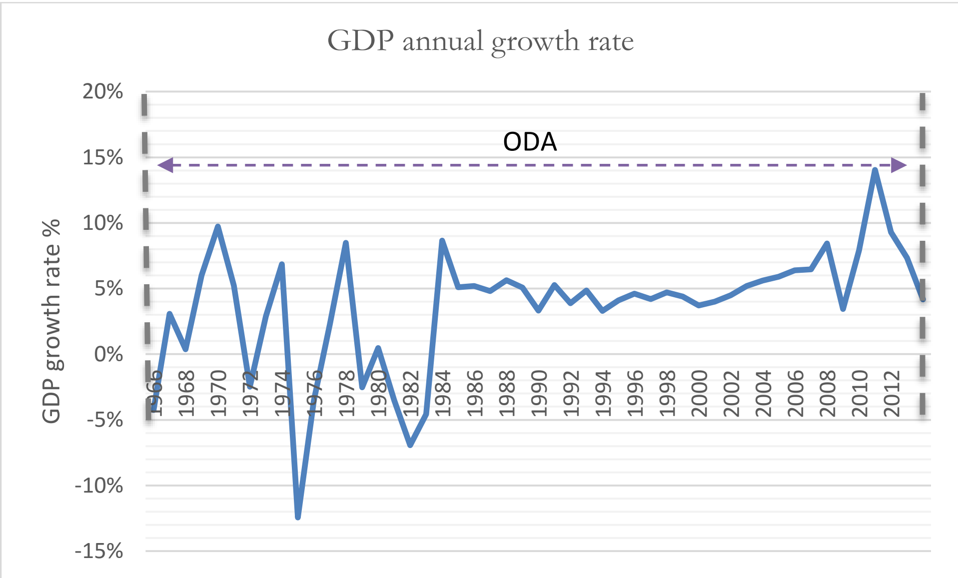
Source: World Bank 2015, World Development Indicators.

Figure 8. ODA as a percentage of GDP, Ghana, 1960-2006.



Source: Aklilu, 2009

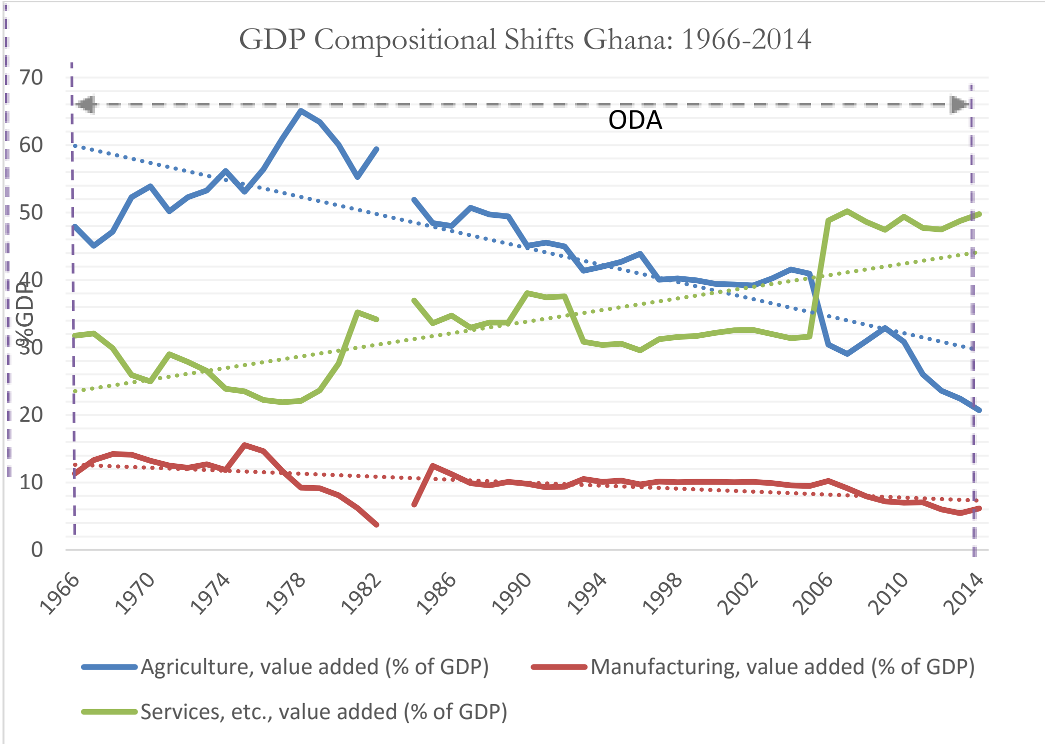
Figure 9. GDP Annual Growth Rate, Ghana, 1966-2014



Source: World Bank 2015, World Development Indicators

Moreover, structural changes in Ghana seems to not follow the model of GDP compositional shifts in Japan. More precisely, even though agricultural production has showed a steady declining trend during the whole period of Ghana's ODA assistance, manufacturing sector, in contrast with Japan, has followed the same declining pattern. Accordingly, services has received much attention in the economy and showed a clearly increasing trend from 1966-2014.

Figure 10. GDP Compositional Shifts, Ghana: 1966-2014.



Source: World Bank 2015, Africa Development Indicators.

Growth rate of manufactured exports during the years of unprecedented ODA inflows in Ghana - 1979-2014 (Figure 10) - was no more than 1.14% of total economy growth, whereas manufactured production has never increased 9.8 percent during the whole period – almost half of a century - of receiving foreign aid.

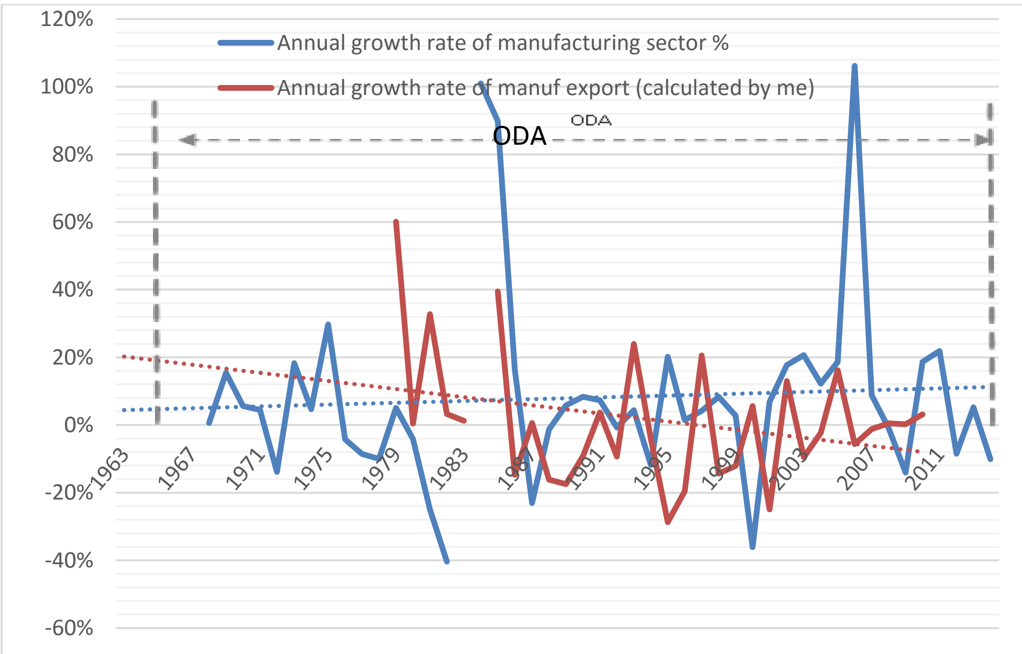
Table 3. ODA and manufacturing data, Ghana, the years of receiving aid - 1966-2014

	1966-2014
ODA as a percentage of GDP	6.5%
Growth rate of total economy	3.7%
Growth rate of manufacturing exports*	1.14%
Manufacturing as a percentage of GDP	9.8%

Source: World Bank 2015, Africa Development Indicators; * - 1979-2014

There is no clear relation between the growth of manufactured production and the growth rate of manufactured exports in Ghana (Figure 11). The growth rates are rather irregular and the trends go in opposite direction - while manufactured production shows a slightly rising trend, the growth of manufactured exports is decreasing. The latter speaks about inability of the country to assure a solid relation between the output growth rates in industry and exports (like it was in the case of Japan) for the sake of economic growth.

Figure 11. Annual growth rate of manufacturing and manufactured exports, Ghana, 1963-2014.



Source: World Bank 2015, Africa Development Indicators.

Ghana showed a much more effective economic development before its independence in 1957 compared to the period after. Whereas, during the first half of the 20th century Ghana's share of international trade and exports were increasing quickly, it showed a completely reverse picture at the end of the century (Teal 2002). According to Leith (1996 as cited in Teal 2002), throughout the end of 20th century economic policy of Ghana has been improved compared to the one the country had since independence. But even though the new economic policy of the country helped to stop the declining trend of exports, it appeared to be unable to help the exports grow (Teal 2002). Moreover, it still failed to assure macroeconomic stability and appropriate technical progress in 1990s (Teal 2002). Teal (2001 as cited in Teal 2002) based on the facts from households, concluded that there was no indication for raised incomes due to the technical progress (Teal 2002). As Leith (1996 as cited in Teal 2002) also indicated, whereas there was a production growth, real output was still low. Moreover, the statistics from manufacturing firms also indicated that there was no principal productivity progress (Teal 1999).

Finally, to the question if the economic policy starting from the launch of structural adjustment program in the mid-1980s, had inverted the major sources of earlier failure, Teal (2002) provides the following explanation. In 1954 per capita exports in Ghana have reached as much as US$300, what was about the triple of the export levels the country showed during the very beginning of the last century – US$100 in 1907-1910 (Teal 2002). Cocoa exports accounted more than 60 per cent of overall exports. After the independence, up to 1998 the level of per capita exports decreased considerably, reaching the initial 1910 levels: even though there was documented a minor increase during the mid-1980s, in the 1990s the levels were varying around US$100 per capita (Teal 2002).

Ghana's 20th century international trade experience could be explained as times of cocoa exports (Teal 2002). However, in the 1990s non-cocoa exports have increased both totally and comparatively to cocoa exports (Teal 2002). However, as Teal (2002) suggests, the registered increase in exports in the 1990s was almost exclusively thanks to gold retrieval.

As to the economic growth during those years, according to the author, it can only speak about the deepness of failure of the post-independence government in 1980s and its development policies. There was no any indication of the long-term economic growth in Ghana (Teal 2002). And the fact that Ghana's exports fail to increase, along with the population growth, is the reason of economic stagnation of the country too (Teal 2002). Broadly speaking, even though in 1999 exports of Ghana were consisted of equal amounts of cocoa exports, non-cocoa primary exports (mainly treated agricultural products) and new exports, according to Teal (2002) during that period the country was unable to enter the international markets with new export goods.

Nowadays, export policy in Ghana emphasizes three main economic goals (WTO 2001). Firstly, it aims to diversify agricultural output, secondly - to assure broader local processing of such products, and thirdly – to stimulate manufacturing production. But, still, the economic policy of Ghana, in all the mentioned export areas, has failed to assure the increase of corresponding exports (Teal 2002).

It has been considered that the main reason of the failure in manufacturing exports was the lack of skilled labor in Ghana, like in Africa in general (Lall et al 1994). However, according to Teal (2002), even the investment in labor skills in the country is very unlikely to improve its manufactured production. The first reason could be considered the fact that the return on the skills is minor compared to the one of physical capital (Bigsten et al. 2000). The second reason, according to Teal (2002), might be the evidence that during the first half of 1990s there was a decrease in experienced labor demand in the country. Another reason, as Teal (2002) claims, is that since the skills could be seemed as tradable good, one cannot be sure if those should be developed in Ghana. Finally, the fourth aspect, is that the small productivity levels, as Teal (2002) argues, would not be able to stop exports from being profitable, assured that the salaries of labor are low enough. And, on the contrary, increased productivity levels and, as a consequence, high salaries might not foster labor-intensive gainful exporting. Hence, an assumption that increased investment in education and skills might help to increase exports in Ghana does not have any foundation (Teal 2002). Moreover, the author adds that there is a rent seeking by employees in companies in Ghana, what speaks about salaries which are much higher than the opportunity cost of labor. Along with another argument which says that it is merely the large companies that are able to enter the export market, these two specifics are in line with the analysis of inability to cultivate an effective trade in labor-intensive manufactural sector in Ghana (Teal 2002). A wider range of policies aimed at promoting structural change would be necessary to achieve economic growth in Ghana.

Chapter 5 Conclusion

As it can be seen from the study, aid and growth debate is still alive and creates many disagreements. At the same time, there are historical examples of late-industrialized countries that might serve as a prominent example of aid having positive impact on economic growth. Hence, considering the development strategies of those countries and as well as the specifics of aid provided (with particular reference to donor policy) and trying to follow the well-known route of their growth might help current late-industrializing countries to catch up with affluent economies and assure their long-term economic growth.

On the example of Japan, the research has shown that the country's development strategies was well-prepared and carefully structured to ensure economic growth. Due to the strategy of export-led industrialization the country from a secluded agricultural society has become of the most powerful industrial countries in the world. Even though the ODA that Japan has received after the Second World War (1946-1970) was much less than those received by Sub-Saharan Africa and Ghana (1960-up to date), Japan had necessary level of autonomy that its main donor – USA – provided and used the foreign assistance mainly for industrialization purposes. The country's economic structure has experienced significant changes during the years 1953-1990. Manufacturing was the main developing sector of the economy along with the increasing exports; its share in economy increased considerably – about 36 percent – during less than 20 years (1953-1970). The latter assured Japan's fast inclusion in international trade, provided the country with necessary amount of capital and helped to grow.

In the case of Ghana, however, in spite of continuous ODA inflow – from 1966 to 2014 – there is no any significant changes in economic growth. Moreover, during the history of its development, Ghana, from a 'star pupil' became of the archetypes of sub-Saharan African countries failure. The reason, as we could see from the research, is the development route that the country has chosen starting from the early years of its history. In particular, economic strategy of Ghana did not prioritize the structural changes with particular emphasize to industrialization like we saw in the case of Japan. The country has specifically concentrated on development of services and initially in agriculture (which is currently experiencing decline as well). Even though during the years of providing aid, Ghana has showed some improvements in manufactured production, those enlargements were never accompanied with improved manufactured exports, what, according to our research in Japan, could have been a driving factor for economic growth. Moreover, the slight increase in exports, that the country has experienced during some years, were solely due to the cocoa exports and gold, i.e. agricultural and natural resources exports, which, as we discussed in this paper, are very likely to undermine other sectors of economy and create aid dependency but not assure economic growth. This is what, in reality, happened to Ghana.

To conclude, for the late-industrializing countries, to help their economic growth and assure poverty alleviation, a properly developed industrial policies which would assure structural changes in the economy leading to export-led industrialization are of great importance. Moreover, donors, being interested in growth of the developing countries, must assure that the necessary level of independence is given to developing countries – an autonomy that would allow them make right decisions concerning their development strategies, would let them learn and follow the experiences of late-industrialized countries, such as East Asian 'tigers' and would support in shifting to a more sustainable path with steady and long-term economic growth and improved living standards of people.

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