



Does political stability improve the aid-growth relationship? A panel evidence on selected Sub-Saharan African countries

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ABSTRACT

Significant ambiguity still surrounds the aid-growth relationship despite fifty years of research on the subject. For Sub-Saharan Africa (SSA), a possible reason for the lack of consensus is that until recently the influence of political stability on the aid-growth relationship had been largely ignored despite its relevance for the region. Further, although overlooked by the literature, the Instrumental Variable (IV) technique, the preferred treatment method of endogeneity in aid-growth relationships, may be ineffective in eliminating endogeneity bias because instruments for aid are neither sufficiently exogenous nor strong. Using a dataset of thirty-one SSA countries from 1984-2007, we re-visit the question of whether aid can spur growth in SSA using first-differencing (FD) to eliminate unobserved effect endogeneity while focusing on the role of political stability on the aid-growth relationship. Results suggest aid promotes growth conditional on political stability in SSA and that First Differencing (FD) eliminates a substantial amount of the endogeneity bias. Growth is found to be most sensitive to aid at high levels of political stability. Our results demonstrate the pertinence of a stable political environment to attaining the UN's Millennium Development Goals (MDGs) for SSA countries since these goals inherently assume that aid can promote growth.

Key Words: Growth, Aid, Political Stability, Endogeneity, SSA, and IV

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