



# Foreign Aid And Economic Growth In Nigeria

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**Abstract:** The study examined the causal relationship between foreign aid and economic growth in Nigeria. The study employed granger causality test as estimated technique, the result revealed that there is a unidirectional relationship from gross domestic product to official development assistance in Nigeria, also, there is a unidirectional relationship from real exchange rate to gross domestic product in Nigeria. Furthermore, there is no causal relationship between foreign direct investment and gross domestic product in Nigeria and there is no causal relationship between inflation rate and gross domestic product in Nigeria and concluded that funds should be channeled to good causes, and anti-corruption efforts should be increased. For the benefit of residents, the government should invest more in infrastructure. The government must set the exchange rate and cut money supply to manage inflation.

**Keywords-** Gross Domestic Product (GDP), Official Development Assistance (ODA), Foreign Direct Investment (FDI), Real Effective Exchange Rate (REER) and Inflation Rate (IFR).

## INTRODUCTION

Every country wants a stronger economy (Abate, 2022). Several transport choices may help you get there. There are political and scientific economic growth theories, domestic and foreign capital may boost economic development (Harrod, 1939). Economic progress requires capital; certain conditions must be met for it to operate. Foreign investment is typically the last resort for emerging nations struggling to reduce poverty and strengthen domestic resources. This conversation will examine the merits and downsides of using foreign money to enhance economic growth. For 70 years, international summits have prioritised poverty reduction because assistance and finance from multilateral creditors may help impoverished states prosper. Thus, we must reassess foreign currency's role in recipient countries' economy. Rich countries aid poor nations as a diplomatic tool (McArtur & Werker, 2016). Government execution determines emerging countries' economic prosperity. Developing countries need money to develop. If money is limited, it makes sense to seek aid elsewhere. In economically suffering countries, this is prevalent. Foreign aid may boost developing countries' economies by attracting investment. Chenery and Strout (1966) and other economists agree that foreign aid covers developing countries' currency imbalances and savings. Development theorists say underdeveloped countries need financial resources to strengthen their economies, aid increases savings, which stimulates the economy, according to Ogundipe, Ojeaga, and Ogundipe (2014).

ODA was founded by the UN Charter, agreed at the San Francisco Summit on June 26, 1945. ODA reduces poverty, promotes saving and investment, and improves economic growth in developing countries. Developing countries get international and bilateral help. Donor countries provide "bilateral assistance" (ODA) to developing nations (OECD, 2015). Internal development transactions include debt reduction, administrative expenses, development awareness, and NGOs. Official Development Assistance is typically driven by political considerations rather than a genuine desire to help the receiving country improve its

institutions and infrastructure, according to Ukwueze, Ugwu, and Okafor (2021). Nigeria must immediately analyse the impact of foreign help on its economy due to the urgent need for massive investment. High unemployment, low industrial capacity utilisation, inadequate infrastructure, high poverty rates in a fast-growing population, and economic instability due to global crude oil price variations are reasons for this. Foreign aid is considered as a realistic strategy to help economies. Over time, Nigeria has received the most foreign aid. The government spent 0.89 percent of GNI on development assistance in 1970. According to the World Bank (2020), it contributed 0.87 percent to the country's GDP in 2018. The World Bank estimates that ODA averaged USD2.7 billion from 2012 to 2018 (2019). Strong evidence suggests that the fundamental economic difficulties that triggered aid acceptance are not being resolved despite considerable ODA investments in the economy.

The World Poverty Clock reports that Nigeria has more severe poverty than India in 2018. This number exceeded 105 million in September 2020 and accounts for 51% of Nigeria's population (World Data Lab, 2020). Addressing excessive unemployment and unsustainable crude oil reliance are now economic priorities. Other nations have improved, while Nigeria's socioeconomic status has deteriorated despite massive international help. The Marshall Plan helped Taiwan, South Korea, Japan, Singapore, and Western Europe after World War II. Some of these countries have offered temporary foreign help (O'Connell & Soludo, 2001). Foreign aid has failed in Nigeria owing to its uncertain macroeconomic environment, social and political unrest, and inadequate governance, according to Salisu (2007). Burnside and Dollar (2000) say states with solid institutions gain most from foreign help, while Cooksey (2003) says corruption may diminish its efficacy. This study seeks to fill a vacuum in foreign assistance and economic development literature by examining how institutions might boost Nigerian economic growth. Despite differing views on how foreign assistance will effect the economy, the moderate side has not been adequately investigated. According to Vitola and Senfelde (2015), institutions are norms that govern economic activity. These regulations may be private or government-imposed. Acemoglu et al. (2002) claimed that institutions, not geography, may have brought down several affluent colonial administrations.

Discussions continue on how to establish institutions in emerging countries like Nigeria (Andrews, 2013). Nations with weak institutions struggle to expand and progress quickly (Abubakar, 2020). Countries' production capacities depend on their institutions. Nigeria's government agencies have deteriorated. Since 2000, political stability, regulatory quality, government performance, voice and accountability, and corruption control have declined, according to the World Bank's 2021 report. The majority of emerging nations have experienced this. The Nigerian government established the Public Complaints Commission, Code of Conduct Bureau, and Corrupt Practices Investigation Bureau to improve institutions (Utile, Ijirshar & Sem, 2022). Committees were created to ensure government and industry expenditure was accountable for long-term economic growth. The Nigerian Financial Intelligence Unit, Fiscal Responsibility Commission, and Independent Corrupt Practices Commission are notable entities. Due to institutional flaws and deterioration, studying the influence of institutional quality on Nigerian economic development is vital. This is essential for organisations that are ineffective owing to a lack of political will or legislative backing and must carefully distribute limited funds. Long-term economic growth and development need institutions, according to the literature. Another intangible factor in an institution's success is reputation (Bruinshoofd, 2016). An institutional quality composite score was calculated using six World Bank governance indicators. Nigeria's weakening institutions cause economic uncertainty. A nation's economic development depends on its institutions. However, economists differ on how these two components link (Bruinshoofd, 2016).

This study will examine the main notion that high-quality institutions boost economic development. Research on the apparent effect has been conflicting. Researchers have found negative effects (Ogundipe, Ojeaga, & Ogundipe (2014), Ajide (2014), Tang and Bundhoo (2017), Ishnazarov and Cevik (2017), Duru, Okafor, Eze, and Ebenyi (2020), Ukwueze, Ugwu, and Okafor (2021), Abate (2022), Isiyaku, Zasha, and Suleiman (2022), Ekpe and Abubakar (2020) thinks FDI and local investment may boost or destroy the economy. Farheen (2014) suggests targeting problem areas for aid. However, help to certain nations has distinct purposes and applications. If these nations could aid as they saw fit, development results may improve. In light of the preceding, this study examines the causal relationship between foreign aid and economic growth in Nigeria.

## LITERATURE REVIEW

### Conceptual Literature

#### Foreign Aid

According to Murshed and Khanaum (2013), developing countries need foreign aid to overcome poverty and grow their economies. Aid flows may not always enhance development, but research shows they do. Burnside and Dollar's breakthrough study shows how policy affects international aid. Isiyaku, Zasha, and Suleiman (2022) studied economic policy indicators, foreign aid, and economic success in an interaction term study. After adjusting for fiscal, monetary, and foreign currency considerations, the research found that only strong economic policies gain from foreign aid. Murshed and Khanaum (2013) propose integrating assistance and policy in an ideal policy framework. ODA has historically prioritised economic development. Yiew and Lau (2018) say ODA goes towards social and economic infrastructure, services, and manufacturing, according to Niyonkuru (2016). Social infrastructure that provides water, sanitation, and education strengthens economies. National energy, transportation, and communication networks increase when governments invest in economic infrastructure. Productive sectors including agriculture, forestry, fishing, industry, mining, construction, commerce, and tourism are supported. FDI-friendly nations may grow faster. Morrissey (2001), cited in Yiew and Lau (2018), suggests that ODA may boost economic development in several ways. Official development assistance benefits include higher investments in human and physical resources, improved access to imported capital goods and technology, protection from negative effects on investment and savings rates, and technology transfers that boost capital productivity and technological advancements.

#### Economic Growth

Ekpe & Ogbuabor (2023) say a nation's economic success may be measured by its commodity and service production. Economic growth is measured by GDP, inflation, labour, capital, trade, exchange rate, and employment. The economy thrives when a country can create and distribute commodities and services. GDP grows when a country produces and distributes more products and services. How much a country's residents' purchasing power grows after inflation is its economic development. Statistics use real GDP growth percentages to measure economic success (IMF, 2012). Economic development is typically measured against inflation. It's probable that this change may reduce manufacturing price inflation. National income accounting measures growth. GDP measures economic activity with pros and cons. To quantify economic advancement, countries might compare their GDP/population ratio, or per capita income. The annualised GDP percentage change is the "rate of economic growth" when comparing two points in time. Growth rate measures the average GDP level during a particular time period, not its volatility around this trend. Economic growth—economic policy's main goal—has been extensively studied (Fadare, 2010). Academics question economic growth. Traditional knowledge holds that capital and labour drive economic growth (Khorravi and Karimi, 2010). GDP grows as a country's economy does. This is promising since it suggests the economy can produce more goods and services (Abbas, 2005). An industrial unit's introduction boosts the economy. More commodities and services produced determine economic growth, not manufacturing techniques (Matiti, 2013). Inflation must be included into GDP growth or included to calculate economic growth. Money supply growth is the sole variable used to estimate GDP growth (Ayres & Warr, 2006).

## THEORETICAL REVIEW

### Harrod-Domar Theory

The 1939 Harrod-Domar model and 1946 Domar model explain aid, investment, and GDP growth. According to the Harrod-Domar model, assistance reduces the savings-investment gap in developing nations, encouraging investment. Due to budgetary constraints, most low-income states depend on foreign assistance to develop. Development economics research show that developing nations' lack of money and savings hinders economic progress (Ewubare & Ozigbu, 2019; Rotarou & Ueta 2009; Moreira, 2005). These countries depend on foreign investment to boost economic development. Najeb (2014) asserts that the Harrod-Domar model describes economic development and that investment increases growth. Manufacturing investment shortages limit developing country development. Emerging nation economies are often analysed using the Harrod-Domar model. The World Bank and IMF use it in their development models because it can quantify the monetary resources needed to expand at a specific pace. Foreign aid may help overcome the "finance gap," the difference between investment funds and accessible funds. Economic growth is directly related to foreign aid. Easterly (1999) said that the Harrod-Domar model was the most influential growth model in economic history, despite its focus on U.S. recessions and short-term investment.

According to theory and experience, investment and economic growth and aid and investment are not causally related. 17 of 88 countries surveyed demonstrated a favourable association between aid and

investment (Esterly, 2003). Aid and investment are one-to-one in just six of the seventeen countries. Easterly (2003) found that investment improved one of 138 countries. These data show that corrupt activities, incompetent leadership, and low-quality institutions increase support fungibility. Despite its flaws, the Harrod-Domar model helped explain developing economy dynamics. According to Ewubare and Ozigbu's (2019) Harrod Domar model, aid recipients may impair capital production efficiency. Aid distribution is hampered by politics. Snowden (2009) discovered that support reduces the Incremental Capital Output Ratio (ICOR), which reduces its economic growth benefits. Previous growth theory was by economists Harrod and Domar. Money savings boost the economy, they say. This hypothesis suggests that when a country saves more each year, its standard of life grows. Only when savings rates increase can GDP grow significantly.

## Empirical Review

Tang and Bundhoo (2017) explain how aid impacts SSA's economy. This study examined the top 10 foreign assistance recipients in Sub-Saharan Africa to discover how ODA affects economic development. Ethiopia, DRC, Tanzania, Kenya, Côte d'Ivoire, Mozambique, Nigeria, Ghana, Uganda, and Malawi are covered. Multiple regression analysis shows that assistance does not substantially effect GDP growth. The two most significant economic variables—investment and imports—rose with FDI. The investigated countries seem to get all their investment and import funds from elsewhere. The study found that a country's political, economic, and institutional environment determines its foreign aid eligibility.

Ishnazarov and Cevik (2017) evaluated how ODA affects OIC member states' economic and human growth. They used 2002–2015 data. Human Development Index (HDI) pillars include education, longevity, and quality of life. The sector-specific Official Development Assistance is also examined. The research includes urbanisation, income, civil unrest, FDI, and income. The findings show that Official Development Assistance (ODA) is the most successful and has the greatest influence on human development. Civil upheaval hits the HDI hard, according to study. The findings suggests disproportionate ODA for health and education. It advised soothing popular unrest to attract huge foreign investors.

Saibu and Obioesio (2017) evaluated fiscal efficiency, economic progress, and foreign aid in Nigeria. A 2SLS estimate approach based on an extended Barro-style model was investigated. Foreign aid somewhat boosted economic growth using our fiscal optimality index and other criteria. Previous research have demonstrated that programme effectiveness, policy state, and institution quality all affect how much foreign assistance affects Nigeria's economic progress.

From 1990 to 2017, Ewubare and Ozigbo (2019) evaluated how foreign assistance affected Nigerian human capital development. Research used the Phillips-Perron unit root test and ARDL model to estimate results. Late t-values were discovered. Official Development Assistance boosts education funding significantly. Delays in implementing and finishing the comprehensive grant plan reduce future government education investment. Statistics show a favourable correlation between education spending, technological cooperation awards, and ODA. Technical cooperation funds and Official Development Assistance (ODA) have raised state education spending by 4.289 percent and 0.829 percent, respectively. Future public healthcare spending is closely associated with current ODA. Public healthcare expenditure grows 1.099 percent for every percent increase in ODA. Public healthcare expenditure rises 3.19% disproportionately for every 1% increase in ODA. Fourth Sustainable Development Goal promotes lifelong learning and equitable education for everyone. To attain this goal, donor governments and NGOs must emphasise education aid.

Abubakar (2020) examined Nigeria's GDP growth and institutional quality from 1979 to 2018. Research evaluated this relationship using good governance and contract-intensive money. The study used OLS and Johansen Cointegration for estimation. Quality institutions, particularly those involving contracts and money, boost economic growth statistically. Though statistically insignificant, the effective governance index boosts the economy. FDI and domestic investment have statistically significant positive and negative effects on economic growth. A third of the time, the model approaches long-term equilibrium. The findings show that Nigeria's public and private sectors require top-notch institutions to administer them properly, boosting the economy and development.

Duru, Okafor, Eze, and Ebenyi (2020) examined Nigeria's economic development and foreign aid from 1984 to 2017. Autoregressive distributed lag (ARDL) was used to estimate this study. Data shows foreign financial aid did not boost Nigeria's economy. A poor macroeconomic policy environment slowed growth in the short and long run. Nigeria's macroeconomic policy framework affected foreign aid's economic effect. Help goes far in Nigeria, depending on policies. A reliable macroeconomic policy framework should encourage domestic savings and enable effective foreign aid usage without government staff.

Hassan (2021) used 1984–2018 data to assess how institutional quality affects Nigeria's recipient nations' financial aid and GDP growth. The study estimated data using Johansen and canonical cointegration regression. The data suggest that foreign assistance may increase economic development, but its impact relies

on institution quality. The research suggests that Nigeria's fiscal authorities assess the institutional system for accepting, distributing, and employing foreign aid due to widespread corruption and misallocation of funds.

To determine how institutional quality affects Nigeria's foreign assistance from 1980 to 2016, Ukwueze, Ugwu, and Okafor (2021) examined data. Research estimates were made using the ARDL model. Institutional quality did not effect Nigeria's foreign aid, save for the statistically significant "independence of judiciary" category. A quick look shows that the long-term discrepancy is reduced by 25% in the next quarter and that practically all variables statistically affect multilateral aid. Therefore, donor organisations should recognise that political dynamics, geography, and colonial history impact official development assistance.

Regional economic policies influenced education and health from 1980 to 2017, according to Iwegbu and Dauda (2022). We investigated if and how foreign aid may alleviate African poverty. Study employed panel DOLS (dynamic ordinary least squares) estimation. Fiscal measures that favour education and foreign assistance raise incomes, except in Central Africa. Central and western areas consumed more. Effective health foreign aid fiscal policy boosts household income in West and Central Africa and consumption in Western and Southern regions. West and Central Africa, excluding the Central Region, reduces poverty via effective health and education fiscal policies and foreign aid. All regions except Central Africa showed income increases when government investment on education and foreign aid rose. Healthcare and foreign assistance boost East and West African economies. If foreign aid is to help Africa develop, health and education expenditures must increase, which requires greater family income.

The impacts of over-aid on developing countries' economy were investigated by Abate (2022). They examined aid and economic progress, concentrating on economic freedom and institutional honesty. From 2002 to 2019, the research was done. Panel data analysis in this work used System Generalised Method of Moments estimation. Growth and foreign assistance form an inverted U. Ideal foreign aid to GNI ratio is 9.7%. Dynamic panel threshold regression study demonstrated a negative relationship between aid and economic growth for economic freedom indices below 60.521 and institutional quality scores below -0.614. Assistance may enhance economic progress at particular stages. Economic freedom and institutional quality effect help and development. Developing nations should not rely only on donors. They must update their institutions and gain economic independence to maximise help.

Isiyaku, Zasha, and Suleiman (2022) analysed Nigeria's GDP growth and foreign aid between 1999 and 2021. Study analyses used conceptual frameworks and dependency theory. The data shows that foreign assistance has not boosted Nigeria's economy. Foreign help will be more effective if politicians take economic measures.

From 1996Q1 to 2019Q1, Ekpe and Ogbuabor (2023) evaluated how foreign debt and institutional quality affected the Nigerian economy. We estimated research using the ARDL model. Minor evidence suggests that foreign debt hurts economic performance in the short and long run. Economic productivity temporarily increases by lowering corruption. The economy is unaffected by government efficiency. Preventing corruption has a tiny but favourable influence on economic performance and foreign debt in the long run, despite short-term negative effects. This paper outlines a strategy to properly utilise foreign loans.

Stanislav, Mansoor, Karel, and Kamal (2024) examined Nigeria's 1980–2019 economic and governmental development aid. Granger causality was estimated using the autoregressive distributed lag (ARDL) model. Formal development assistance like foreign aid or loan extensions does not improve the Nigerian economy, the research found. This hinders its development. A research found that workers are crucial to Nigeria's economy today and in the future. Foreign assistance and gross capital creation hinder economic growth. The research found no association between official development aid and Nigerian GDP growth. SME financing and support should focus on local capital generation. This research examines the long-term consequences of government development assistance on Nigeria's economy using ARDL bounds testing, making it stand apart. Results put doubt on long-held ideas and illuminate aid's role in Nigeria's economic development,

**RESEARCH METHOD**

The study adopts a model that is built based on the modification of the model used by Ewubare and Ozigbo (2019) which is stated below as;

$$GDP = f(ODA, FDI, INFR, REER) \dots\dots\dots 3.1$$

This model can, for simplicity, be stated in the econometric form of equation as depicted below:

$$GDP = \beta_0 + \beta_1 ODA + \beta_2 FDI + \beta_3 INFR + \beta_4 REER + \mu \dots\dots\dots 3.2$$

Where;

- f = functional notation
- GDP = gross domestic product
- ODA = Official Development Assistance
- FDI = Foreign Direct Investment
- INFR = Inflation Rate
- REER = Real Effective Exchange Rate
- μ = Error term
- β<sub>0</sub> = Constant Parameter
- β<sub>1</sub>-β<sub>5</sub> = Coefficients of Regression

**Data Analysis and Interpretation**

The study examined how institutional quality and foreign assistance influenced Nigeria's economy from 1986 to 2022. The examined independent-dependent relationships using paired Granger causality. GDP indirectly measured economic growth. Official Development Assistance, Gross Fixed Capital Formation, Real Effective Exchange Rate, and Inflation Rate explained it. The study findings are examined and explained here.

**Data Presentation**

Data from 1986 to 2022 was used to assess and display the study's findings in the table below. There was raw and log-linearized data.

**Granger Causality**

**Granger Causality Result**

Causality Results	Obs	F-Statistic	Prob.
LNODA does not Granger Cause LNGDP	35	0.13030	0.8783
LNGDP does not Granger Cause LNODA		4.13189	0.0260
LNFDI does not Granger Cause LNGDP	34	2.16721	0.1327
LNGDP does not Granger Cause LNFDI		0.32857	0.7226
LNREER does not Granger Cause LNGDP	35	4.47537	0.0199
LNGDP does not Granger Cause LNREER		2.07678	0.1430
LNIFR does not Granger Cause LNGDP	35	2.54889	0.0950
LNGDP does not Granger Cause LNIFR		3.18952	0.0555
LNFDI does not Granger Cause LNODA	34	0.02044	0.9798
LNODA does not Granger Cause LNFDI		0.14094	0.8691
LNREER does not Granger Cause LNODA	35	0.11024	0.8960
LNODA does not Granger Cause LNREER		0.25983	0.7729
LNIFR does not Granger Cause LNODA	35	2.03443	0.1484
LNODA does not Granger Cause LNIFR		4.64388	0.0175

LNREER does not Granger Cause

LNFDI	34	1.77038	0.1882
LNFDI does not Granger Cause LNREER		0.13453	0.8747
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LNIFR does not Granger Cause LNFDI	34	5.27480	0.0111
LNFDI does not Granger Cause LNIFR		0.29938	0.7435
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LNIFR does not Granger Cause			
LNREER	35	2.87312	0.0722
LNREER does not Granger Cause LNIFR		2.15018	0.1341

**Source: Eviews 10 (2025)**

Empirical study examined causal relationship between foreign aid and economic growth in Nigeria. Results are in the table. Foreign aid, and GDP were linked in this study. Results revealed that there is a unidirectional relationship from gross domestic product to official development assistance in Nigeria, also, there is a unidirectional relationship from real exchange rate to gross domestic product in Nigeria. Furthermore, there is no causal relationship between foreign direct investment and gross domestic product in Nigeria and there is no causal relationship between inflation rate and gross domestic product in Nigeria.

### SUMMARY OF THE RESEARCH FINDINGS

The Nigerian research focused on causal relationship between foreign aid and economic growth in Nigeria. Study used paired Granger causality as estimated technique. There is a unidirectional relationship from gross domestic product to official development assistance in Nigeria, also, there is a unidirectional relationship from real exchange rate to gross domestic product in Nigeria. Furthermore, there is no causal relationship between foreign direct investment and gross domestic product in Nigeria and there is no causal relationship between inflation rate and gross domestic product in Nigeria.

### CONCLUSION AND RECOMMENDATIONS

The study examined causal relationship between foreign aid and economic growth in Nigeria from 1986 to 2022. The employed pairwise Granger causality analysis to examine variable correlations. There is a unidirectional relationship from gross domestic product to official development assistance in Nigeria, also, there is a unidirectional relationship from real exchange rate to gross domestic product in Nigeria. Furthermore, there is no causal relationship between foreign direct investment and gross domestic product in Nigeria and there is no causal relationship between inflation rate and gross domestic product in Nigeria. Funds should be channeled to good causes, and anti-corruption efforts should be increased. For the benefit of residents, the government should invest more in infrastructure. The government must set the exchange rate and cut money supply to manage inflation.

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