

International Aid and the Pursuit of Peace: A Quantitative Analysis

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Rananjan Banerjee

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Abstract

This thesis investigates the complex and often contested relationship between foreign aid and peace, focusing on how aid flows influence peace outcomes across countries and under varying governance and conflict conditions. Using a balanced panel dataset of 99 countries from 2008 to 2022, the study employs fixed-effects regression models to estimate the impact of net official development assistance (ODA) per capita on the Global Peace Index (GPI), a multidimensional measure of peace. While the results show limited evidence that aid alone consistently improves peace, the analysis finds that the effect of aid is strongly conditioned by the quality of governance. Specifically, aid is significantly more effective in promoting peace when delivered in countries with high levels of government effectiveness. Contrary to common assumptions, the presence of ongoing conflict does not significantly moderate this relationship. These findings contribute to the literature by highlighting the conditional nature of aid's effectiveness and emphasizing that institutional context not merely conflict status is a critical determinant of whether aid contributes to peace. The thesis concludes with policy recommendations advocating for more targeted, governance-sensitive aid strategies and calls for further research into the political economy of aid allocation and peacebuilding.

Keywords: foreign aid, peacebuilding, Global Peace Index, governance, conflict, panel data, international development.

1. Introduction

Foreign aid has long been regarded as a vital instrument for promoting peace and development, particularly in fragile and conflict-affected states. Since the end of the Cold War, aid has increasingly been framed not just as a developmental tool but as a strategic mechanism to stabilize regions experiencing political violence and state failure. According to the OECD, global Official Development Assistance (ODA) reached \$211 billion in 2022, marking one of the highest levels ever recorded. A substantial portion of this funding was directed toward fragile and conflict-affected contexts, including Syria, Afghanistan, South Sudan, and the Democratic Republic of Congo. Donor countries and multilateral agencies often justify such spending by invoking the notion of a “peace dividend” the idea that financial assistance can mitigate conflict drivers, strengthen state institutions, and facilitate long-term stability. Yet, these assumptions are increasingly being questioned in light of persistent violence and instability in many aid-receiving countries. As of 2023, more than 110 armed conflicts were active globally, with some of the most protracted occurring in countries that have received significant aid flows over decades. For example, the Democratic Republic of Congo has received over \$27 billion in aid since 2000, yet continues to rank among the least peaceful countries in the world according to the Global Peace Index. Similarly, Afghanistan, which was the top recipient of U.S. foreign aid for nearly two decades, fell back into Taliban control in 2021 despite receiving more than \$145 billion in U.S. reconstruction and development assistance. These examples raise a critical question: is foreign aid truly contributing to peace, or is it failing to address the deeper structural causes of conflict?

The question of whether foreign aid promotes peace is not just academic, it is deeply consequential for global policy and security. In 2022, the United Nations Peacebuilding Fund disbursed over \$195 million to support peacebuilding initiatives in conflict-prone areas, while the World Bank allocated over \$30 billion through its International Development Association (IDA) specifically targeting fragile and conflict-affected states. These figures reflect a growing international consensus that sustainable peace requires both political negotiation and robust financial support. However, despite these investments, progress remains uneven. According to the 2023 Global Peace Index, produced by the Institute for Economics and Peace (IEP), global peacefulness has deteriorated for 13 of the past 15 years. Over 75 countries saw a decline in their peace scores in 2023, many of which are significant recipients of foreign aid. These trends highlight a disconnect between aid flows and peace outcomes, raising concerns about the effectiveness and strategic orientation of international assistance programs. If foreign aid fails to reduce violence or, worse, fuels instability, then donor strategies must be urgently reassessed. Understanding the actual impact of aid on peace is therefore vital, not only for academic inquiry but also for crafting more effective and ethical foreign policy.

While the global aid industry is vast, comprising thousands of agencies, donors, and implementing partners, the literature assessing its role in peacebuilding remains surprisingly limited and often inconclusive. A significant portion of empirical studies focus on the link between aid and development outcomes, such as GDP growth, health, or education. For example, between 2000 and 2020, foreign aid contributed to a 20% increase in primary school enrolment across low-income countries and helped reduce global child mortality by over 50%. However, when it comes to conflict reduction or peace promotion, the evidence is far more

ambiguous. Studies like those by Collier and Hoeffler (2002) offer some optimism, showing that aid can reduce the probability of civil war recurrence when properly allocated in post-conflict contexts. Yet others, such as Grossman (1992) and de Ree & Nillesen (2009), report that aid can either exacerbate conflict by providing economic rents to rival factions or produce no statistically significant effect on peace outcomes. A recent meta-analysis of aid effectiveness studies by the Center for Global Development found that less than 10% of studies include peace or conflict as a primary outcome variable, illustrating how underexplored this area remains. The literature is also divided on whether governance mediates the relationship between aid and peace. While some scholars argue that aid is only effective in countries with strong institutions, others claim that even well-governed aid often fails in the face of complex conflict dynamics. This lack of consensus suggests the need for more context-sensitive, data-driven research that incorporates governance and conflict conditions into the aid–peace equation, an approach this thesis undertakes.

2. LITERATURE REVIEW

One of the earliest and most persistent debates in development and peace studies is whether foreign aid reduces conflict and promotes peace in recipient countries. Scholars have long sought to quantify and explain this relationship, yet empirical findings remain deeply divided. Some argue that aid can stabilize societies emerging from civil war by supporting reconstruction, infrastructure, and basic governance. Others contend that aid may prolong or even exacerbate violence, especially when misallocated or poorly managed. A seminal contribution to the optimistic view is that of Collier and Hoeffler (2002), who examined the economic causes of civil wars and found that aid, when properly allocated and monitored, can reduce the risk of conflict recurrence. Their findings suggest that post-conflict countries receiving sustained aid flows tend to achieve a "peace dividend", a period of stability during which investments in state capacity, social services, and infrastructure help to prevent a relapse into violence. In their framework, aid is seen not only as a developmental resource but also as a strategic peacebuilding tool. This view has since influenced numerous donor strategies, particularly in post-war contexts like Rwanda, Liberia, and Sierra Leone. However, the idea that aid is always beneficial has been challenged by scholars like Grossman (1992), who provides a more cynical view. Grossman argues that in weak states or regions with fragmented authority, aid can become a resource to be captured by armed groups or corrupt elites. Instead of fostering peace, aid may inadvertently fuel the political economy of war by increasing the stakes of control and deepening grievances. This "resource curse" logic suggests that external assistance, if unaccompanied by institutional safeguards, may incentivize violence rather than mitigate it. Further complicating the picture are studies like that of de Ree and Nillesen (2009), which find no significant relationship between foreign aid and conflict recurrence in post-conflict settings. Using panel data from a sample of post-conflict countries, their analysis suggests that aid does not consistently reduce the probability of returning to war. This finding points to the heterogeneity of aid impacts and challenges the assumption that financial assistance automatically contributes to peace. Adding another dimension, Findley, Powell, and Strand (2011) argue that the type and targeting of aid are more consequential than the total amount disbursed. In their view, humanitarian aid, governance assistance, and peacebuilding funds each interact differently with local contexts. For example, aid targeting education or health may have indirect long-term effects on peace by improving societal well-being, while

aid directed to the security sector may have immediate but volatile consequences depending on how it is used. Their work emphasizes the importance of understanding not just how much aid is given, but how and where it is directed.

While foreign aid is often expected to catalyse development and peace, an increasing body of literature suggests that the quality of governance in recipient countries plays a pivotal role in determining aid effectiveness. Governance encompasses the institutional capacity of the state, the integrity of public administration, and the rule of law. Without capable institutions to manage aid transparently and strategically, even generous aid packages may fail to achieve their intended outcomes or worse, become counterproductive. A foundational study in this regard is that of Burnside and Dollar (2000), who conducted a cross-country empirical analysis and found that foreign aid has a positive impact on economic growth, but only in countries with sound fiscal, monetary, and trade policies. Their work introduced the influential idea that aid works “in a good policy environment.” Though focused primarily on economic outcomes, this insight has been widely extrapolated to other domains including peace and security on the assumption that governance quality mediates all forms of external intervention. According to this logic, aid can only be effective in promoting peace if the recipient government is capable, credible, and responsive to its citizens. However, this “conditionality thesis” has not gone unchallenged. Easterly, Levine, and Roodman (2004) re-examined the Burnside and Dollar data and critiqued their methodology. They argued that the finding that aid works only in good policy environments is not robust across model specifications or time periods. Their analysis reveals that when different samples and instruments are used, the aid-policy interaction becomes statistically insignificant. This undermines the claim that governance quality consistently conditions aid effectiveness and suggests that the empirical relationship may be more fragile than originally thought. Despite this critique, other scholars have continued to emphasize the centrality of institutions. Svensson (1999), for instance, argues that the political and institutional context in which aid is received determines whether it supports genuine development or is siphoned off into rent-seeking and corruption. His game-theoretic model illustrates how weak institutional accountability leads to aid diversion, while strong institutions create incentives for proper use. Svensson’s work implies that the effectiveness of aid in achieving peace outcomes such as conflict reduction or improved social cohesion cannot be separated from the institutional characteristics of the recipient state.

More recently, studies have shifted focus toward governance indicators such as government effectiveness, control of corruption, regulatory quality, and political stability to better measure the enabling environment for aid. These indicators, developed by the World Bank and other organizations, allow researchers to quantify the institutional context and test interaction effects. For instance, it is hypothesized that foreign aid contributes more positively to peace in countries with high scores on government effectiveness, because aid in these settings is more likely to be strategically allocated, transparently managed, and aligned with peacebuilding goals. The implication of this literature is significant: aid outcomes are not just about money they are about mechanisms. Aid must pass through domestic political and administrative systems, and its ultimate effect depends on the integrity and capability of those systems. Poor governance may result in aid capture, misuse, or misalignment with peacebuilding priorities. In contrast, strong governance can act as a multiplier, enhancing aid’s potential to address grievances, provide public goods, and promote institutional legitimacy. In summary, while there is debate over the

exact magnitude and consistency of the governance–aid interaction, most scholars agree that governance quality is at least a moderating factor.

While much of the empirical literature focuses on aid's effectiveness in promoting development or peace under certain domestic conditions, a growing strand of research takes a more critical view, interrogating the underlying political and strategic motivations of aid itself. This body of work questions the assumption that aid is purely altruistic or that it is always designed with the recipient country's best interests in mind. Instead, it emphasizes that foreign aid is often a tool of foreign policy, shaped as much by donor goals as by recipient needs. One of the key criticisms comes from the work of Dreher et al. (2023), who argue that donor countries frequently allocate aid based on geopolitical, economic, or strategic interests rather than on humanitarian or peacebuilding needs. This “donor-centric” logic challenges the foundational premise of much of the aid literature that foreign assistance is primarily intended to reduce poverty or conflict. For example, countries may channel aid to allies in military coalitions, former colonies, or regions of strategic importance, even if those recipients have poor governance records or are unlikely to use aid effectively. As such, aid may reinforce existing power structures, bolster authoritarian regimes, or entrench elite control, thereby undermining both peace and accountability. Further, critical scholars have raised concerns about the institutional architecture of the aid system itself. The global aid industry composed of multilateral institutions, bilateral donors, international NGOs, and private contractors is often criticized for being fragmented, competitive, and more accountable to donor constituencies than to the populations it seeks to assist. This can result in misaligned incentives, where aid agencies prioritize visibility, short-term outputs, or donor branding over long-term structural change. In fragile states, where local institutions are already weak or contested, such dynamics can exacerbate tensions, foster dependency, or displace local ownership of peace processes. Another recent contribution is by Amin and Djiofack (2024), who explore how the presence of conflict influences the effect of aid on inequality. Their findings suggest that in unstable regions, foreign aid does not necessarily reduce inequality and may in some cases widen it. They argue that in conflict-affected environments, aid often fails to reach marginalized groups and can instead concentrate in the hands of those who are already politically or militarily powerful. This selective distribution can fuel perceptions of injustice or favouritism, potentially intensifying underlying grievances. In this view, the impact of aid is not only shaped by technical design or governance quality, but also by power relations and the dynamics of inclusion and exclusion. Additionally, these critical perspectives shed light on the symbolic function of aid, which may serve as a tool for international legitimacy rather than substantive transformation. For instance, donor countries may provide aid to demonstrate global leadership, manage international reputations, or maintain influence in multilateral institutions. In such cases, the allocation of aid becomes less about its developmental or peacebuilding impact and more about its value in the global political economy. As a result, the effectiveness of aid becomes secondary to its function as a diplomatic or economic instrument.

Taken together, these critiques suggest that foreign aid is not a neutral or technocratic input but a politically laden instrument that interacts with both global and local power structures. This perspective urges scholars and policymakers to be cautious about making blanket claims about aid's impact and to interrogate the broader political context in which aid operates. For research on aid and peace, this means recognizing that aid flows may sometimes be part of the problem

rather than the solution, especially when they are designed or delivered without sufficient attention to conflict sensitivity, equity, and accountability.

In the context of this thesis, these insights are crucial. They provide a necessary counterbalance to more optimistic or econometric approaches, reminding us that aid is embedded in a complex web of interests and institutions. This calls for empirical models that not only quantify relationships but also interpret them in light of these underlying power dynamics—a task taken up in the sections that follow.

3. Data & Variables

3.1 Overview of the Dataset

This study employs a balanced panel dataset of 99 countries over the 15-year period from 2008 to 2022, designed to investigate the relationship between foreign aid and peace outcomes in a rigorous and systematic manner. The sample includes countries from diverse geopolitical contexts and varying levels of aid dependency, governance quality, and conflict exposure. These countries were selected based on data availability across all key variables particularly those related to peace outcomes, aid inflows, and governance indicators. The dataset balances breadth and comparability, providing both cross-sectional and temporal variation suitable for fixed-effects panel regression analysis.

The dependent variable, peace is measured using the Global Peace Index (GPI), produced annually by the Institute for Economics and Peace (IEP). Explanatory variables include net Official Development Assistance (ODA) per capita, sourced from the World Bank's World Development Indicators (WDI) and OECD databases, and Government Effectiveness, from the Worldwide Governance Indicators (WGI). Control variables include GDP per capita, youth population (15 to 24 as % of total population), and a state-based conflict dummy, with conflict data taken from the Uppsala Conflict Data Program (UCDP). A distinguishing feature of this study is the use of net ODA per capita rather than total aid volumes. This approach adjusts for population size, allowing for a more accurate cross-country comparison of aid intensity. Aid values are expressed in constant 2021 USD and are log-transformed to normalize the data and capture diminishing marginal returns. Similarly, the study focuses on the youth demographic aged 15 to 24, a group often associated with increased political volatility, especially in fragile states. Expressing this group as a percentage of the total population enables the model to control for demographic pressures that may influence peace outcomes. To ensure empirical reliability, missing data points were treated using listwise deletion, resulting in a final dataset of over 1,300 valid country-year observations. Robustness checks confirm that the final panel retains sufficient variation across all variables of interest. By integrating data from multiple authoritative sources and applying consistent lag structures (e.g., one-year lags for ODA and GDP), this dataset provides a strong foundation for identifying potential causal relationships between foreign aid and peace, and the conditions that moderate them.

3.2 Dependent Variable: Global Peace Index (GPI)

The Global Peace Index is the primary measure of peace outcomes used in this study. Developed by the Institute for Economics and Peace, the GPI is a composite index that evaluates 163 countries, representing over 99.7% of the global population. It ranks countries annually on a scale where a higher score indicates lower levels of peace, using a wide range of indicators grouped into three key domains:

1. Societal Safety and Security

This dimension assesses levels of domestic conflict, crime, political instability, and terrorism. It includes metrics such as, homicide rates, level of perceived criminality, number of refugees and internally displaced persons (IDPs), political terror scale.

2. Ongoing Domestic and International Conflict

This category captures the intensity and duration of internal and external conflicts, based on number of conflict-related deaths, duration and frequency of conflicts, impact of terrorism and war-related events

3. Militarization

This dimension evaluates the extent to which a country prioritizes military expenditure over social needs based on military spending as a percentage of GDP, size of armed forces relative to population, weapons imports and exports.

Each indicator is scored on a scale of 1 to 5, weighted according to relevance, and aggregated into a single GPI score. The average global GPI score in 2023 was 2.07, reflecting a steady decline in peacefulness globally over the past decade. Countries like Iceland, New Zealand, and Ireland consistently rank among the most peaceful, while countries such as Syria, South Sudan, and Afghanistan are among the least peaceful.

Using GPI as a dependent variable offers a comprehensive measure of peace, encompassing not just the absence of war but also broader elements of human security and state stability. Unlike binary conflict indicators, GPI captures gradations of peace, making it well-suited for assessing the subtle effects of aid and governance over time.

3.3 Main Independent Variables

To investigate the relationship between foreign aid and peace, the central independent variable in this study is net Official Development Assistance (ODA) per capita, lagged by one year. This variable captures the inflation-adjusted, donor-provided net aid amount, divided by the total population of the recipient country in a given year. Using per capita aid rather than total aid offers several advantages: it accounts for country size, avoids skewness caused by large-population recipients, and aligns more closely with the distributive potential of aid within society. The per capita aid values are measured in constant 2021 U.S. dollars, obtained from the World Bank's World Development Indicators (WDI). They are then log-transformed to reduce skewness, normalize extreme values, and model diminishing returns, consistent with standard econometric practice. The use of a one-year lag reflects the practical reality that aid impacts on institutional change, social stability, or peace are not immediate, but are likely to emerge with some delay. The log-transformed, lagged ODA per capita variable thus serves as the core explanatory input for understanding aid's contribution to peace.

A second key independent variable is Government Effectiveness (GE), drawn from the World Bank's Worldwide Governance Indicators (WGI). GE reflects perceptions of the quality of public services, the competence of civil servants, the independence of the bureaucracy from political pressures, and the credibility of government commitments. Scores range from -2.5 (lowest effectiveness) to +2.5 (highest effectiveness). Government effectiveness is included in the model to test whether aid works better in countries with stronger institutions, a hypothesis widely suggested in the aid effectiveness literature.

To assess whether the effect of aid is conditional on governance, this study also includes an interaction term: $\log(\text{ODA per capita}) \times \text{Government Effectiveness}$. This interaction captures whether the impact of aid on peace outcomes is amplified or diminished depending on the institutional quality of the recipient country. Theoretically, a significant positive interaction would suggest that aid is more likely to promote peace in countries with strong governance supporting the view that institutions act as filters through which aid must flow.

3.4. Control Variables

To isolate the effect of aid on peace, several control variables are included to account for potential confounders, such as, **Log of GDP (lagged one year)**: Economic strength is widely considered a determinant of peace. Countries with higher income levels may have more resources to invest in security, public services, and conflict prevention. Lagging GDP helps reduce simultaneity bias, ensuring that short-term peace outcomes do not influence current GDP levels. **Youth Population (% aged 15–24)**: This variable measures the proportion of the total population that falls within the 15 to 24 age group. High youth bulges are often associated with increased political volatility, especially when combined with unemployment, limited educational opportunities, and social exclusion. Studies have linked large youth cohorts to heightened risks of civil unrest, radicalization, and rebellion. The data is sourced from the UN Population Division, and is included as a percentage of total population. **Conflict Dummy (State-based Violence)**: This binary variable takes the value 1 if the country experienced a state-based armed conflict in the given year, and 0 otherwise. Data is drawn from the Uppsala Conflict Data Program (UCDP). Including this variable controls for the baseline presence of conflict, preventing misattribution of violence trends to aid or economic factors.

These control variables are essential for ensuring that observed relationships between aid and peace are not spurious. They also provide a richer understanding of the structural conditions under which peace is either sustained or undermined.

4. METHODOLOGY AND EMPIRICAL STRATEGY

This section outlines the methodological framework employed to evaluate the relationship between foreign aid and peace. It provides a detailed explanation of the econometric strategy, variable operationalization, model specification, estimation procedures, and robustness checks. The overall aim is to build a rigorous, internally consistent analytical approach that can isolate the impact of aid on peace while accounting for important contextual factors like governance quality and the presence of conflict. Given the longitudinal nature of the data covering 99 countries across 15 years (2008 to 2022) this study uses a panel data regression framework

with fixed effects. This choice is guided by both empirical and theoretical considerations. Fixed-effects models allow for control over unobserved time-invariant country-specific characteristics that could otherwise bias the relationship between aid and peace. Such characteristics may include colonial history, geographical size, ethnolinguistic diversity, or entrenched institutional structures. By using fixed effects, the model captures the variation within countries over time, rather than relying solely on cross-sectional differences that may reflect historical or structural endowments rather than policy impacts. Additionally, year fixed effects are included to absorb the influence of global shocks or temporal trends, such as global financial crises, shifts in the international aid architecture, pandemics, or worldwide conflict waves. These year dummies ensure that macro-level events do not contaminate the estimated effects of foreign aid and governance on peace within individual countries. The dependent variable in all models is the Global Peace Index (GPI), a composite measure published by the Institute for Economics and Peace. The GPI reflects a country's level of peace across three domains: societal safety and security, ongoing domestic and international conflict, and militarization. A higher GPI score corresponds to lower levels of peace, making a negative coefficient on any predictor indicative of peace improvement.

The primary independent variable is log-transformed net ODA per capita, lagged by one year. This captures the intensity of foreign aid relative to population size and allows for a more equitable comparison across countries with vastly different populations. The one-year lag structure is designed to reflect the delayed impact of aid, which typically requires time to translate into programmatic interventions and social or institutional changes. A log transformation is applied to smooth out extreme values and account for diminishing marginal returns to aid. The baseline control variables include, 1. Log of GDP per capita (lagged): a proxy for economic strength and state capacity. 2. Youth population (15 to 24 years) as a percentage of the total population: included to capture demographic pressure, often associated with political instability and unrest. 3. Conflict dummy: a binary variable indicating whether the country experienced state-based armed conflict in the given year, derived from the UCDP dataset.

Three models are estimated to evaluate different dimensions of the aid–peace relationship.

Model 1: Direct Effect of Foreign Aid on Peace

The first model estimates the direct impact of foreign aid on peace outcomes, without considering potential moderating variables like governance or conflict. It serves as the baseline specification and is represented as,

$$GPI_{i,t} = B_0 + B_1 \times \log(ODA \text{ per capita}_{i,t-1}) + B_2 \times \log(GDP_{i,t-1}) + B_3 \times GE_{i,t} \\ + B_4 \times Youth_{i,t} + a_i + \lambda_t + e_{i,t}$$

Here, $GPI_{i,t}$ is the Global Peace Index score for country I in year t, where higher values represent lower levels of peace. $\log(ODA \text{ per capita}_{i,t-1})$ is the log-transformed net Official Development Assistance per capita, lagged by one year to reflect delayed effects. $\log(GDP_{i,t-1})$ is the lagged economic development indicator, representing a country's economic strength. $Youth_{i,t}$ is the percentage of the population aged 15–24, which reflects demographic pressure often linked to instability. a_i are country fixed effects that absorb time-invariant factors like geography, colonial history, or political system. λ_t are year fixed effects, which control for

shocks or global trends (e.g., financial crises, pandemics) that affect all countries. $e_{i,t}$ is the idiosyncratic error term.

In this specification, B_1 is the main coefficient of interest, capturing the average within-country effect of aid on peace. A negative value of B_1 would suggest that higher aid per capita is associated with lower GPI scores (i.e., more peace), while a positive value would suggest a worsening of peace outcomes.

Model 2: Conditional Effect — Governance as a Moderator

Model 2 builds on the first specification by considering Government Effectiveness (GE) as both an independent variable and as part of an interaction term with foreign aid. This model explicitly tests whether the effectiveness of aid depends on the quality of governance in the recipient country:

$$\begin{aligned} GPI_{i,t} = & B_0 + B_1 \times \log(ODA \text{ per capita}_{i,t-1}) + B_2 \times GE_{i,t} \\ & + B_3 \times (\log(ODA \text{ per capita}_{i,t-1}) \times GE_{i,t}) + B_4 \times \log(GDP_{i,t-1}) \\ & + B_5 \times Youth_{i,t} + a_i + \lambda_t + e_{i,t} \end{aligned}$$

Government Effectiveness is taken from the World Bank's Worldwide Governance Indicators and ranges from -2.5 (weakest governance) to $+2.5$ (strongest governance). Including it in the model allows for two levels of interpretation, B_2 captures the direct effect of government effectiveness on peace, holding aid constant. A negative coefficient would suggest that stronger governance contributes directly to lower GPI (greater peace). Whereas, B_3 is the coefficient on the interaction term, which measures whether the effect of aid on peace varies depending on governance quality.

The interaction term is critical: it tests the theoretical claim that aid is more effective in countries with strong institutions. For instance, if B_1 is small or insignificant but B_3 is negative and significant, it implies that aid alone does little, but when delivered in well-governed environments, it can significantly improve peace outcomes.

The inclusion of the interaction term changes the interpretation of the model. The marginal effect of aid on peace is no longer constant, it depends on the value of GE:

$$\frac{\partial GPI}{\partial \log(ODA)} = B_1 + B_3 \cdot GE$$

This means that the effect of aid is amplified or dampened depending on how effective the government is. Such a model offers deeper insight into why aid may work in some countries and fail in others.

Model 3: Conditional Effect — Conflict as a Moderator

The third model adds an additional layer of context by testing whether the presence of conflict itself modifies the effect of aid. A dummy variable for state-based armed conflict is introduced along with its interaction with foreign aid:

$$\begin{aligned}
GPI_{i,t} = & B_0 + B_1 \times \log(ODA \text{ per capita}_{i,t-1}) + B_2 \times Conflict \text{ Dummy}_{i,t} \\
& + B_3 \times (\log(ODA \text{ per capita}_{i,t-1}) \times Conflict \text{ Dummy}_{i,t}) + B_4 \times GE_{i,t} \\
& + B_5 \times Youth_{i,t} + B_6 \times \log(GDP_{i,t-1}) + a_i + \lambda_t + e_{i,t}
\end{aligned}$$

The Conflict Dummy takes the value 1 if the country is experiencing ongoing state-based conflict during year t , and 0 otherwise. B_2 captures the average difference in peace levels between conflict and non-conflict countries, controlling for other variables. B_3 reflects how the effect of aid on peace changes in conflict settings compared to non-conflict settings. This model tests an important hypothesis in conflict and development literature: is aid still effective—or even appropriate—when countries are experiencing active conflict? If B_3 is not significantly different from zero, it implies that aid performs similarly in both conflict and non-conflict settings. If it is significant and negative, it indicates that aid has greater peace-promoting potential in the presence of conflict, possibly by stabilizing fragile contexts. A significant positive coefficient could imply that aid is being misused or is ineffective in violent settings, possibly due to elite capture or logistical breakdowns.

All models are estimated using robust standard errors clustered at the country level, to correct for heteroskedasticity and serial correlation within panels. The Modified Wald test confirms the presence of heteroskedasticity, justifying this approach. Clustering at the country level is a standard technique in panel analysis to ensure that the statistical inference is not artificially precise due to within-country correlation over time. Multicollinearity diagnostics are also conducted using Variance Inflation Factors (VIFs). In Model 1, all VIFs are well below the conventional threshold of 5. In Models 2 and 3, interaction terms slightly elevate the VIFs (some exceeding 8), but these values remain acceptable given the theoretical importance of interaction effects. The average VIF across all models remains below 3, suggesting that multicollinearity does not materially affect coefficient stability or interpretability. Further robustness is ensured by testing for stationarity using the Im-Pesaran-Shin (IPS) unit root test. Most key variables are stationary, and the fixed-effects estimator is known to be resilient even when some regressors are weakly non-stationary, especially when the goal is to analyse within-country variation over a moderate time frame.

Finally, the explanatory power of the models is evaluated through within- R^2 , between- R^2 , and overall- R^2 statistics. Although the within- R^2 values are modest—as is common in political economy research—they are statistically significant and substantively meaningful. F-statistics and p-values for joint significance confirm that the models are valid and that the included regressors help explain variation in peace outcomes.

5. EMPIRICAL RESULTS AND INTERPRETATION

This section presents the results of the three panel regression models designed to evaluate the relationship between foreign aid and peace, and how this relationship is conditioned by governance quality and the presence of conflict. Each model is estimated using country and year fixed effects, with robust standard errors clustered at the country level to address potential heteroskedasticity and serial correlation. The dependent variable across all models is the Global Peace Index (GPI), where higher scores indicate lower levels of peace. Therefore, a negative

coefficient on any independent variable implies a contribution toward greater peace (i.e., a reduction in the GPI score).

5.1. Model 1: The Direct Effect of Foreign Aid on Peace

The first model assesses the direct relationship between net ODA per capita (lagged) and peace outcomes. The regression results indicate that the coefficient on log-transformed lagged aid per capita is negative ($B = -0.0176$) and borderline statistically significant ($p = 0.089$). This suggests a weak but potentially meaningful association: higher aid per capita is marginally associated with improvements in peace, controlling for economic development, youth demographics, and unobserved country and year effects. The coefficient for lagged GDP per capita is positive ($B = 0.0288$, $p = 0.164$), though not statistically significant.

Table 1: Model 1 Fixed-Effects Regression Results

Variable	Coefficient	Robust Std. Error	t-statistic	p-value
Log (Lagged ODA)	-0.0176*	0.0102	-1.72	0.089
Log (Lagged GDP)	0.0288	0.0205	1.40	0.164
Government Effectiveness	0.0297	0.0265	1.12	0.264
Youth Percentage	0.0011	0.0030	0.38	0.708
Constant	-0.1433	0.0997	-1.44	0.154
Number of Observations	1,345	R ² (Within)	0.0237	
Number of Countries	99	R ² (Between)	0.0459	
Obs per Country (Min–Max)	3 – 14	R ² (Overall)	0.0004	
Avg Obs per Country	13.6	Sigma_u (σ_u)	0.0669	
F-statistic (17, 98)	2.15	Sigma_e (σ_e)	0.0971	
Prob > F	0.0102	Rho (ρ)	0.322	

***p < 0.01, **p < 0.05, *p < 0.10

This indicates that economic development alone does not exhibit a clear or immediate relationship with peace outcomes in the short term. The youth population percentage is also statistically insignificant, with a coefficient of $B = 0.0011$ ($p = 0.708$), suggesting that demographic pressure from youth bulges does not directly impact national peace levels in the short term within this model's specification. These results imply that about 32% of the unexplained variance in GPI is attributable to country-specific effects supporting the choice of fixed-effects modelling.

While the direct impact of foreign aid on peace appears weak, the negative sign of the coefficient aligns with theoretical expectations that aid, under certain conditions, may contribute to peacebuilding. However, the lack of strong statistical significance highlights the importance of considering contextual moderators, such as governance quality, which is examined in the next model.

5.2. Model 2: Governance as a Conditional Moderator

Model 2 introduces Government Effectiveness (GE) as both a standalone explanatory variable and as part of an interaction term with lagged aid per capita. This model tests whether the effect of aid on peace is contingent upon the quality of governance in the recipient country. The results reveal that the interaction term ($\log \text{ODA} \times \text{GE}$) is positive and statistically significant ($B = 0.1031$, $p = 0.045$). This is a crucial finding: it indicates that as governance improves, the marginal effect of aid on peace becomes more beneficial.

Table 2: Model 2 summary statistics

Variable	Coefficient	Robust Std. Error	t-statistic	p-value
$\Delta \log(\text{ODA})$	-0.0048	0.0060	-0.80	0.424
Δ Government Effectiveness (GE)	-0.0099	0.0250	-0.39	0.693
$\Delta (\log \text{ODA} \times \text{GE})$	0.1031*	0.0514	2.00	0.045
$\Delta \log(\text{GDP})$	-0.0022	0.0265	-0.08	0.935
Δ Youth %	-0.0376**	0.0156	-2.41	0.016
Constant	0.0129	0.0111	1.16	0.245
Estimation Method		Fixed Effects (FE)		
Dependent Variable		ΔGPI		
Observations		1,328		
Number of Countries (Groups)		99		
R^2 (Within)		0.0203		
R^2 (Between)		0.0849		
R^2 (Overall)		0.0058		
F-statistic (Model)		1.39		
p-value (F-stat)		0.126		
Intraclass Correlation (ρ)		0.1003		
F-test for Fixed Effects		$F(98,1211) = 1.28$, $p=0.039$		
Year Fixed Effects		Included		
Robust Errors		Clustered by country		

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$

In practical terms, foreign aid is more likely to reduce GPI scores (i.e., improve peace) in countries that have higher levels of institutional competence and administrative capacity. Interestingly, the direct effect of $\log \text{ODA}$ per capita becomes statistically insignificant ($B = -0.0048$, $p = 0.424$) once governance is introduced. Similarly, the coefficient for GE alone is not significant ($B = -0.0099$, $p = 0.693$), suggesting that neither aid nor governance, in isolation, has a strong effect on peace but their interaction is decisive.

The youth population variable becomes significant in this model ($B = -0.0376$, $p = 0.016$), indicating that higher proportions of youth may be associated with improved peace outcomes, possibly reflecting successful youth engagement programs in well-governed aid-receiving states. GDP per capita remains insignificant.

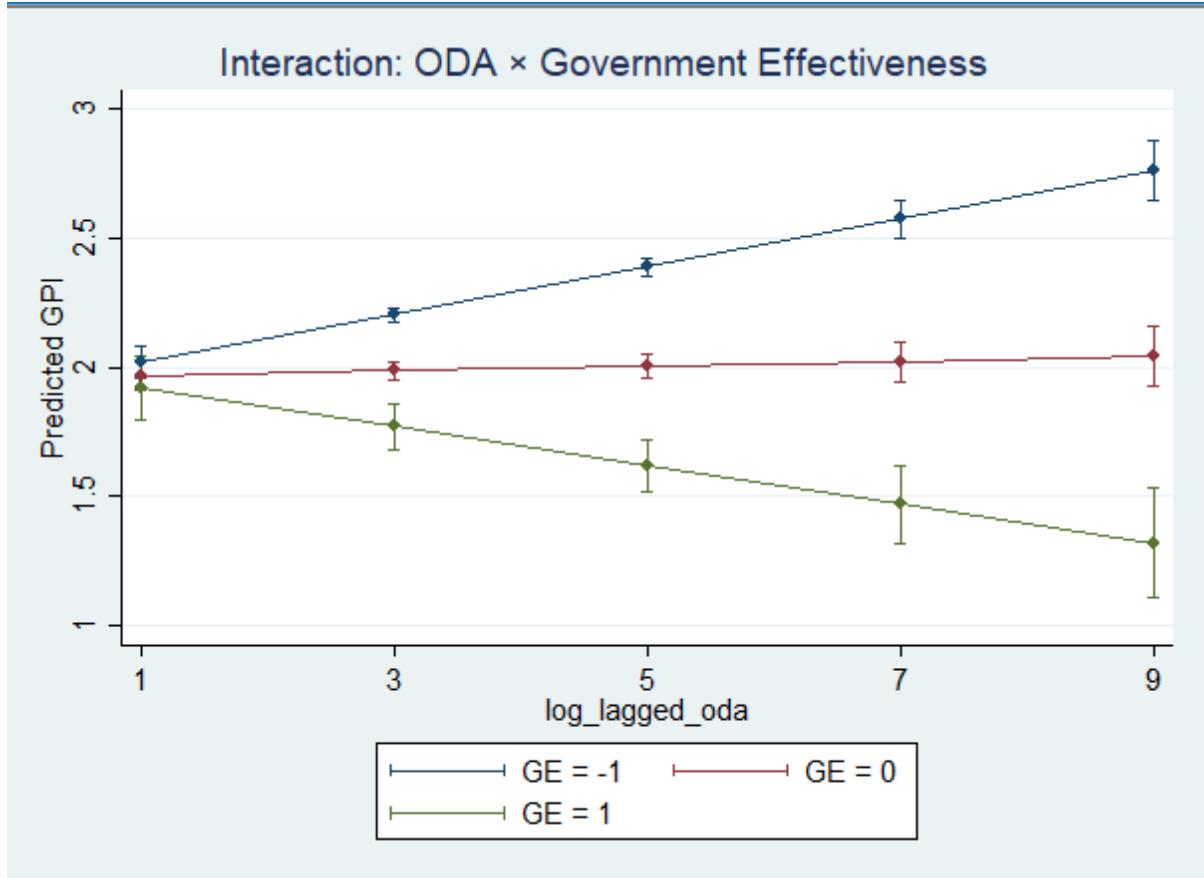


Figure 5.1: Interaction Effect of Foreign Aid and Government Effectiveness on Predicted Peace Outcomes

The graph shows predicted GPI scores across varying levels of log-transformed lagged ODA per capita for three levels of government effectiveness. In countries with low governance ($GE = -1$), increased aid is associated with worsening peace. In high-governance contexts ($GE = +1$), more aid leads to improved peace, suggesting that the effectiveness of aid is significantly conditional on institutional quality. These results support the view that aid works best when institutions work well. Aid by itself does not significantly impact peace, but in the presence of effective governance, it becomes a powerful lever for stability. This aligns closely with the findings of Burnside and Dollar (2000) and extends them into the peacebuilding domain.

5.3 Model 3: The Role of Conflict Context

Model 3 explores whether the presence of active conflict conditions the effect of aid on peace. The interaction between aid and a binary conflict dummy is introduced to test whether aid functions differently in fragile or violent settings.

Table 3: Model 3 summary statistics

Variable	Coefficient	Std. Error	t-Statistic	p-Value
Log Lagged ODA	0.0364*	0.0197	1.85	0.068
Dummy (Conflict)	0.0724	0.0988	0.73	0.466
Interaction Term	0.0319	0.0345	0.92	0.358
Youth Percentage	0.0170	0.0104	1.63	0.106
Government Effectiveness	-0.2631**	0.1095	-2.40	0.018
Constant	1.4609***	0.2859	5.11	0.000
Number of Observations			1,442	
Number of Countries			99	
Within R ²			0.200	
Between R ²			0.389	
Overall R ²			0.357	
F-Statistic			2.63	
Model p-Value			0.001	
Rho (ρ)			0.741	

***p < 0.01, **p < 0.05, *p < 0.10

In this model, the coefficient on lagged ODA per capita is positive ($B = 0.0364$, $p = 0.068$)—a marginally significant result, suggesting that in non-conflict settings, higher aid levels may be weakly associated with worsening peace outcomes. This somewhat counterintuitive result could be due to aid distortion, dependency, or inefficient allocation in peaceful yet poorly governed contexts. The conflict dummy itself is not significant ($B = 0.0724$, $p = 0.466$), indicating that, on average, countries in conflict do not have significantly different peace trajectories than those without, once controls are included. The interaction term ($ODA \times conflict$) is also statistically insignificant ($B = 0.0319$, $p = 0.358$), suggesting that the effect of aid does not significantly differ between conflict and non-conflict settings within this model specification. However, one of the most important findings from Model 3 is that Government Effectiveness becomes highly significant ($B = -0.2631$, $p = 0.018$), reinforcing the result from Model 2, governance is consistently and independently associated with improved peace outcomes, regardless of aid or conflict status. Model 3 suggests that the presence of conflict does not significantly alter aid's impact on peace, but that governance remains a decisive factor. Aid may even underperform in peaceful countries when governance is weak. This highlights the importance of targeting aid strategically, not only based on conflict status but also on institutional readiness.

5.4. Synthesis of Findings

Across the three models, the analysis yields several important insights, such as, there is no robust evidence that foreign aid alone directly improves peace outcomes. Then, the interaction between aid and government effectiveness is statistically significant and substantively meaningful, suggesting that institutional quality is a critical enabling factor for aid to have a

positive impact. The presence of conflict does not significantly moderate the effect of aid, implying that donor efforts in conflict-affected contexts may need better targeting or design rather than sheer volume. Government effectiveness emerges as the most consistent and significant predictor of lower GPI scores (i.e., more peaceful conditions) across all models, underscoring the centrality of governance in peacebuilding.

These results support a conditional view of aid effectiveness: aid is not inherently good or bad for peace, it depends on who delivers it, how it is governed, and the institutional context into which it flows.

6. Discussion

The findings presented in Section 5 contribute meaningfully to the ongoing academic and policy debate regarding the effectiveness of foreign aid in promoting peace. This section provides a critical interpretation of those results, linking them to the theoretical frameworks and empirical studies reviewed in Section 2. It also unpacks the implications of conditional relationships particularly those involving governance and offers insights into why aid may perform differently across contexts.

The first key insight from the results is the limited direct impact of foreign aid on peace outcomes. In Model 1, the coefficient for lagged net ODA per capita was negative indicating a directionally positive effect on peace but only marginally significant and of small magnitude. This supports the view that aid, as a financial flow, is not inherently transformative in the absence of other mediating factors. It echoes the findings of de Ree and Nillesen (2009), who concluded that post-conflict aid alone does not necessarily reduce the risk of renewed violence. Similarly, Findley et al. (2011) emphasize that aggregate aid volumes may mask variation in impact across types, targets, and sectors. The results here reinforce that aid is not a panacea, and that its effects are context-sensitive rather than automatic.

The second and most robust finding is the interaction between aid and governance quality, which emerges clearly in Model 2. The statistically significant interaction term suggests that aid's ability to contribute to peace improves with stronger government effectiveness. In countries with well-functioning public institutions, rule of law, and administrative competence, foreign aid may be more likely to fund productive programs, reinforce institutional legitimacy, and address the root causes of conflict. This finding lends strong empirical support to the conditionality thesis advanced by Burnside and Dollar (2000), as well as Svensson (1999), both of whom argue that aid works only in sound policy environments. Notably, governance itself was not statistically significant as a standalone predictor in Model 2 but it becomes significant in Model 3, especially when accounting for the conflict dummy. This underscores that governance may not only amplify the benefits of aid but may also independently contribute to peace. Effective governments are better able to manage social tensions, deliver public services equitably, and mitigate risks of political violence. Therefore, institutional quality should be understood not simply as a moderator but also as a direct determinant of peace.

The third major insight arises from the examination of conflict status as a conditional factor. The results of Model 3 show that neither the conflict dummy nor the aid \times conflict interaction term is statistically significant. This suggests that the presence of ongoing state-based violence does not systematically alter the effect of aid on peace, once other controls are accounted for.

This finding challenges some common donor assumptions, that aid must be ramped up or specially structured in conflict zones to have an impact. It may be that aid in conflict zones is either poorly targeted, quickly politicized, or diverted toward short-term relief efforts that fail to translate into structural peacebuilding. Alternatively, the insignificance of the aid \times conflict interaction may reflect high variability across conflict-affected countries—some with functioning institutions and donor coordination, others with deep fragmentation. Therefore, conflict presence alone may not be a sufficient lens through which to evaluate aid effectiveness. Instead, governance remains the more consistent and explanatory filter, suggesting that “fragility” should be understood institutionally, not just in terms of violence.

The youth population variable, significant in Model 2, presents an interesting nuance. Contrary to the common assumption that youth bulges exacerbate conflict risk, the negative and statistically significant coefficient suggests that a higher share of youth may be associated with improved peace outcomes—especially in well-governed settings. This may reflect successful youth inclusion policies, targeted aid programs, or improvements in education and employment access driven by aid. It reinforces the idea that aid effectiveness depends not only on governance quality, but also on how aid is targeted and implemented. Collectively, these findings support a conditional, governance-centered theory of aid and peace. They suggest that Aid alone is insufficient to promote peace; good governance is both a moderator and an independent driver of peace outcomes; conflict presence does not fundamentally change the aid–peace relationship, but may still introduce implementation challenges; policy context, institutional readiness, and local capacity must be central to any peace-focused aid strategy.

This nuanced perspective aligns with the more critical views of Dreher et al. (2023), who caution against one-size-fits-all assumptions about aid, and with the practical insights of the “triple nexus” development discourse, which emphasizes the need for coherence between humanitarian, development, and peace efforts. By focusing not just on whether aid “works,” but under what conditions it works, this study contributes to a more policy-relevant and empirically grounded understanding of how foreign assistance can or cannot contribute to sustainable peace.

7. CONCLUSION

This thesis set out to investigate a critically important yet underexplored question in international development: Does foreign aid promote peace? And under what conditions does it do so? In a global context marked by persistent conflict, rising aid flows, and increasing expectations for development assistance to deliver not only growth but also stability, understanding the relationship between aid and peace is both academically and practically vital.

Using a panel dataset of 99 countries over the period 2008–2022, this study tested three core models using fixed-effects panel regression techniques. The Global Peace Index (GPI) was employed as a broad and multidimensional measure of peace, while the key independent variable was net ODA per capita (lagged). In addition to basic control variables such as GDP and youth population, the models introduced interaction terms to examine whether government effectiveness or the presence of conflict moderated the effect of aid on peace.

The results offer three major conclusions. Firstly, Foreign aid, in isolation, has a weak and inconsistent effect on peace outcomes. The direct relationship between lagged ODA per capita and the GPI was found to be statistically marginal and substantively limited. This finding aligns with a growing body of literature that questions whether aid alone can reduce conflict or promote societal security without considering deeper structural and institutional dynamics. Secondly, Governance quality significantly conditions the effectiveness of aid. The interaction between aid and government effectiveness emerged as the most robust and statistically significant finding across the models. Specifically, aid has a greater peace-promoting effect in countries where institutions are stronger, more credible, and better equipped to channel aid toward public goods rather than elite rents. This result reinforces the governance-centric view of aid effectiveness and highlights the need for institutional capacity-building as a central pillar of peace-focused aid. Thirdly, the presence of conflict does not significantly moderate the relationship between aid and peace. Contrary to common assumptions, the analysis found no strong evidence that aid works better or worse in countries experiencing state-based violence. This suggests that conflict status alone is an insufficient indicator of aid effectiveness. Instead, institutional quality remains the more decisive factor.

In terms of answering the central research questions; does foreign aid contribute to peace? The answer is yes but only conditionally. Aid by itself does not guarantee peace and may even be neutral or counterproductive in poorly governed environments. Under what conditions does aid promote peace? Aid is most effective when delivered in countries with strong institutions, effective governance, and strategic targeting mechanisms. Does conflict alter this relationship? Surprisingly, no the impact of aid does not appear to be significantly different in conflict-affected countries, once governance is accounted for. These findings have important implications for how aid is conceptualized, allocated, and evaluated. They challenge one-size-fits-all models of aid delivery and support a more nuanced, context-sensitive approach grounded in political economy and institutional analysis. Looking forward, this study opens several avenues for future research. First, researchers could examine disaggregated forms of aid (e.g., humanitarian vs. governance-focused aid) to determine which types are most effective in different contexts. Second, subnational data could offer more granular insights into how aid affects peace in specific regions or provinces. Third, incorporating qualitative methods such as case studies or fieldwork could illuminate the causal pathways through which aid interacts with governance structures and peace processes. Finally, a dynamic panel model or instrumental variable approach could strengthen causal inference and address endogeneity concerns more directly.

In conclusion, while foreign aid can play a meaningful role in promoting peace, its success depends not just on how much is given, but on how it is used, who governs it, and whether it is embedded in a broader strategy of inclusive, accountable, and context-specific development. Aid is most powerful not as a blunt financial instrument, but as a strategic tool embedded in a larger framework of peacebuilding and state-building. This thesis underscores the need for smarter aid, not just more aid in the global pursuit of peace.

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