EFFECT OF GOVERNANCE AND FOREIGN AID ON POVERTY ERADICATION

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BY

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DECLARATION

We hereby declare that:

(1) This undergraduate research project is the end result of my own work and that due acknowledgement has been given in the references to ALL sources of information be they printed, electronic, or personal.

(2) No portion of this research project has been submitted in support of any application for any other degree or qualification of this or any other university, or other institutes of learning.

(3) Equal contribution has been made by each group member in completing the research project.

(4) The word count of this research report is **9264.**

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WGI	Worldwide Governance Indicators
SDG	Sustainable Development Goals
GDP	Gross Domestic Products
OECD	Organization for Economic Cooperation and Development
IMF	International Monetary Fund
UN	United Nations
ODA	Official Development Assistance
DAC	Development Assistance Committee
INF	Inflation rate
AGE	Age dependency ratio
SSA	Sub-Saharan Africa
ARDL	Autoregressive distributed lag
VAR	Vector Autoregression

Abstract

According to the Sustainable Development Goal 1 (SDG 1), the United Nations (UN) aims to eliminate extreme poverty by the year 2030. The South Asian region greatly contributed to this achievement as it thrives on a continuous economic growth and poverty reduction throughout the decades. However, despite the improvements done throughout the years, the Covid-19 pandemic, and the effects from the war in Ukraine has worsened the situation. Foreign aid is one of the main sources of livelihood for the people for most countries, however the effectiveness of the aid inflow remains questionable as presented, where the quality of governance disrupts the aid distribution to the poor. This study aims to investigate the relationship between foreign aid, governance, and poverty for 8 South Asian countries, namely Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. The secondary data collected ranges between the year 2000 to 2020 in the form of quantitative data from a secondary source. Quantile regression model is used in this study. The results show that foreign aid and governance both has a direct positive influence on poverty eradication at lower levels of poverty alleviation. At higher poverty alleviation levels, the two variables lose its effect to reduce poverty. Additionally, governance is found to only be effective in moderating aid on poverty eradication when the highest level of poverty eradication is achieved. Therefore, it is crucial for policy makers to understand that improving the quality of governance is not the only way to reduce poverty depending on the level of poverty eradication achievement of the country.

Chapter 1: Introduction

1.0 Introduction

This chapter provides an overview of the research topic, the outline is as stated: firstly, the background of the study, followed by problem statement, research objectives and significance of the study.

1.1 Background

The global extreme poverty rates were found to be halved since the year 1990, however it remains the main concern of the United Nations (UN) as there is still 20% of the people in developing countries living without access to basic needs such as clean water, food, sanitation etc (SDG Tracker, n.d.). According to the Sustainable Development Goal 1 (SDG 1), the UN aims to eliminate extreme poverty by the year 2030 for those living on less than $1.90 a day. Throughout the years 2015 to 2018, the global poverty situation had seen an improvement where poverty rates continued its decline. The South Asian region, in particular, greatly contributed to this achievement as it thrives on a continuous economic growth and poverty reduction throughout the decades. Countries such Bangladesh, Nepal, and India had lowered their poverty rates by large in the 1990s, whereas Sri Lanka had halved their poverty rates (Devarajan, n.d.). However, despite the improvements done throughout the years, the Covid-19 pandemic and the effects from the war in Ukraine has worsened the situation.

Pietras-Eichberger (2021) discussed the issue of global poverty, in which the history of poverty was introduced. Throughout the history of humanity, most people had

been living in poor conditions with limited materials to sustain a good quality of life. Diseases, natural disasters and food insecurity were the norm of the population, in which only a small percentage of the prestigious such as the royalties lived on the highest level of the hierarchy. As time passed, religion, societal and racial division created conflicts and wars which added on to the poor's misery. In September 2000, the Millennium Development Goals were imposed by the United Nations with the eradication of extreme poverty and hunger as its first goal. Despite the successful achievement of reducing the rate of people living in extreme poverty, the number of people being undernourished was found to increase. In short, the people had only received adequate food supply to sustain their lives but not enough to stay healthy. To improve the global poverty situation, the SDG was drawn up by 2016 with more defined goals set.

However, judging from the current situation, the World Bank deduced that the poverty eradication goal of SDG by the year 2030 is seen to be unattainable, as the world is still seeing recovery from the pandemic-stricken economies (World Bank, 2022). As such, foreign aid became the most common way to assist the countries in need which money, commodities or services are provided to the receiving countries. Foreign aid began as an assistance with commercial or political purposes (Hjertholm & White, 2000). Colonial powers in the post-war period provided the colonised countries with loans and grants for infrastructure with the objective of gaining materials and inputs for their countries' manufacturing industry. Early institutions founded to provide post-war relief includes the United Nations Relief and Rehabilitation Agency (UNRRA), the World Bank, and the Marshall Plan.

Implemented on June 5, 1947, the Marshall Plan was a successful model for today's aid relief program. The Secretary of State of the United States at that time, George C. Marshall, expressed the concern of the high unemployment and poverty rate, as well as the displacement issues after the World War II. This plan was announced with the aim to provide funds for all of the European nations, which they were economically devastated by the war. An approximate $13 billion worth of fund was invested in this plan to finance debts, reconstruct private and public infrastructure,

restructure political stability, and promote international trade (International Monetary Fund, n.d.). Countries that participated in this plan had to agree with conditions such as reducing government controls, increasing multilateral trade with the US and within Europe, improving currency convertibility, etc. The Marshall Plan was a success in which by the time the plan ended, countries that participated experienced a growth higher than levels before the war in their economies.

At the present time, the official development assistance (ODA) is a standard and main form of financing development aid as adopted by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) in 1969 (OECD, n.d.). It is provided by local governments or executive agencies of donor countries to the recipient countries in the form of grants and loans while being concessional in nature. Due to the pandemic, foreign aid from donors reached USD 161.2 billion in the year 2020 to assist the countries in need (OECD, 2021). According to the OECD, the ODA has rose by 4.4% in the year 2020. By 2022, aid allocation peaked at $204 billion to assist the humanitarian crisis in different countries, particularly the aid to Ukraine due to Russia's invasion.

The aspect of governance was explained by Khan (2012) to be a form of societies' interaction with the government. He described a general opinion of governance for developing countries to be market-supporting with democratic elements such as sustaining a rule of law and supressing corruption to enable an efficient allocation of resources. Khan (2012) had detected an identical issue within the poor countries, which is the existence of poor governance and jurisdiction. From the perspective of Leftwich (1993), he emphasized that the term "governance" should be explained separately in two ways. The first way being the definition by the World Bank and the International Monetary Fund (IMF) of having an adequate level of managerial and administration within the country. The second way is associated with political terms by the Western governments. He voiced the concern of the Western institutions, such as the World Bank, for supporting countries with "bad" governance, where non-democratic regimes and high levels of corruptions prevails.

In the report published by the World Bank in 2017, the institution explained a major cause for policy ineffectiveness, which is the existence of inequality in power. The issue of power asymmetries explained the reason for the failure of anti-corruption laws and agencies, the unsuccessful decentralization and ineffective fiscal policies (World Bank, 2017). The IMF had listed the detrimental effects of poor governance, which includes market distortions, disruption of economic development, lost of growth opportunities, etc (International Monetary Fund, n.d.). Currently, the institutions urge developing countries to focus on their strategies to tackle the issue of poor governance by emphasizing transparency in management, enhancing commitment of leaders in the enforcement, and encourage cooperation between the state and the general public.

1.2 Problem Statement

Global poverty has been a critical issue that the world faces until today, as people living in different regions in the world face the lack of access to food, education, and basic health care. The severity of this issue is reflected on the living conditions of the children. According to the United Nations International Children's Emergency Fund, the rate of new-born deaths was recorded at 44% and 60% for under-5 deaths, half of the world's stunted children lives in South Asia (United Nations International Children's Emergency Fund South Asia, n.d.). The effect of malnutrition is displayed on the country's labour productivity as people are weaker to work efficiently and productively. Heltberg (2009) stated that chronic child malnutrition is significantly associated with a country's economic growth over time, hence showing the importance of poverty reduction.

Foreign aid is one of the main sources of livelihood for the people for most countries, however the effectiveness of the aid inflow remains questionable as presented,

where the quality of governance disrupts the aid distribution to the poor. Taking the flood in Pakistan in June 2022 as an example, $9 billion was raised to assist the country's recovery, however only $38.35 million was reported to reach the locals (Firstpost, 2023). Similarly, the aid to Afghanistan posed another question regarding its aid effectiveness. The European Union (EU), for example, had been funding humanitarian aid to Afghanistan since 1994, however the country still remains as the world's largest humanitarian crisis in 2023 (United Nations, 2023). The Special Inspector General for Afghanistan Reconstruction condemned a lack of transparency within this process as they cannot confirm if the aid has reached the people or funded the Taliban instead (Al Jazeera, 2023). On the contrary, Bhutan is also a recipient of ODA but had been experiencing a drastic fall in poverty headcount ratio at national poverty lines compared to Afghanistan's rising rates (World Bank, n.d.).

This study focuses on the South Asian region with the aim of providing a solution for South Asia's rising poverty rates. The region had been experiencing improvements throughout the years, but the pandemic and the Ukraine war threatened to reverse its achievements. The case in Pakistan suggested that good quality of governance can help achieving the SDG 1 through a more efficient aid allocation. The contradicting situation between Afghanistan and Bhutan also suggested the importance of including governance as a determinant. Henceforth, the study aims to investigate the relationship between foreign aid and poverty, particularly under the influence of governance factors in South Asia.

1.3 Research Objectives

The relationship of foreign aid and governance on poverty eradication of South Asia will be investigated in this study.

1. To investigate the relationship between foreign aid and poverty eradication.

2. To investigate the relationship between governance and poverty eradication.

3. To investigate the impact of governance on the foreign aid and poverty eradication relationship nexus.

1.4 Significance of Study

This study focuses on the countries in South Asia, which increases literature on the South Asian countries. The results of this study serve as a source of information for future researchers for their studies on poverty eradication in South Asia. It also allows policy makers from South Asia to use the results as a reference to improve accuracy while designing policies to tackle the poverty issue and achieving efficiency in aid allocation.

Additionally, this study uses quantile regression to analyze the data. It provides an insight on aid and governance effects on poverty at different levels. Hence, it enables policy makers of different countries in the South Asian region to design their poverty reduction policies according to their relative countries' poverty situation. As a result, the issue of poverty can be effectively contained with accurate regulation and practices, hence accelerates the achievement of the SDG 1.

1.5 Conclusion

In general, Chapter 1 provided a background of the study regarding the poverty situation in the South Asian region and issue of foreign aid and governance. The problem statement, research objectives and significance of study were also discussed. The next chapter will be discussing the literature review.

Chapter 2: Literature Review

2.0 Introduction

This chapter provides an understanding on the past studies done on the variables, namely poverty, foreign aid, and governance. The chapter is divided into two sections: theoretical and empirical literature review.

2.1 Theoretical Literature Review

2.1.1 Cyclical Theory of Poverty

Abdulai and Shamshiry (2014) discussed about the definition of cyclical poverty and its occurrence. Economic downturns such as depression or chronic recession phases will cause unemployment that triggers cyclical poverty. Bradshaw (2007) explained that the loss of an income source leads to a lack of consumption and savings, inadequate investment in human capital such as training and education, resulting in an inability to reverse the financial situation and fall into the spirals of poverty. He emphasized that the linkage between individual crises, such as earnings, and community deficiencies like the inability to afford public health services, are significantly correlated. Addae-Korankye (2019) continued that the lack of investment in human capital will cause the market to dwindle and the economy to remain stagnant, as there is no growth from the supply-side factors. As a result, the disinvestment in the economy will lead to a fall in

opportunities in the market for individuals and businesses, which the poor will lose their chances to break through the poverty cycle.

Abdulai and Shamshiry (2014) also suggested that the occurrence of cyclical poverty could arise from the labour sector. They stated that unforeseeable and uncontrollable circumstances such as natural phenomena like disasters causes food shortages, leading agricultural economies into cyclical poverty. Addae-Korankye (2019) mentioned that health issues of the people are one of the reasons why the poor remain poor. It is due to the fact that their inability to obtain health services and a hygienic living condition leads to poor health, resulting to low labour productivity. Lack of education is also one of the factors causing a cyclic poverty situation as inadequate schooling reduces the chances for the poor to gain higher paid jobs. Bitler, Hoynes and Kuka (2017) added that the cyclicality of child poverty is larger in magnitude. The insufficient supply of resources in terms of nutritious food supply and education from childhood makes them harder to break free from the poverty cycle as they are in shortage of the necessary qualities to compete in society.

2.1.2 Structural Theory of Poverty

The structural theory of poverty was described as an occurrence due to the systematic barriers that prevents the poor from escaping poverty (Brady 2019; Bradshaw, 2007; Elesh, 1973). This theory believes that the societal structure and system of an economy limits individuals' access to opportunities and hinders their well-being while disregarding their efforts and competency. Those who possess higher skills and knowledge may still lose their chances in employment or social services due to their personal demographics. These demographics were explained to be in the form of attributes such as gender, race and urbanization, where people are

discriminated upon (Brady, 2019). Since the attributes are uncontrollable, it results in a generational poverty cycle when none of the members of the family line could reverse this social discrimination as they too possess the same attributes. Davis & Sanchez-Martinez (2015) highlighted that this occurrence of social exclusion is the reason of deprivation of resources, which causes poverty to persist.

Studies had suggested solutions to tackle this issue, mainly from the aspect of political and communal advocacy for change (Abdulai & Shamshiry, 2014; Bradshaw, 2007). With a rise in power, those at a disadvantage could shift power relations for the reallocation of resources to communities experiencing extreme segregation in terms of societal and economical aspects. Brady (2019) compared the cases of development for China and sub-Saharan Africa. The economic development of China had demonstrated the effectiveness of reducing structural poverty through urbanization and increasing female labour participation, which reflected the solution to the persistent poverty situation in sub-Saharan Africa.

2.1.3 Poverty Theories, Foreign Aid, and Governance

Studies had demonstrated that supply side and societal factors are the causes to a persistent poverty cycle. In this case, foreign aid posed as a support to tackle this issue. Aid flows could exist in the form of project aid, commodities aid, financial assistance, and technical support (White, 1998). Different types of aid are provided to recipient countries depending on their economic situation and desired macroeconomic effect. While poverty alleviation had been the main concern of donor countries, aid allocation became one of the direct methods of achieving this objective. The element of governance is incorporated as the execution of policies are required, and that the quality of governance relates to the effectiveness of such execution.

Thus, the study suggested the variables of foreign aid and governance as a solution to the cyclical and structural poverty issue.

Table 2.1: Summary of Theoretical Literature Reviews

Theories	Authors	Description
Cyclical Theory of Poverty	Abdulai and Shamshiry (2014)	Economic downturns and natural phenomenon trigger cyclical poverty through unemployment and food shortages from disasters.
	Bradshaw (2007)	Loss of income source leads to an inadequate investment in human capital, resulting in the inability to reverse the financial situation and fall into the spirals of poverty.
	Addae-Korankye (2019)	Poor health and disinvestment in the economy will reduce opportunities in the market which the poor will lose their chances to break through the poverty cycle.
	Bitler, Hoynes and Kuka (2016)	Child poverty makes them harder to break free from the poverty cycle as they are in shortage of the necessary qualities to compete in society.
Structural Theory of Poverty	Brady (2019)	Personal demographics limits individuals' access to opportunities and hinders their well-being.
	Davis & Sanchez-Martinez (2015)	Social exclusion is the reason of deprivation of resources, which causes poverty to persist.
	Elesh (1970)	Systematic barriers prevent the poor from escaping poverty by disregarding their personal efforts and competency.

Source: Developed for the research

2.2 Empirical Literature Review

2.2.1 Foreign Aid and Poverty Eradication

One of the recent studies on this issue is done by Mahembe and Odhiambo (2021) which focused on the impact of foreign aid on extreme poverty in sub-Saharan Africa over the period 1981-2013 using dynamic panel estimation techniques. They found a significant poverty reduction effect from foreign aid. Additionally, they tested whether the effect of poverty reduction due to foreign aid would change depending on the different proxies used, which indicates the volume and allocation of foreign aid. It is found that loans and bilateral aids are tested insignificant, thus they concluded that the 5 volume and allocation of foreign aid is important.

On the other hand, Khan, Zeeshan and Haque et. al. (2022) investigated the relationship between foreign aid, poverty and other supporting variables using the panel data model. Their study was based on the Middle East and North Africa (MENA) countries over the period 1991 to 2019. Two proxies were used to measure poverty reduction, which is the headcount ratio and poverty gap index. However, an insignificant negative relationship between foreign aid and poverty reduction is found, which the authors suggested the reason to be the conditioning on time invariant growth rates of countries.

Additionally, the study by Shitile and Sule (2019) focused on Nigeria's aid and grants effectiveness on poverty reduction using the ARDL model for the years 1999 to 2017. In this study, aid was represented in the form of official development assistance (ODA), grants, technical cooperation grants and external loans. It was found that a significant positive relationship was

found between ODA and technical cooperation grants and poverty in the short run, while grants and external loans has a negative relationship. Their relationship with poverty is reversed in the long run. The author suggested that external solutions such as foreign aid does not relate to poverty alleviation.

The study by Arivin and Barillas (2002) investigated the relationship between aid and poverty using the Granger causality method on 118 countries from 1974 to 1998. The pooled data was first tested based on regions then income level. Testing the world as a whole, aid was not found to impact poverty levels in any ways at the country's democracy level. On a regional level, East Asia and the Pacific region experienced a poverty reduction from aid. However, aid increases poverty levels for low-income countries. The authors explained this situation with the misallocation of aid, where the funds were used on sectors such as military instead of assisting the poor, resulting in the poor not receiving the aid at all.

Alvi and Senbeta (2011) studied the effects of foreign aid on poverty in 79 developing countries receiving aid. The dynamic panel estimation technique was used for the period 1981 to 2004 while controlling for variables such as income, trade, inflation, real gross domestic product, and others. ODA was used as proxy for aid while the poverty line of $1 a day was used for poverty. Results show that while aid strongly assist poverty reduction when the factor of income is controlled, multilateral aid and grants are the aid options that helps in the reduction. On the contrary, bilateral aid and loans do not help reducing poverty.

2.2.2 Governance and Poverty Eradication

The study by Hassan, Bukhari and Arshed (2019) investigated the relationship between globalization, competitiveness and development expenditures while considering the factors of governance indicators with poverty alleviation. Data of 73 developing countries was analysed using panel data for the period 2005 to 2016. In their study, 10 governance indexes were used such as voice and accountability, political stability, rule of law, competitiveness, trade openness and others. Poverty gap as $1.90 a day was proxy for poverty levels. The results of the study showed that the governance factors, namely governance effectiveness, voice and accountability and regulatory quality assist poverty alleviation, in which government effectiveness is found to be most effective on reducing poverty levels.

Workneh (2020) did a similar study using a maximum likelihood estimation of random effect models on 34 countries in SSA between the years 2010 to 2017. The control variables include foreign direct investment, inflation, unemployment, exports and imports, and others. The following three factors was found to effectively reduce poverty: government effectiveness, voice and accountability, and rule of law. Additionally, the factor of gender inequality is found to be crucial in the governance-poverty relationship, where the negative impact of gender inequality may rise too high and reduce the poverty alleviation effects governance have on poverty. On the other hand, Jamil, Shen and Ud Din (2022) investigated the same variables using panel data of 29 countries. By using the World Bank database and Worldwide Governance Indicators database, governance was found to be highly effective in mitigating poverty.

Coccia (2021) studied how institutional change can initiate poverty alleviation for 191 countries by using governance indicators as proxy for measurement by using the Ordinary Least Squares (OLS) method. The countries were categorized into three subsets, which are stable, intermediate, and fragile countries. Results show that good governance do reduce poverty

levels in general, more so when there is the factors of political and economic stability, democracy, and rule of law. Moreover, the effects are more significantly observed for stable economies due to higher stability and the growing existence of technology used in society.

Widiastuti, Mawardi, Zulaikha et. al. (2022) studied the impact governance quality have on poverty for Organization of Islamic Cooperation (OIC) member countries by using a panel data analysis with the fixed effect model. The authors developed an institutional quality index which consists of voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. Among the six indexes employed, only voice and accountability and regulatory quality significantly and negatively affect poverty levels. With the results shown, the authors suggested that increasing freedom of speech can better improve development and leading to a reduction in poverty levels.

Sarker, Hossin, Min et al. (2018) focused on how governance alleviate poverty in Bangladesh as they stated that the main aspect leading to poverty in the country is bad governance. Accountability, transparency, participation, and predictability was found to directly improve the poverty situation, whereas corporate social responsibility was suggested to be the main aspect in poverty eradication. Additionally, the study proposed that decentralization through democracy could alleviate rural poverty. Kwon and Kim (2014) used a panel data estimation to investigate the governance-poverty relationship for 98 developing countries and found no linkage between the two variables, especially for South Asian and sub-Saharan African regions. Their results show that good governance is only effective on poverty reduction in the middle-income countries. The authors suggested that good governance is not sufficient to alleviate poverty for countries with high poverty levels.

2.2.3 Foreign Aid, Governance and Poverty Eradication

By investigating the relationship between aid and poverty in SSA, Ijaiya (2004) included governance as a variable in their regression model using data for the year 1997. A dummy variable to determine social and political stability or instability was used as proxy for governance. The authors had found that aid has no significant influence on poverty due to bad governance. Several reasons were suggested to explain the low governance quality such as a mismanagement of funds due to high corruption levels, institutional failure due to coups and wars, weak economic stability and more. Macroeconomic policies that promote stability were highly suggested.

Asra, Estrada and Kim et. al. (2005) used the ordinary least squares and two stage least squares in studying aid effectiveness of 49 countries between 1960 and 1998. One observation was taken from every 5 years throughout the observation period to prevent the data leaning towards certain countries. The authors had found that quality of governance does not affect aid effectiveness. Even though governance quality and macroeconomic environment do negatively affect poverty levels individually, however the effects of aid on poverty is not dependent on the governance situation. Similarly, Sharma and Bhattarai (2013) used data from Nepal between 1965 to 2008 using ARDL model and found no significance that democratic governance has any positive impact on aid effectiveness. However, they emphasized that such results may occur due to the usage of a dummy variable to represent the democratic governance, in which the dummy variable may not accurate enough.

Afzal, Mirza and Arshad (2021) used VAR and Granger causality tests to show that foreign aid, democracy, and media openness had contributed to poverty reduction. The authors stated that, despite being influenced by bad

governance factors, foreign aid had improved poverty levels due to political stability from changing to a democratic regime. Additionally, openness of media within the country provided the people a freedom of speech to voice their rights and easy access to information, thus contributing to poverty reduction. On the other hand, Matteis (2013) found that aid effectiveness is higher on poverty eradication when the funds are focused on poverty reducing means. However, governance was found to not influence aid effectiveness in this study.

Table 2.2: Summary of Empirical Literature Review on Foreign Aid and Poverty

Author(s)	Period	Countries	Dependent variables	Independent variables	Methodology	Findings
Mahembe and Odhiambo (2021)	1981-2013	44 SSA countries	Poverty headcount ratio	ODA	Dynamic panel estimation	ODA has a significant poverty reduction effect Democracy enhances the effectiveness of ODA in poverty reduction
Khan et. al. (2022)	1991 - 2019	21 MENA countries	Poverty headcount ratio	Foreign aid GDP per capita Gini Index Income inequality Remittance as % GDP	System-GMM approach	Insignificant negative relationship between foreign aid and poverty reduction
Shitile and Sule (2019)	1999 - 2017	Nigeria	Poverty incidence index	ODA Grants Technical cooperation grants External loans	ARDL Model	Significant positive relationship between ODA and technical cooperation grants and poverty in the short run Grants and external loans have a negative relationship Reversed relationship in the long run

Source: Developed for the research

Table 2.2: Summary of Empirical Literature Review on Foreign Aid and Poverty

Author(s)	Period	Countries	Dependent variables	Independent variables	Methodology	Findings
Arivin and Barillas (2002)	1974 - 1998	118 countries	GNP per capita	Foreign aid as % GNP Freedom House democracy index	Granger causality method	Aid does not impact poverty at the country's democracy level at world level East Asia and the Pacific region experienced a poverty reduction from aid
Alvi and Senbeta (2011)	1981 - 2004	79 developing countries	Poverty line of $1 a day	ODA	Dynamic panel estimation technique	Aid strongly assists poverty reduction when the factor of income is controlled Bilateral aid and loans do not help reducing poverty

Source: Developed for the research

Table 2.3: Summary of Empirical Literature Review on Governance and Poverty

Author(s)	Period	Countries	Dependent variables	Independent variables	Methodology	Findings
Hassan, Bukhari and Arshed (2019)	2005 - 2016	73 developing countries	Poverty gap as $1.90	WGI	Panel data estimation	Governance effectiveness, voice and accountability and regulatory quality assist poverty alleviation
Workneh (2020)	2010- 2017	34 SSA countries	Human development index	Gender inequality index WGI	Maximum likelihood estimation for REM	Government effectiveness, voice and accountability, and rule of law reduce poverty Negative impact of gender inequality may reduce the poverty alleviation effects governance have on poverty
Jamil et. al. (2022)	2004 - 2016	29 developing countries	Poverty headcount ratio	WGI Female participation in the labour market	Panel data analysis with FEM	Governance was found to be highly effective in mitigating poverty

Source: Developed for the research

Table 2.3: Summary of Empirical Literature Review on Governance and Poverty

Author(s)	Period	Countries	Dependent variables	Independent variables	Methodology	Findings
Coccia (2021)	2000, 2004 &2007	191 countries	Poverty index	GINI coefficient Kaufmann governance indicators	OLS method	Political and economic stability, democracy, and rule of law reduce poverty levels
Widiastuti, Mawardi & Zulaikha et. al. (2022)	2007 - 2020	39 OIC member countries	National Poverty Lines	Institutional quality index Islamic Human Development Index	Panel data analysis with FEM	Only voice and accountability and regulatory quality significantly and negatively affect poverty levels
Sarker, Hossin, Min et al. (2018)	-	Bangladesh	Household income and expenditure surveys Poverty headcount ratio	8 elements of governance	Qualitative documentary analysis	Accountability, transparency, participation, and predictability was found to directly improve the poverty situation. Decentralization through democracy could alleviate rural poverty

Source: Developed for the research

Table 2.3: Summary of Empirical Literature Review on Governance and Poverty

Author(s)	Period	Countries	Dependent variables	Independent variables	Methodology	Findings
Kwon and Kim (2014)	2002 - 2009	98 developing countries	Poverty headcount ratio	WGI	Panel data estimation	No linkage between the two variables, especially for South Asian and sub-Saharan African regions. Good governance is only effective on poverty reduction in the middle-income countries.

Source: Developed for the research

Table 2.4: Summary of Empirical Literature Review on Foreign Aid, Governance and Poverty

Author(s)	Period	Countries	Dependent variables	Independent variables	Methodology	Findings
Ijaiya (2004)	1997	SSA countries	Poverty reduction	Foreign aid Social and political stability or instability	OLS	Aid has no significant influence on poverty due to bad governance
Asra et. al. (2005)	1960 - 1998	49 countries	Poverty headcount index	Effective development assistance (EDA) Quality of Governance index	OLS TSLS	Governance quality and macroeconomic environment do negatively affect poverty levels individually, however the effects of aid on poverty are not dependent on the governance situation
Sharma and Bhattarai (2013)	- 1965 - 2008	Nepal	Real GDP	Democracy dummy Foreign aid	ARDL model	No significance that democratic governance has any positive impact on aid effectiveness

Source: Developed for the research

Table 2.4: Summary of Empirical Literature Review on Foreign Aid, Governance and Poverty

Author(s)	Period	Countries	Dependent variables	Independent variables	Methodology	Findings
Afzal, Mirza and Arshad (2021)	2002 - 2016	Pakistan	Poverty headcount at $1.90	ODA Freedom in the world index Free press index GDP growth	VAR and Granger causality	Foreign aid had improved poverty levels due to political stability from changing to a democratic regime Openness of media contributes to poverty reduction
Matteis (2013)	1980 - 2008	78 countries	Poverty line of $2 a day	ODA GDP per capita Governance	Simultaneous equations	Governance was found to not influence aid effectiveness Aid effectiveness is higher on poverty eradication when the funds are focused on poverty reducing means

Source: Developed for the research

2.3 Literature gap

In summary, the South Asian region was rarely focused on by empirical studies which most of the studies were done on sub-Saharan Africa or individual countries. Additionally, the factor of governance was rarely taken into consideration while assessing the relationship between foreign aid and poverty eradication. Multiple empirical studies had stated the importance of institutional quality in ensuring aid effectiveness (Mahembe & Odhiambo, 2021; Arivin & Barillas, 2002; Chong, Gradstein & Calderon, 2009). Henceforth, this study takes governance into account while investigating the aid-poverty relationship nexus for South Asian countries.

2.4 Conclusion

Generally, past studies had shown different results over the years. Foreign aid was found to have different effects on poverty alleviation due to various external factors. Good governance had shown to have significant poverty alleviation effect in empirical literatures. However, results are inconsistent when governance is included in assessing the relationship between aid and poverty. Methodology of the study will be discussed in Chapter 3.

Chapter 3: Methodology

3.0 Introduction

This chapter has four sections, firstly is the outline of the research design for the study which describes the data and variables used. Then the details of the data source are listed, followed by the conceptual framework and model specification.

3.1 Research Design

This study aims to investigate the relationship between foreign aid, governance, and poverty for 8 South Asian countries, namely Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. The secondary data collected ranges between the year 2000 to 2020 in the form of quantitative data from a secondary source. The time series faces constraints as the earliest data shown on the Sustainable Development Goals (SDG) index is the year 2000, and that the most up to date year for all data is 2020.

Quantile regression model is used in this study. It allows the estimation of different quantiles of a dependent variable distribution in a linear model, which shows the causal relationship between the independent and dependent variables more thoroughly (Cade & Noon, 2003). Hence, the use of this model enables us to examine different relationship of the independent variables, namely foreign aid and governance, with the dependent variable, poverty eradication, at different levels of poverty. The results are estimated and analysed using Stata software after collecting and compiling the data.

3.2 Data Source

Yearly time series data are used in this study for the 8 South Asian countries from the year 2000 to 2020. The data are collected from The World Bank, World Governance Indicators, and the SDG Index, in which a total of 168 observations will be taken into consideration. The dependent variable for this study is poverty eradication, whereas independent variables consist of foreign aid and governance. The proxy, definition and source of each variable will be discussed as follows.

3.2.1 Poverty Eradication

The SDG Index will be used as proxy for the dependent variable, poverty eradication, to determine aid and governance effectiveness through identifying their achievement in the SDG Goal 1: poverty eradication (Wei, Zhong, Song et. al, 2023). It measures the total progress towards achieving all 17 SDGs. The higher the score, the closer the country is towards achieving the goal. The index is generated by taking the average of three indicators, namely percentage of poverty headcount ratio at $1.90 per day, percentage of poverty headcount ratio at $3.20 per day, and percentage of poverty rate after taxes and transfers, which are obtained from the World Bank and OECD statistics (SDG Tracker, n.d.).

3.2.2 Foreign Aid

For the first independent variables, foreign aid, it will be proxied by the net official development assistance (ODA) per capita according to several empirical studies. Alvi and Senbeta (2011), Chong et. al. (2009) and Gillanders (2016) had used ODA in their study of the relationship between foreign aid and poverty. The indicator is a weighted average of concessional loans, disbursements for private sector instruments. and grants made on annual terms. It excludes aid flows made for the use of military and anti-terrorism purposes.

3.2.3 Governance

For the second independent variable, governance, the six indicators of the Worldwide Governance indicators will be used. It includes Voice & Accountability, Political Stability and Lack of Violence, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. Hassan et. al. (2019), Workneh (2020) and Jamil et. al. (2022) had used the six indicators of WGI to study the relationship between governance and poverty.

3.2.4 Control Variables

The control variables used in this study includes economic growth (GDP), inflation rate (INF) and age dependency ratio (AGE) (Alvi & Senbeta, 2011; Asra et. al., 2005; Chong et. al., 2009; Jamil et. al., 2021).

Table 3.1: Data source

Variables	Proxy	Description	Source
Poverty eradication	SDG	The SDG Index Score, and all goal and indicator scores, calculated using time series data that was carried forward in years with missing data.	Sustainable Development Solutions Network
Foreign aid	ODA	Net ODA received per capita (current US$)	World Bank
Governance	WGI	Estimate of six Worldwide Governance Indicators (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance)	World Bank
Economic growth	GDP	GDP per capita (current US$)	World Bank
Inflation rate	INF	Inflation, GDP deflator (annual %)	World Bank
Age dependency ratio	AGE	Age dependency ratio (% of working-age population)	World Bank

Source: Developed for the research

Table 3.2: Countries' Income Classification

Income level	Countries
Upper middle income	Maldives
	Bangladesh
	Bhutan
Lower middle income	India
	Nepal
	Pakistan
	Sri Lanka
Low income	Afghanistan

Source: Developed for the research

Table 3.2 shows the source of data and definition for the dependent, independent and control variables used in this study. Table 3.3 shows the income classification for the 8 South Asian countries used in this study.

3.3 Conceptual Framework

Figure 3.1: Conceptual Framework
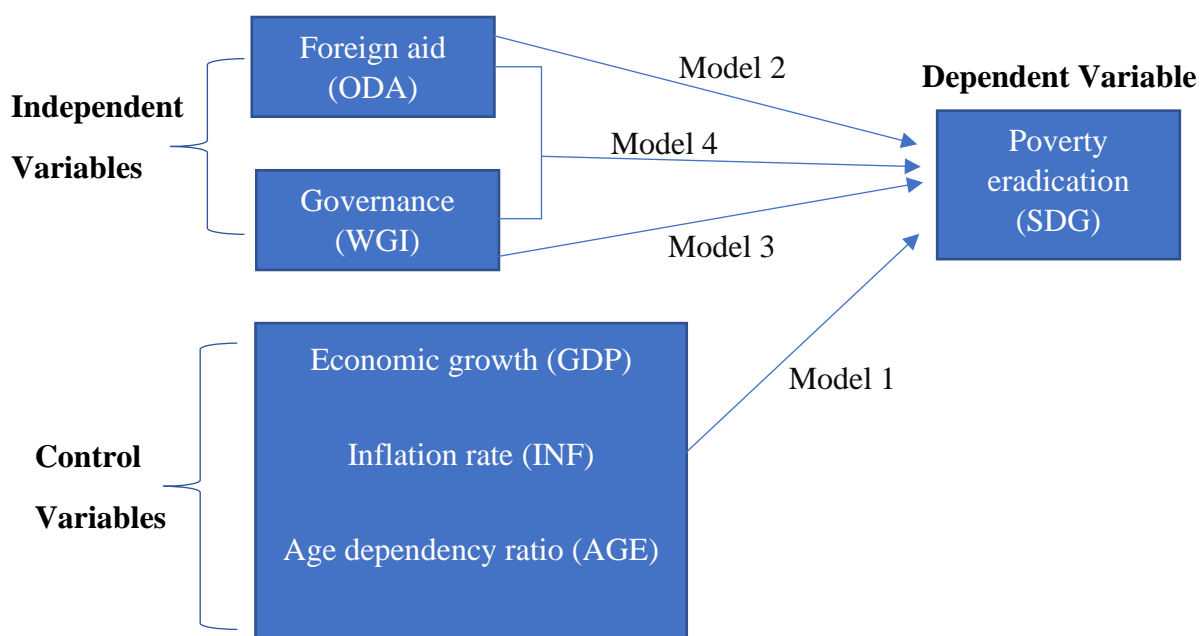
Source: Developed for the research

Figure 3.1 shows that foreign aid and governance are the independent variables, whereas poverty eradication is the dependent variable of this study. Both the independent variables, foreign aid and governance, are expected to have a positive relationship with the dependent variable, poverty eradication.

3.4 Research Hypothesis

The following hypothesis are obtained from the conceptual framework:

Variables	Hypothesis
ODA	H_{01}: There is no relationship between ODA and SDG in the South Asian Region.
	H_{A1}: There is a positive relationship between ODA and SDG in the South Asian Region.
WGI	H_{01}: There is no relationship between WGI and SDG in the South Asian Region.
	H_{A1}: There is a positive relationship between WGI and SDG in the South Asian Region.
WGIlnODA	H_{01}: There is no relationship between WGIlnODA and SDG in the South Asian Region.
	H_{01}: There is a relationship between WGIlnODA and SDG in the South Asian Region.

3.5 Model Specification

The econometric model is as follows:

$$SDG_{i,t}(\tau|X_{i,t}) = \beta_0 + \beta_{1,\tau}lnGDP_{i,t} + \beta_{2,\tau}INF_{i,t} + \beta_{3,\tau}AGE_{i,t} + \varepsilon_i \qquad (1)$$

$$SDG_{i,t}(\tau|X_{i,t}) = \beta_0 + \beta_{1,\tau}lnODA_{i,t} + \beta_{2,\tau}lnGDP_{i,t} + \beta_{3,\tau}INF_{i,t} + \beta_{4,\tau}AGE_{i,t} + \varepsilon_i \qquad (2)$$

$$SDG_{i,t}(\tau|X_{i,t}) = \beta_0 + \beta_{1,\tau}lnODA_{i,t} + \beta_{2,\tau}WGI_{i,t} + \beta_{3,\tau}lnGDP_{i,t} + \beta_{4,\tau}INF_{i,t} + \beta_{5,\tau}AGE_{i,t} + \varepsilon_i \qquad (3)$$

$$SDG_{i,t}(\tau|X_{i,t}) = \beta_0 + \beta_{1,\tau}lnODA_{i,t} + \beta_{2,\tau}(WGI * lnODA)_{i,t} + \beta_{3,\tau}lnGDP_{i,t} +$$
$$\beta_{4,\tau}INF_{i,t} + \beta_{5,\tau}AGE_{i,t} + \varepsilon_i \tag{4}$$

Where,

$SDG_{i,t}$	= Country i's SDG Index Score in year t;
$lnODA_{i,t}$	= Country i's logarithmic of official development assistance in year t;
$WGI_{i,t}$	= Country i's governance indicators in year t;
$lnGDP_{i,t}$	= Country i's logarithmic of GDP per capita in year t;
$INF_{i,t}$	= Country i's inflation rate in year t;
$AGE_{i,t}$	= Country i's age dependency ratio in year t

Model 1 shows the basic model of this study with the three control variables, namely economic growth, inflation rate and age dependency ratio. Model 2 shows the direct relationship between foreign aid and poverty. Model 3 shows the direct relationship between both foreign aid and governance with poverty. Model 4 incorporates a moderation factor (WGI*lnODA), where governance has a moderation effect to show the impact of governance on the foreign aid and poverty relationship nexus.

3.6 Conclusion

This chapter explains the methodology used in this study to investigate the research objective. It outlines the research design, data source, conceptual framework and model specification of the study. The findings of the study will be analysed in the next chapter.

Chapter 4: Results

4.0 Introduction

The relationship between foreign aid and governance with poverty eradication of the South Asian countries will be analysed in this chapter. The descriptive statistics and correlation analysis are explained, followed by a detail analysis of the models used in this study.

4.1 Model Identification

4.1.1 Descriptive Statistics

Table 4.1: Descriptive Statistics

Variables	Observations	Mean	Std. Dev.	Minimum	Maximum
SDG	168	64.49	22.85	32.80	99.77
lnODA	168	3.232	1.515	-0.438	6.405
WGI	168	-0.597	0.582	-1.963	0.609
WGIlnODA	168	-1.918	2.596	-9.636	3.349

Source: Developed for the research

Table 4.1 shows the descriptive statistics of the dependent variable and independent variables of the study. The results show a sample size of 168 observations. The mean represents the average of the data. The greatest

mean is found in SDG with a value of 64.49, followed by lnODA with a value of 3.232. WGI has mean of negative 0.597, whereas WGIlnODA has the lowest mean with a value of negative 1.918. The value of standard deviation represents how far the value is spread out in relation to its mean value. The highest standard deviation is found in SDG which deviates from the mean by 22.85, whereas the lowest is found in WGI which deviates from the mean by 0.582. SDG also has the greatest difference (66.97) between its minimum (32.80) and maximum (99.77). WGI has the smallest difference between its minimum (-1.963) and maximum (0.609) value.

4.1.2 Correlation Analysis

Table 4.2: Correlation Analysis

	sdg	lnoda	wgi	wgilnoda	lngdp	inf	age
sdg	1.0000						
lnoda	0.7539	1.0000					
wgi	0.1142	0.0245	1.0000				
wgilnoda	-0.1631	-0.2353	0.9199	1.0000			
lngdp	0.5001	0.2702	0.6060	0.4796	1.0000		
inf	-0.0874	-0.0301	-0.1162	-0.0656	-0.0561	1.0000	
age	-0.0029	0.0761	-0.7610	-0.7419	-0.7650	0.1181	1.0000

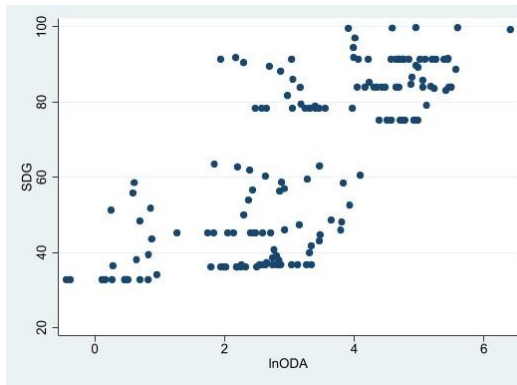Source: Developed for the research

Table 4.2 shows the correlation between the dependent variable, SDG, and independent variable, lnODA and WGI. The value of correlation describes how strong the relationship or association is between two variables. It can be observed that lnODA shows a value of positive 0.754 with SDG, which is within the range of 0.80 to 1.00. This indicates that lnODA has a strong and positive correlation with SDG. WGI shows a value of positive 0.114 with SDG, which is within the range of 0.00 to 0.19. It means that WGI has a very weak and positive correlation with SDG. The moderating variable,

WGIlnODA has a value of negative 0.163 with SDG. It is also within the range of 0.00 to 0.19. This indicates that WGIlnODA has a very weak and negative correlation with SDG.
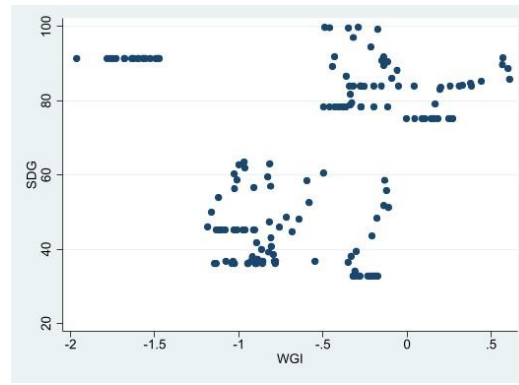
4.1.3 Scatter Plot
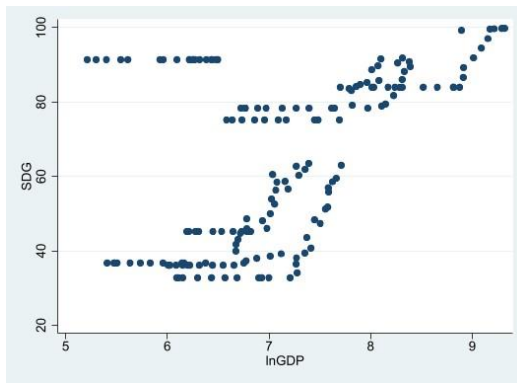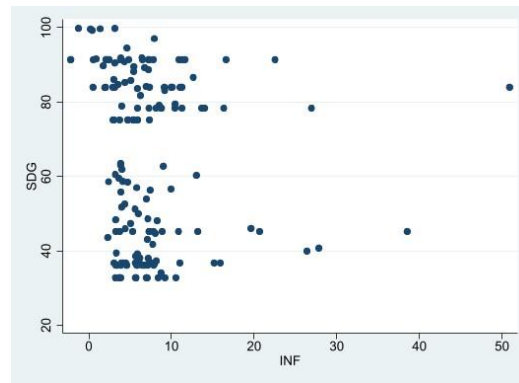
Figure 4.1: Scatter Plot

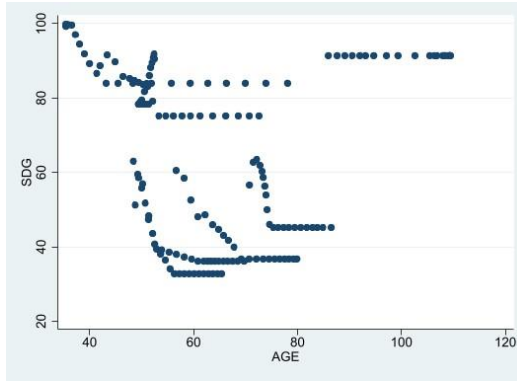**Foreign Aid (lnODA)**   **Governance (WGI)**

Economic Growth (lnGDP)   **Inflation Rate (INF)**

Age Dependency Ratio (AGE)

Source: Developed for the research

Figure 4.1 shows the scatter plots for the dependent variable, SDG, on the Y-axis against the independent and control variables on the X-axis. The scatter plot for lnODA, WGI and lnGDP showed a positive relationship with SDG. However, the control variables, INF and AGE, did not show a clear pattern with SDG from the scatter plot. Generally, the plots are very dispersed and does not show clear patterns at all quantiles of the variables. This situation may present the implication that the residuals are not normally distributed. Henceforth, the use of quantile regression is applied in this study.

4.2 Findings

4.2.1 Model 1

Table 4.3: Model 1

Variables	15%	25%	50%	75%	95%
lnGDP	29.6290***	26.9007***	32.8507***	20.9374***	10.6797***
	(2.2140)	(1.5530)	(2.3712)	(6.3803)	(1.0857)
INF	-0.3715	-0.5115*	-0.6778***	-0.3491	-0.3193

	(0.2683)	(0.2687)	(0.2353)	(0.3221)	(0.2017)
AGE	0.8986***	0.7451***	1.3885***	0.8440**	0.4859***
	(0.1318)	(0.1910)	(0.2385)	(0.3267)	(0.0460)

Source: Developed for the research

Table 4.3 shows the result of Model 1, the control model of the study. lnGDP and AGE was found to be highly positively affecting poverty eradication at 1% and 5% significance level for all quantiles. INF is negatively significant at quantile 25% and 50% with a 1% and 10% level of significance respectively.

4.2.2 Model 2

Table 4.4: Model 2

Variables	15%	25%	50%	75%	95%
lnODA	6.1138***	7.4818***	7.6131***	7.0749***	2.9019
	(1.0456)	(0.8492)	(0.7771)	(1.3245)	(2.7224)

Source: Developed for the research

Table 4.4 shows the results of Model 2, which investigates the direct relationship between SDG and lnODA of the South Asian countries. The results indicates that lnODA has a positive and highly significant relationship with SDG at the first four quantile (15%, 25%, 50% and 75%), which all four shows a 1% significance level. The positive coefficients of lnODA range between 6.11 to 7.61 at the first four quantile. This means that when the goal of poverty eradication is achieved between 15 to 75%, 1 unit

increase in lnODA will increase SDG by 6.11 to 7.61 units. However, lnODA has an insignificant relationship with SDG at the highest quantile, 95%. This indicates that when the goal of poverty eradication is achieved up to 95%, ODA is ineffective in assisting the reduction of poverty. The results for lnODA are consistent and similar throughout each model tested.

4.2.3 Model 3

Table 4.5: Model 3

Variables	15%	25%	50%	75%	95%
lnODA	6.6140***	7.3178***	7.1406***	6.0246***	2.1716
	(0.9048)	(0.7502)	(0.6761)	(1.7900)	(3.7323)
WGI	8.2652**	6.8285*	7.2626***	4.3221	-2.2871
	(3.8340)	(3.6363)	(1.8454)	(5.9243)	(7.8946)

Standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$
Source: Developed for the research

Table 4.5 shows the results of Model 3, which investigates the relationship between SDG and WGI. WGI shows positive and significant relationship with SDG at the 15%, 25% and 50% quantile, each at a 5%, 10% and 1% level of significance respectively. When the goal of poverty eradication is achieved up to 15%, 1 unit increase in WGI increases SDG by 8.27 units. When the goal of poverty eradication is achieved up to 25%, 1 unit increase in WGI increases SDG by 6.83 units. When the goal of poverty eradication is achieved up to 50%, 1 unit increase in WGI increases SDG by 7.26 units. However, when the goal of poverty eradication is achieved up to 75% and 95%, WGI showed insignificant relationship with SDG.

4.2.4 Model 4

Table 4.6: Model 4

Variables	15%	25%	50%	75%	95%
lnODA	7.3213***	7.5645***	7.2885***	7.8967***	3.1432
	(1.0176)	(0.8397)	(0.9075)	(1.2987)	(2.6314)
WGIlnODA	1.4299	0.6138	1.0519	-1.8961	-1.4205*
	(1.2572)	(1.0523)	(0.9076)	(1.2390)	(0.8582)

Standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$

Source: Developed for the research

Table 4.6 shows the results of Model 4, which investigates the impact of governance on the foreign aid and poverty relationship nexus. The results show that the variable WGIlnODA, which governance is used as a moderator, showed insignificant results throughout the first four quantile. At the highest quantile, 95%, a negative relationship is found between SDG and WGIlnODA at 10% level of significance. It indicates that when the goal of poverty eradication is achieved at 95%, 1 unit increase in WGIlnODA will reduce SDG by 1.42 units.

4.3 Conclusion

This chapter analysed the findings of the relationship between foreign aid and governance with poverty eradication of South Asian countries. Results of foreign aid was found to be consistent in all quantiles of all models. WGI has significant results up to 50% quantile, whereas the moderating variable WGIlnODA is only

significant at the highest quantile of 95%. Discussion of the results will be carried out in the next chapter.

Chapter 5: Conclusion

5.0 Introduction

In this chapter, the discussion and summary of findings will first be discussed, followed by the policy implication and limitations of study. The study will then end with a conclusion.

5.1 Discussion and Summary of Findings

5.1.1 Foreign Aid and Poverty Eradication

The results from Model 2 shows the direct relationship between foreign aid and poverty eradication. Foreign aid was found to have positive and significant relationship with poverty eradication for 15%. 25%, 50% and 75% quantile. These findings indicates that foreign aid is effective in eradicating poverty when poverty alleviation is less achieved. The findings are consistent with Mahembe and Odhiambo (2021), Khan et. al. (2022) and Alvi and Senbeta (2011) which they found statistically significant evidence that aid reduces poverty levels. However, it is not consistent with several studies. Page and Shimeles (2015) stated in their study that ODA is one of the reasons for the slow achievement of poverty reduction for African countries. Arvin and Barillas (2002) found that aid has a damaging effect on poverty due to misallocation of aid. These studies suggested that

institutional quality is the factor leading to the insignificant result of aid and poverty.

Findings from Model 2 also show that relationship of aid with poverty eradication is insignificant at the highest quantile, 95%. This result indicates that when poverty eradication has reached its highest achievement, where poverty rates are reduced to its lowest, aid will be ineffective in alleviating the remaining existing poverty. It suggests that aid is only effective until a certain extent of poverty level, when the country has reached a very low poverty rate, aid should not be used for poverty alleviation, but rather other economic variables should be given more attention.

5.1.2 Governance and Poverty Eradication

While investigating the relationship between governance and poverty eradication, governance was found to have significant impact on poverty eradication up until the 50% quantile. It indicates that governance has poverty alleviation effects at low levels (15%, 25% and 50%) of poverty eradication achievement. The results are in line with Hassan et. al. (2019), Jamil et. al. (2022) and Coccia (2021) which governance was found to be highly effective in mitigating poverty, especially using the following variables: governance effectiveness, voice and accountability, and regulatory quality.

The results had also shown that at higher levels (75% and 95%) of achievement, governance will lose its effectiveness and have an insignificant negative impact instead. The findings by Workneh (2020) may explain this situation, where he stated that when the level of gender inequality is too high, the negative effects it brings may override the positive

impact caused by good governance. Kwon and Kim (2014) stated that governance does not have poverty alleviation effects in South Asia due to the factor of structural inequality which restrains its progress. Hence, it can be deduced that the higher level of poverty eradication, the less important the function of governance in poverty alleviation. In this case, external factors such as gender and structural inequality may tamper the good governance effectiveness.

5.1.3 Foreign Aid, Governance, and Poverty Eradication

From the findings from Model 3, it is found that governance show significance in moderating the aid and poverty eradication relationship only at the highest level (95%) of poverty eradication. When poverty eradication is between the levels of 15% to 75%, governance show no significance in assisting aid to alleviate poverty. Several empirical studies had shown such results. Asra et. al. (2005), Sharma and Bhattarai (2013), and Matteis (2013) had found no significance that governance has any influence on aid effectiveness on reducing poverty. Chong et. al. (2009) found that poor institutional quality and corruption is not the main reason for aid ineffectiveness on poverty reduction, but rather misallocation of aid and preferences of policy makers may explain this situation.

Such evidence shows the poor decision making of policy makers in aid allocation, which provides a possibility that poor policy planning occurs at the lower levels of poverty eradication. A shortage of professional and skilled labour due to higher poverty levels may be the answer to this occurrence. The study by Ferguson, Bovaird and Mueller (2007) explained the situation where children in poverty are more likely to receive less educational attainment than their peers. Hence, it is suggested that the lack

of knowledge on policymaking due to lack of skilled labour leads to poor planning of aid allocation despite the existence of good governance.

5.1.4 Summary

In short, the results show a few clear points: firstly, both foreign aid and governance is effective in poverty alleviation at the lower levels of achievement for poverty eradication. Secondly, external factors such as inequality could potentially hinder the aid or governance effectiveness in reducing poverty. Thirdly, despite the existence of good governance in moderating aid to reduce poverty, misallocation of aid may reduce the governance moderation effect in poverty eradication.

5.2 Policy Implications

Since the direct positive influence of foreign aid and governance on poverty alleviation is shown, policy makers should efficiently use the aid received by ensuring institutional quality. Anti-corruption measures are one of the policies to achieve good governance. It includes regulations such as transparency which track the flow of aid. It ensures that the resources will reach the individuals or organizations intended. Accountability encourages harsh punishment on individuals who broke the law and act as a precedent to prevent further misconduct. Institutional quality also serves as good governance, where public service delivery is important in reducing poverty. Gonzalez and Mendoza (2002) suggested in their study of governance in South Asia that the government should only be leading the direction of market functions and let the market itself grow. Privatization is recommended to improve market efficiency through competition.

Furthermore, policy makers should provide responsiveness to the needs of people through providing good quality of social services. This includes institutions such education, health services and clean irrigation systems. The South Asian Council for Social Services (SACSS) is a non-profit organization that had been supporting the aging citizens, healthcare access, ensuring food security, etc. The cooperation between the government and such organizations accelerates the effects of eliminating the extreme poverty situation. An open and accessible political institution is also important to act as a medium for the public to raise opinions and make decisions for their own well-being. These measures ensures that aid can be delivered effectively and accurately to the businesses and household in need. It can also put aid into good use by using the aid to fund the institutions, which then helps to eradicate poverty.

The findings of the study had also shown the importance of focusing on other external variables such as gender and structural inequality, as it could potentially jeopardize the positive effects brought by foreign aid and good governance. To eliminate such inequality, policy makers should enforce regulations for businesses to accept female labour. They can also pass anti-discriminatory policies to provide the discriminated parties a job opportunity. Other than that, educational quality could also affect aid effectiveness. Policy makers should place importance on funding educational institutions and provide scholarships, especially for children in the rural areas. On the condition that good governance is established, foreign aid can help the policy makers to fund such projects, in which it would increase the number of skilled labours in the country.

5.3 Limitations of Study

This study consists of several limitations, one being its generalizability. As the study is done on the South Asian countries, the results cannot be used to reflect the economic conditions in other countries. Moreover, the observations are limited to the year 2000 to 2020. The results may not be able to define occurrences past the year 2020 or in the far future. The dispersed residuals shown in the scatter plot also presented the issue of lack of data for accurate analysis of the findings. Furthermore, this topic lacks relevant empirical literatures. Although there had been studies done on the relationship between aid, governance and poverty, the South Asian region is less discussed. As most of the studies are done on other regions or countries, there are less academic research on relevant studies for the South Asian region to support this topic.

Lastly, there is a possibility where some important variables are omitted in this study. As the result has shown, variables such as inequality and educational quality could potentially affect the aid and governance influence on poverty eradication, this study did not take these variables into account. The omission of possible explanatory variable may decrease the effect on poverty eradication by its magnitude or draw false conclusions regarding the findings obtained. The inclusion of such variables may improve the accuracy on the influence of aid and governance on poverty eradication.

5.4 Conclusion

This study investigates the relationship between foreign aid and governance with poverty eradication. The results show that foreign aid and governance both has a direct positive influence on poverty eradication at lower levels of poverty alleviation. At higher poverty alleviation levels, the two variables lose its effect to reduce poverty. Additionally, governance is found to only be effective in moderating aid on poverty eradication when the highest level of poverty eradication is achieved. Therefore, it is crucial for policy makers to understand that improving

the quality of governance is not the only way to reduce poverty depending on the level of poverty eradication achievement of the country. In fact, several other economic indicators should be focused on as well to amplify the effectiveness of the poverty reduction policies. This paper will help policy makers to understand the functionality of aid and governance on poverty eradication for countries at different levels of poverty reduction achieved. Future studies should expand the research sample geographically and also in terms of the span of time observed. Likewise, further research can include more economic variables that could potentially influence poverty reduction in their study of poverty eradication.

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