

Executive Summary

Whether or not ODA, grant in particular, has been effective in economic growth of the recipients has been controversial. There appears to be a belief that grant is not so effective in raising economic growth rate. The current research tests the effectiveness of grant in economic growth of Korea's main development partners using econometric analyses.

For that purpose, this research performs time series analyses with respect to Vietnam in Asia and Tanzania in Africa as well as panel analyses covering 42 main development partners. After performing the econometric analyses, the research team undertook field trips to complement the results from the econometric analyses by understanding the institutional and qualitative factors that explain the effect of grant on economic growth.

When performing time series analyses, this research employs the unit root tests, cointegration tests, ordinary least squares estimations based on the stationary series and the error correction models. The empirical evidence on the case of Vietnam can be summarized in the following manner. First, grant has a positive and significant effect on economic growth of Vietnam. Second, when non-linearity is considered in the analysis, the effect of grant on economic growth is statistically significant and there is evidence of diminishing return to aid. Meanwhile, the calculated turning point shows that the increase in the ratio of grant/GDP in Vietnam actually has a positive effect on per capita real GDP growth rate. Third, FDI inflows are also revealed to have a positive and significant effect on economic growth of Vietnam. Fourth, when aid-policy interaction term is included in the econometric analysis, where policy is measured by inflation rate, the positive effect of grant (or ODA as a whole) on economic growth is revealed not to depend on specific policy condition.

The empirical evidence on the case of Tanzania can be summarized in the following manner. First, when the non-linear effect is considered, grant is revealed to have a positive and significant effect on economic growth of Tanzania and the positive effect of grant on per capita real GDP growth rate tends to decrease with the rise in grant/GDP ratio. Second, there is weak evidence on positive contribution of lower inflation rate and export expansion to economic growth. Third, aid-policy interaction term is revealed to be statistically insignificant. Therefore, we can conclude that the effect of grant on economic growth is not conditional upon specific policy conditions, when policy is measured by inflation rate. Fourth, the effect of grant on economic growth is qualitatively the same as that of ODA as a whole.

In Vietnam and Tanzania, the share of economic infrastructure in ODA is larger than that in the other countries in general. It may be one of the reasons behind the positive and significant contribution of grant and ODA as a whole in economic growth of those two countries.

The main results of the panel analysis for 42 main development partners of Korea during 1996–2013 are as follows. Among others, grant is revealed to have a positive and significant effect on economic growth. There are some evidence of diminishing return to aid. The positive effect of grant on economic growth is revealed not to be conditional upon macroeconomic policy expressed in terms of inflation rate. The conclusions from the panel analysis with respect to grant are qualitatively similar to those with respect to ODA as a whole.

The panel analysis shows significantly different effects of grant on economic growth by regions. The effect is larger in Asia than in Africa. Such an effect is in general the largest in Latin America. The effect of grant on economic growth is revealed not to be conditional upon specific macroeconomic policies. In some cases, diminishing return to aid is found in Asia and Africa.

The panel analysis also shows the positive effect of grant on economic growth by income levels. When policy condition is not considered, the positive and significant

effect of grant on economic growth is found in the least developed countries. Meanwhile, if policy condition is considered in the empirical works, the positive and significant effect of grant on economic growth is also found in the fragile states. Meanwhile, in the middle income developing countries, grant does not have a significant effect on economic growth. In addition, the effect of grant on economic growth is revealed to be conditional upon macroeconomic policies when they are measured by inflation rates. When analyzed by income levels, the non-linear effect of grant on economic growth is not found.

In conclusion, the results of both time series analysis with respect to Vietnam and Tanzania and panel analysis applied to 42 main development partners of Korea show that grant has a positive and significant effect on per capita real GDP growth rate of the recipients. Diminishing return to aid phenomenon is found in some cases. Meanwhile, the effect of grant on economic growth is in general revealed not to be conditional upon macroeconomic policy.