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Hieu Huu Nguyen
Ph.D., Lecturer, Dean of
Fundamental Faculty, Audit
Training Institute, State Audit
Office of Vietnam, Vietnam

The relationship between official development assistance and economic growth: A case of Vietnam

Hieu Huu Nguyen

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Abstract

This research uses the ordinary least-squares regression method to study the impact of official development assistance (ODA) on economic growth of Vietnam in the period 1993-2019. The method also assesses the impact of foreign direct investment (FDI) on Vietnam economy. Statistical data is collected from the General Statistics Office of Vietnam and Ministry of Planning and Investment of Vietnam. The results of statistical tests show the significant regression method, meaning that ODA and FDI have relationship with the economic growth of Vietnam. However, upon testing of each variable, FDI has a positive influence and promote Vietnam's economic growth, while there has not been sufficient evidence to confirm that the ODA has relationship with economic growth of Vietnam. Vietnam needs to apply practical measures to promote the effectiveness and efficiency of using ODA.

Keywords: Official development assistance, economic growth, economy, Vietnam

1. Introduction

ODA is the preferential financial aid of the developed countries or international organizations to the developing countries. ODA is commonly used for agriculture and rural development, hunger eradication, poverty reduction, environment, education, healthcare, transportation, institutional reform etc., The above said areas are fundamentals for socio-economic development. As such, theoretically, ODA is considered by many scholars as external resources which play an important role to accelerate the socio-economic development of the recipient countries. However, there should be statistical hypothesis tests to assess the impact of ODA to the economy.

After a long discontinuance, on November 1993, Vietnam rebuilt the relationship with Paris Club which marked an important milestone in receiving financial aid from international organizations and foreign countries, especially from the developed countries. Up to now, Vietnam has 28 bilateral donors and 31 multi-lateral donors. Total value of ODA for period 1993-2019 is approximately US\$65 billion (this research excludes the study on impact of ODA to Vietnam economy for 2020-2022 period due to negative consequences of Covid-19 pandemic). ODA disbursement accounts for 4-5% of total investment for the whole society and 18-19% of total investment from the state budget of Vietnam. With typical features such as long-term loan, low interest, high grant element etc., ODA serves as a catalyst for the socio-economic development of Vietnam. However, since 2010, the preferential conditions of ODA applicable to Vietnam has been gradually cut down as due to the fact that Vietnam became a lower-middle income country. Especially, after Vietnam terminated IDA loan with preferential conditions of World Bank in 2017 and ADF loan of Asia Development Bank (ADB) in 2019, ODA is no longer a preferential source. ODA is now considered as a loan with commercial rates based upon negotiation and mutual agreements with the donors. Vietnam still has demand on ODA as the economy has many long-term bottlenecks and is facing to emerging challenges. It is necessary for Vietnam to have proper strategies and measures to improve the effectiveness of ODA usage. Analysis and assessment of ODA impact to the economy in 1993-2019 period are critical which create the practical basis to formulate the right policy orientation in attraction and usage of ODA in upcoming development period.

In term of economic growth target, the important question is that: Does ODA have relationship with Vietnam's economic growth from 1993-2019 period? Basing upon the

Corresponding Author:
Hieu Huu Nguyen
Ph.D., Lecturer, Dean of
Fundamental Faculty, Audit
Training Institute, State Audit
Office of Vietnam, Vietnam

statistical hypothesis analysis on the relationship between ODA and economic growth of Vietnam, this research will seek answers to the above question. Therefrom, it proposes policy recommendations to improve the effectiveness of using ODA.

2. Literature Review

There are many scholars who study the impact of ODA to the economic growth of aid-recipient countries. Their studies were implemented with different scales, based on different perspectives of different countries within the region or inter-region or for a single country itself. The results vary, even some studies have contradicted results. Therefore, it is necessary to have statistical hypothesis assessment for a specific country within a certain period of time to assess the importance of ODA to the economic growth of a particular country. The results from these analyses are useful for policy makers in planning the strategy to attract and usage of ODA in order to maximise the effectiveness of this resource which can be attributable to the economic growth.

Wehncke, Marozva and Makoni (2023) ^[15] study the contribution of foreign aid and FDI to the economic growth of 20 selected African countries from 2000-2018. The results show long-term positive relationship between foreign aid and economic growth; between FDI and economic growth; and between FDI and foreign aid. The results also reveal that FDI seems to follow ODA. The scholars recommend that African countries should promote ODA to attract more FDI from which it can boost the economic growth. Dash (2021) ^[7] assesses the impact of foreign aid to economic growth of eight South Asian countries, such as Afghanistan, Bangladesh, Bhutan, India, The Maldives, Nepal, Pakistan, and Sri Lanka from 1996 to 2018. The result shows that there is a positive association between foreign aid and economic growth in the short-run and long-run. The outcome from the study of Moolio and Kong (2016) ^[11] has the same conclusion that foreign aid has a favorable effect on economic growth of Cambodia, Laos, Myanmar, and Vietnam during 1997-2014 period. When study is conducted for each country independently, scholars confirm that ODA has positive impact to the economy. Chansomphou and Ichihashi (2011) ^[6] conclude that foreign aid has a strong positive impact and is the main contributor to income level and income growth of Laos in the long run. Golder, Sheikh and Sultana (2021) ^[9] have the same result when studying the relationship between ODA and Bangladesh economy in 1989-2018 period. Also, the study on impact of foreign aid to economic growth in Nepal from 1975/76 to 2015/16, Pradhan and Phuyal (2020) conclude that ODA has a positive relationship with GDP, however, the relationship is not significant.

On the contrary, ODA also has negative impact on the economy of the recipient countries. From the assessment on the effectiveness of ODA in 142 countries from 1970-2014, Ahn and Park (2019) ^[3] point out that ODA has a negatively significant impact on economic growth of recipient countries. However, it is positively correlated with human development index. The study result of Mitra and Hossain (2013) ^[10] also indicates a significantly negative relationship between foreign aid and per-capita economic growth of the Philippines for the period from 1970-2010. A 1% rise in the share of aid in GDP results in a fall in per-capita real income by 0.51%.

According to other studies, ODA has ambiguous impact on the economic growth. Ekanayake and Chatrna (2010) ^[8] analyze the effects of foreign aid on the economic growth of 83 aid-receiving developing countries in Asia, Africa, Latin America, and the Caribbean. The study focuses on 1980-2007 period which is split into three separated phases: 1980-1989, 1990-1999, 2000-2007. The model is also estimated for different income levels including low income, low middle income, upper middle income and all income levels. The result shows that foreign aid has mixed effects on economic growth of tested countries. For time periods, foreign aid has negative effect in 1980-1989, 1990-1999, and 1980-2007. For regions, foreign aid variable only has a positive sign in Africa, and has negative effect in the last three regions: Asia, Latin America, and the Caribbean. For income levels, foreign aid has a positive influence for low income, upper middle income and all income levels. In the meantime, foreign aid has negative impact to the countries which are classified as low middle income ones. From collection and analysis of data during 2002-2019 period from 44 developing countries, Abate (2022) ^[1] illustrates the relationship between ODA and economic growth in accordance with “inverted U shape” which indicates the existence of optimal level of aid equal to 9.7% of GNI. Foreign aid has positive impact under 9.7% GNI, however, GNI in excess of the above rate has negative impact. On that basis, Abate (2022) ^[1] suggests that the developing countries should not receive a huge amount of aid. Yiew and Lau (2018) ^[16] also indicate that U-shape relationship model between ODA and economic growth of 95 countries in 2005-2013 period. This implies that ODA is not the most important criteria for economic growth of studied countries. The scholars recommend that ODA usage should attach to the attainment of Sustainable Development Goals (SDG). Alemu and Lee (2015) ^[4] study the relationship between ODA and economic growth of 2 groups of countries: Group 1: 20 African countries which have middle-level of income and Group 2: 19 African countries which have low-income level. Data was collected for period of 15 years between 1995 and 2010. The statistical hypothesis test result shows the positive relation between ODA and economic growth in countries which have low-income level. ODA boosts the economic growth in these countries through the acceleration of financial resource from savings, from which the investment capital in these countries increase subsequently. For 20 countries which have middle-income level, ODA does not promote positive impact; economic growth of these countries mainly depends on FDI as well as from the revenue of exporting natural resources. Sothan (2017) ^[13] examines the growth impact of foreign aid in Cambodia over the period from 1980–2014. The empirical findings show that foreign aid has positive impact on growth in the short run, but for long run, it has negative impact on investment and growth. Meanwhile, trade openness has positive effects on growth in both short run and long run; investment has positive contribution to the economic growth in the long run. Sothan (2017) ^[13] recommends Cambodia Government to shift from receipt of ODA to promotion of investment and export for the sustainable development. Many other studies have results which do not confirm the relationship between ODA and economic growth. Boone (1996) ^[5] finds that there is no relationship between aid and growth. Foreign aid does not significantly increase investment, nor benefit the poor. Tang and Bundhoo (2017)

[14] study the relationship between ODA and economic growth of Sub Saharan Africa's ten largest recipients of foreign aid, for a period of 23 years from 1990 to 2012. The result indicates that ODA itself has insignificant impact on economic growth. Abdou-Razak, Cheng and Watare (2019) [2] use time series data from 1970-2018 to analyse the relationship between ODA and economic growth of Togo. The same result obtained from this study with the conclusion that there is no relationship between ODA and economic growth of Togo. Moreover, scholars realize that the more Togo depends on ODA, the worse the economic growth would be.

3. Research Methodology

Ordinary least-square method is used in analysing the impact of ODA, FDI on economic growth of Vietnam in the period 1993-2019. Data is taken from the General Statistics Office of Vietnam and Ministry of Planning and Investment of Vietnam. A regression model is built where independent variable is GDP and dependent variables are ODA and FDI.

$$GDP = F (ODA, FDI)$$

Where:

GDP: Gross domestic product

ODA: Official Development Assistance

FDI: Foreign Direct Investment
The model is expressed as follow:

$$GDP = \beta_1 + \beta_2 ODA + \beta_3 FDI + u$$

Where:

β_1 : Regression constant.

β_2, β_3 : Coefficients to be estimated. They measure the effects of ODA and FDI on GDP, respectively.

u: stochastic error term.

Three hypotheses are set up based on regression results to test the impact of ODA, FDI on the economy:

Hypothesis One: Whether the population regression function is significant or not

Hypothesis Two: Whether ODA impacts GDP or not

Hypothesis Three: Whether FDI impacts GDP or not

4. Empirical Results

Based on the data collected from the General Statistics Office of Vietnam and Ministry of Planning and Investment of Vietnam for 1993-2019 period and using Eviews 10.0, the regression result of the impact of ODA, FDI on economic growth of Vietnam is shown in the following Table 1.

Table 1: Empirical results

Dependent Variable: GDP Method: Least Squares Sample: 1993 2019 Included observations: 27				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-22839.02	9680.895	-2.359184	0.0268
ODA	6.613017	4.692537	1.409263	0.1716
FDI	15.83981	1.150654	13.76592	0.0000
R-squared	0.944769	F-statistic		205.2712
Adjusted R-squared	0.940167	Prob(F-statistic)		0.000000
S.E. of regression	25722.21	Mean dependent var		116542.4
Sum squared resid	1.59E+10	S.D. dependent var		105156.9
Log likelihood	-310.9092			

$$GDP = - 22,839.02 + 6.613017 ODA + 15.83981 FDI$$

Hypothesis One: Whether the population regression function is significant or not

$H_0: R^2 = 0$ (The population regression function is not significant)

$H_1: R^2 \neq 0$ (The population regression function is significant)

F-statistic is used to test. With number of observations (n) =27, number of variables (k) = 3, and significance level (α) = 0.05, the result of F is $205.2712 > F_{\alpha}(k-1; n-k) = 3.4$.

Based on above results, H_0 is rejected, therefore, H_1 is accepted. The significance of regression function shows that ODA and FDI have correlation with GDP. The regression results also indicate that independent variables included in the model (ODA and FDI) explain about 94.4769% (R-squared = 0.944769) variations in the dependent variable (GDP). Hence, only 5.5231% variability in GDP is explained by other factors outside ODA and FDI.

Therefore, the model is statistically robust.

Hypothesis Two: Whether ODA impacts GDP or not

$H_0: \beta_2 = 0$ (ODA does not impact on GDP)

$H_1: \beta_2 \neq 0$ (ODA impacts on GDP)

T-statistic is used to test. With number of observations (n) =27, number of variables (k) = 3, and significance level (α) = 0.05, the result of T is $1.409263 < t_{\alpha/2}^{(n-k)} = 2.064$

The above result indicates that H_0 is not rejected. There is insufficient evidence to conclude that the explanatory variable ODA impacts on the explained variable GDP.

Hypothesis Three: Whether FDI impacts GDP or not

$H_0: \beta_3 = 0$ (FDI does not impact on GDP)

$H_1: \beta_3 \neq 0$ (FDI impacts on GDP)

T-statistic is used to test. With number of observations (n) =27, number of variables (k) = 3, and significance level (α) = 0.05, the result of T is $13.76592 > t_{\alpha/2}^{(n-k)} = 2.064$.

The result indicates that H_0 is rejected, thereby confirming that explanatory variable FDI has positive effect on explained variable GDP.

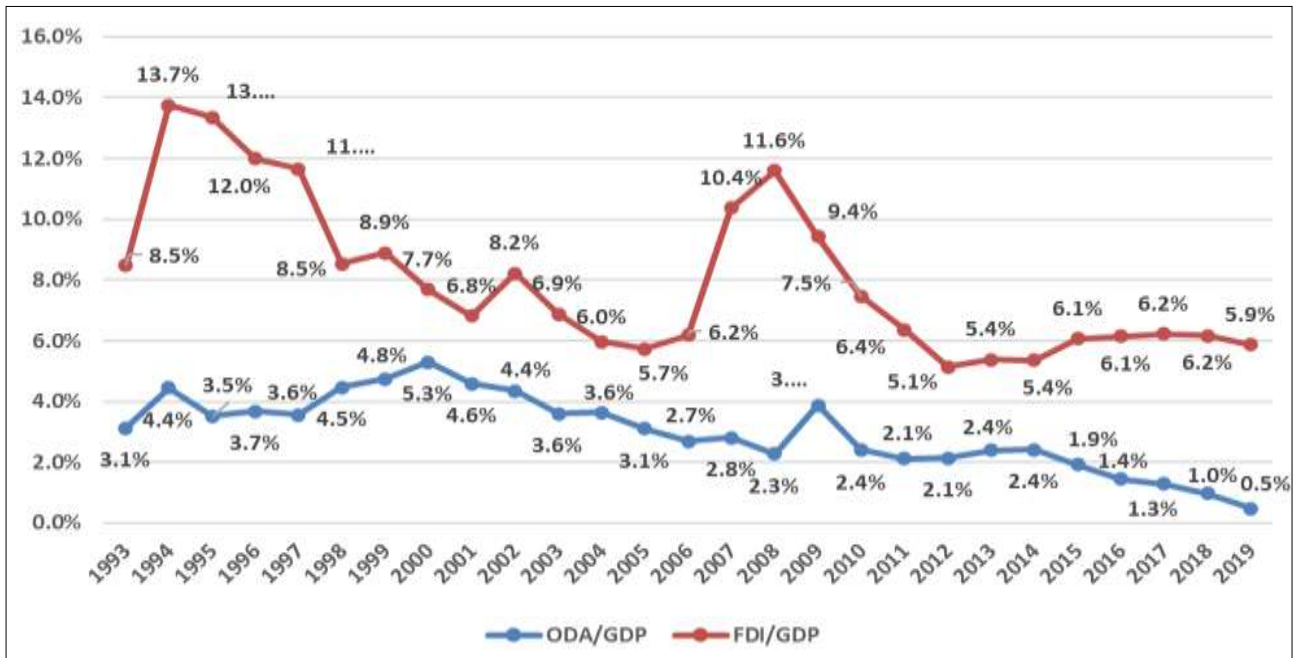
In conclusion, the results of statistical hypothesis tests reveal that in overall, ODA and FDI has the relationship

with economic growth of Vietnam. FDI has a positive impact on GDP, while there is insufficient basis to determine that ODA has relationship with economic growth of Vietnam. This conclusion is in line with study result of Boone (1996) [5], Tang and Bundhoo (2017) [14], Abdou-Razak, Cheng and Watere (2019) [2], and Alemu and Lee (2015) [4] for 20 middle income African countries.

5. Discussions

Vietnam implemented the renovation policy and enhanced the cooperation with international organizations, regions and foreign nations since 1986. The economy of Vietnam developed from a very low starting point. The lack of

domestic savings caused obstacles to the investment development. Thanks to “open door” policy, Vietnam has attracted considerable external resource to overcome the limitation on domestic investment capital. During 1993 - 2019 period, Vietnam received US\$ 2.41 billion from ODA and around US\$ 7.80 billion FDI investment capital on an annual basis. During 1993 -2019 period, Vietnam received US\$ 2,406 billion from ODA on average, around US\$ 7.795 billion FDI investment capital. The total ODA disbursement accounts for 3.01% GDP [see Figure 1]. However, ODA tends to reduce in term of both quantity and proportion in comparison with GDP.



Source: The General Statistics Office of Vietnam and Ministry of Planning and Investment of Vietnam

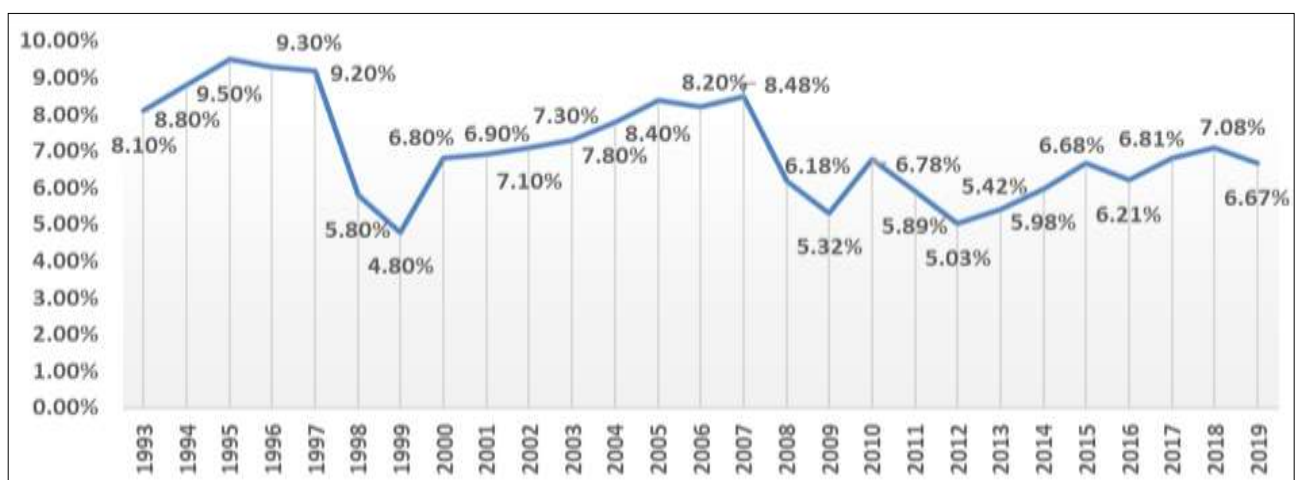
Note:

- (i) ODA/GDP: ODA-to-GDP ratio
- (ii) FDI/GDP: FDI-to-GDP ratio

Fig 1: ODA-to-GDP and FDI-to-GDP ratio of Vietnam 1993-2019

Thanks to the utilization of external resource together with the strategy on promotion of investment from private sector, public sector, Vietnam has achieved the highest economic growth rate in Asean region and compared with other

countries in the world [see Figure 2]. The averaged economic growth rate of Vietnam is about 7.06%/year for 1993-2019 period.

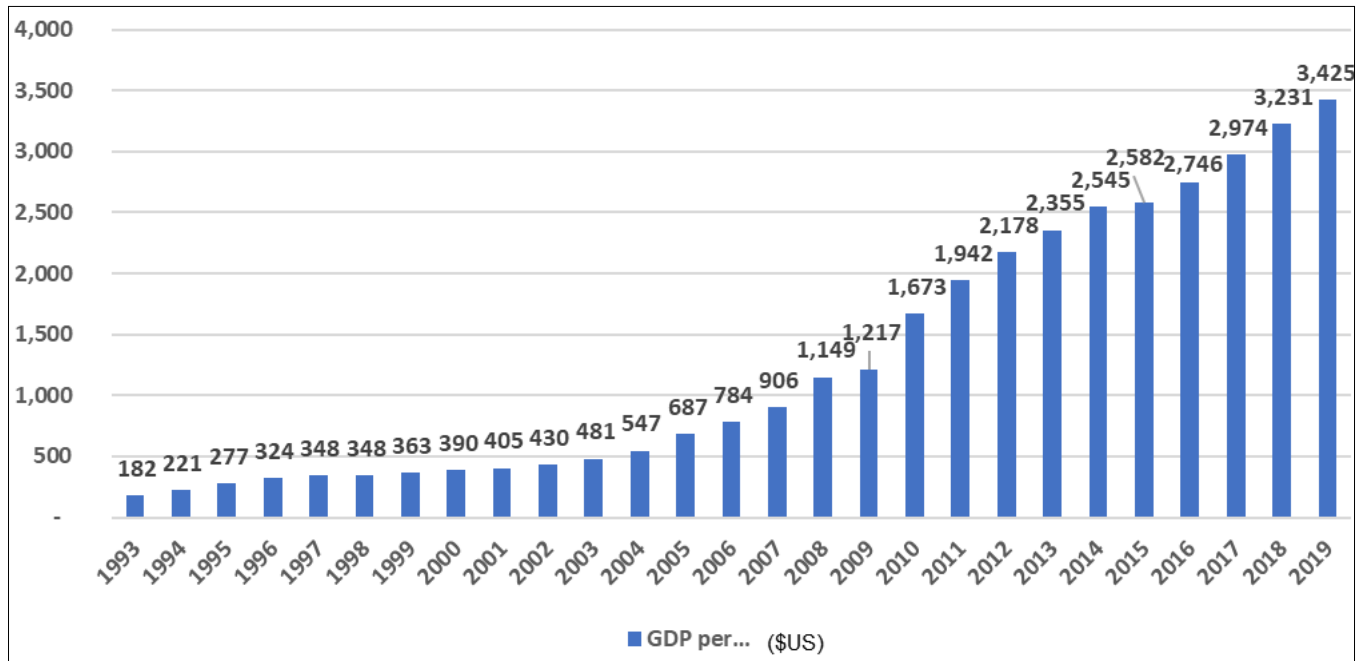


Source: The General Statistics Office of Vietnam

Fig 2: GDP Growth Rate of Vietnam 1993-2019

GDP per capita of Vietnam has been significantly improved [see Figure 3]; in 2008 Vietnam had GDP per capita in

excess of poverty line. Vietnam has officially become lower-middle income countries since 2010.



Source: The General Statistics Office of Vietnam

Fig 3: GDP per capita of Vietnam 1993-2019

ODA has been consolidated into state budget collection pool and used for development investment. In the context that the state budget for development investment is limited, ODA is a valuable resource for investment in public sectors. Many sectors, industries and localities have developed rapidly thanks to ODA.

In the field of transportation, there are many national prioritized ODA programs and projects which have been completed and put into operation and contributed to the completeness and modernization of socio-economic infrastructure. The road and railway system, domestic waterway, seaport, airport, post and telecommunication infrastructure etc., of Vietnam have achieved a remarkable development which promote many closely associated economic fields.

In the field of energy and industry, ODA programs and projects have helped to develop the power system in terms of power sources, transmission and distribution grids, improving reliability and operating safety of the system etc., Thereby improving the capacity of the electricity industry, playing an important contribution to economic growth and improving living standard, as well as making significant contribution to the industrialization and modernization of the country.

In term of environment, many ODA programs and projects have been implemented with the aim of protecting the environment and natural resources; natural disaster risk reduction and prevention; response to climate change, sustainable development and green growth. The living environment is protected and improved through the implementation of ODA projects in areas such as afforestation, water resource management, water supply and drainage, and waste treatment in many towns, cities, industrial zones and residential areas having high population density.

In agriculture and rural development field with poverty

reduction combination, ODA projects have significant contribution to the implementation of Vietnam's sustainable poverty reduction program. Many ODA programs and projects have been implemented to improve the capacity of the poor, create jobs and improve the people's material life. The poverty rate in Vietnam has sharply dropped from 57% in the early 1990s to 5.2% in 2020, with the important contribution of resource supports from foreign countries and international organizations.

In healthcare sector, ODA programs and projects are used to strengthen the physical and technical foundations for medical examination and treatment (construction of hospitals and enhancement of equipment for a number of provincial and city hospitals, district hospitals and commune health stations), improve the quality of healthcare services through the provision of basic medical equipments and high-tech medical equipments, build antibiotic production facilities, national blood transfusion centers, strengthen family planning task, support the implementation of plans prevent HIV/AIDS and infectious diseases such as tuberculosis, malaria, dengue fever, influenza A/H5N1, H1N1 etc., support human resource development, policy formulation and capacity building in healthcare sector management.

In the field of education and training, ODA has supported the development of Vietnam's education and training sector at all levels: primary education, higher education, university and vocational training. Many ODA projects have been implemented to strengthen material and technical foundations for teaching and learning; renovate textbooks and general education curricula; train the trainers to improve their qualifications; send teachers and students abroad for training and retraining; formulate policies and strengthen the management capacity of the education and training sector.

In term of building institutional regime, ODA has played an important role in developing a system of policies and laws,

building mechanisms to serve Vietnam's renovation and reform during the transition period to the market-oriented economy and international integration. Many policies on macroeconomics, finance and banking system reform, state-owned enterprise reform, small and medium-sized enterprises development etc., and laws on land management, commerce, bidding, investment, construction, public debt management etc., have been implemented with technical support and loans from international donors.

For the development of localities, many programs and projects on socio-economic infrastructure development have been invested with ODA capital which contribute to hunger eradication, poverty alleviation, favorable environment for investment, production, business and improve of living standard, especially in rural, mountainous and ethnic minority areas. The strengths and potentials of many localities are enhanced through projects on geographically connection with major economic centers such as Hanoi, Ho Chi Minh City, Da Nang, Can Tho and Hai Phong, international border gates and seaports, airports across the country.

Despite of the above results, the attraction, management and use of ODA in Vietnam still have many shortcomings and limitations below:

Firstly, a large number of ODA project managers have incorrect and improper awareness on nature of ODA. They consider ODA as a non-refundable source of capital, or if it is a loan, the Government is responsible for repayment of debt. Their misperception led to the reality that many inefficient and ineffective ODA projects have still been carried out which put more burden to the country.

Secondly, ODA loans were funded or disbursed with conditional terms on policy, selection of contractors and equipment suppliers. These directly reduce Vietnam's activeness in the management and implementation of ODA projects and indirectly lead to higher costs and loss of opportunities for domestic contractors.

Thirdly, the management and use of ODA are still a questionable matter, there are also violations of Vietnam's law and donor's regulations. The poor management occurs in many localities, ministries and branches using ODA. Corruption and waste directly affect the effectiveness of many ODA programs and projects.

Fourthly, the organization and implementation of some ODA programs and projects are still inadequate and have a lot of loopholes. Investment preparation; appraisal, approval and selection of contractor; signing of construction and installation contracts, equipment procurement; and choosing consultancy services still have many errors. Many projects must increase investment capital. The compensation, migration and clearance works still face many obstacles which prolong the construction time, increase borrowing costs and reduce investment efficiency.

Fifthly, the capacity to absorb ODA of many sectors and localities is still limited. Many ODA programs and projects have been signed, but the disbursement is slow leading to the waste of resources. In recent years, many localities, ministries and central agencies have proposed to return ODA to the central government, the main reason is due to difficulties and obstacles in disbursement.

6. Conclusions

This research uses ordinary least-squares regression method to test the impact of ODA and FDI to economic growth of

Vietnam. The statistical data is obtained from the General Statistics Office of Vietnam and Ministry of Planning and Investment of Vietnam for the period 1993-2019. The test results indicate that ODA and FDI have relationship with the economic growth of Vietnam. However, when examining the relationship separately, the statistical hypothesis tests show FDI has positive impact to Vietnam economy, while there is insufficient basis to conclude that ODA has the relationship with the Vietnam economic growth in 1993-2019 period. Vietnam needs to attract more FDI. On the other hand, it is necessary for Vietnam to apply both short-term and long-term measures to improve the efficiency and effectiveness of using ODA.

7. Recommendations

With the aim of increasing effectiveness and efficiency of using ODA, some policy suggestions are proposed as follows:

Firstly, it is necessary to be properly and fully aware of the nature of ODA, considering ODA as an external resource that complements rather than replaces internal resources for the development process at the national, sectoral, local levels. ODA is not "free capital" but mainly foreign loans under preferential conditions, associated with prestige and national responsibility to the international community.

Secondly, ODA is only used for development investment expenditure, not for recurrent expenditure. The receipt and use of ODA loans must be closely linked with the medium-term public investment plan according to the development phases of the Vietnam economy. New ODA loans need to be assessed in term of their impact on Vietnam's public debt, budget deficit and debt repayment capability. Vietnamese Government needs to strengthen the fight against corruption, loss and waste in the management and use of ODA; prevent and strictly penalize violation acts in accordance with the law.

Thirdly, ODA capital must be allocated centrally to selected projects. The Government of Vietnam should prioritize investment in ODA for: i) projects that directly promote the growth with sustainable development orientation; ii) projects with nature of public goods within the spending plan of the state budget, have spreading effects throughout the country or region, inter-region such as climate change adaptation, education, health, high technology, skills upscaling; iii) essential economic infrastructure projects with no direct return on investment.

Fourthly, the Government of Vietnam needs to develop a set of criteria to evaluate the effectiveness of using ODA. ODA is only received when the project is assessed as having higher socio-economic efficiency compared to the use of domestic loans. ODA resources are prioritized to areas where domestic public investment cannot handle or incapable to handle, or the private sector is not motivated to invest in such project due to difficulty of profit generation.

Fifthly, Vietnam needs to promote the spirit of and awareness on taking the ownership and proactiveness in attracting, managing and using ODA. Ownership manifests itself at both the national and local levels, and must become a decisive factor at all stages of attraction, management and use of ODA. The Government of Vietnam is determined not to accept inefficient ODA or other binding conditions from donors that are detrimental to the sustainable development of the economy. In the long term, Vietnam needs to formalize the roadmap and strategy to end its dependency

on ODA loans.

Sixthly, Vietnam needs to attach the responsibilities of the heads of agencies and units receiving and using ODA with clear implementation milestones, and specific key performance indicator on efficiency and effectiveness of ODA programs and projects. Also, it is necessary to strengthen the inspection, examination and audit of technical specialized agencies and supervision activities of peoples' elected associations for ODA programs and projects.

Seventhly, the Government of Vietnam needs to develop a strategy to receive and use of ODA proportionate with other sources of capital. Investment capital sources from the state budget, private investment, FDI and ODA are encouraged to combine in order to promote the advantages of each kind and source of capital.

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