How to enhance the effectiveness of development aid has been the core agenda in the international development community as the world fights poverty with limited resources. With the establishments of The Millennium Development Goals (MDGs) in 2000 and the implementation of the Paris Declaration (PD) on Aid Effectiveness in 2005, the international community has improved the impact of aid on development. However, today poverty still persists amidst drastic changes in the development landscape.

The review of progress toward the MDGs and global economic structural changes in Chapter 2 points to the needs for increasing development effectiveness. Despite the significant progress in poverty reduction over the past few decades, there are huge disparities across regions and countries. With these lessons, eradicating poverty and tackling inequality are raised as challenges for the post-MDGs era. In addition, the economic structure has been drastically changed by globalization. From the mid-1990s, foreign direct investment (FDI) and remittances have become much larger than Official Development Assistance (ODA), which used to be the major financial flow to developing countries. The accelerated growth of developing countries and the slower growth, as well as the fiscal constraints, of high-income countries are thought to affect roles of aid. As highlighted in the Monterrey Consensus for Financing for Development (FfD) adopted in 2002, aid is expected to play key roles in assisting developing countries to fully utilize the opportunities of globalization.

In the field of development economics, a large number of cross-country empirical studies have been conducted in order to assess the impact of aid on growth and poverty reduction. The current mainstream discourse asserts the importance of good policies, including fiscal, monetary, and trade policies, for effective development aid (Burnside & Dollar, 2000; Collier & Dollar, 2001, 2002). Nevertheless, the controversies have remained, leaving room for further research. I suspect that one of the reasons for the continuing controversy came from the usage of aggregate aid data. The different effects of sectoral aid should be taken into consideration in the specification
of the empirical analyses. I also argue that institutional quality, and capacity in particular, should be focused on as a key factor for the development effectiveness. The reviews of the theories and concepts of development aid in Chapter 3 present the importance of institutions with the emergence of new institutional economics. Furthermore, I look at not only the growth effect of aid, but also the distribution effect, based on the research framework of Poverty-Growth-Inequality (P-G-I) triangle (Figure 1.1). This idea comes from my attempt to incorporate the current discussions on globalization and inequality into the debate on development effectiveness. One of the most influential papers by Dollar and Kraay, *Growth is Good for the Poor* (2002), revealed the empirical evidence that, on average, the poor benefited from growth equiproportionally with that of the national average. However, they failed to find any factors of openness which had systematic effects on the poor other than through growth. Therefore, this study seeks to find out if aid is indeed good for the poor, bringing more benefits to the poor than any other income groups.

With this background and my interests, I examine development effectiveness in reducing poverty and inequality with emphasis on the roles of institutions. I also pay attention to the impact of globalization in order to form useful policy suggestions. There are four core analyses: Chapter 4) impact of globalization on P-G-I triangle; Chapter 5) impact of aid on P-G-I triangle; Chapter 6) comparison of the distribution effects of aid and globalization; and Chapter 7) identification of the pro-poor institutions and the cases of successful development aid. I conduct cross-country empirical analyses for Chapters 4-6 with the panel data of growth spells for the period 1978-2010. I mainly use the medium-term dataset, which contains 242 growth spells of the 5-9-year period each with the average duration of 5.72 years from 99 countries. I use the short-term and long-term dataset for comparison. The data for the sectoral aid analysis (economic, social, and aggregate aid) contains 183 growth spells for 60 countries. Most of the data comes from World Development Indicators (WDI), except the institutional index of the International Country Risk Guide (ICRG), and the OECD-DAC aid data. For the index of institutional quality, I form the “capacity” sub-composite (ICRG-Capacity) by compiling five particular components from the ICRG Political Risk: (i) government stability; (ii) investment profile; (iii) corruption; (iv) law and order; and (v) bureaucracy quality. These five indicators denote the management capacity of recipient countries. In order to complement the empirical analyses, I employ a case study for Chapter 7 based on a field survey in Ethiopia, the country that is identified as having high pro-poor institutions.

This study illustrates several key findings. First, the study reaffirms that the impact of globalization on growth is diverse among countries, and it is overall neutral to income distribution. With a series of estimations in Chapter 4, FDI exerts a positive and significant impact on growth, while trade and remittances do not show a robust impact. I examine the impact of integration on inequality by regressing the levels of average bottom quintile income on the levels of national average income with the variables of my concern. None of the factors of globalization
significantly and robustly affect inequality. The country fixed-effects estimations indicate that changes in income distribution are greatly influenced by the country-specific factors. I also observe the different tendency in nature of policies and institutional quality. That is, policies have effects on growth performance in the shorter term while institutions have effects in the longer term.

Second, this study asserts that economic aid is good for growth. In Chapter 5, the estimation results of the impact of aid with variables of policy (inflation) and other factors reveal that economic aid has a positive and significant impact on growth, while social aid and aggregate aid have positive, yet smaller and insignificant impacts.

Third, this study finds that building institutions could be a key determinant for increasing development effectiveness. I examine the impact of aid on growth through the different conditions of institutional quality of a recipient country; high, low, improving, or not improving. The results imply that development effectiveness does not depend on the initial levels of institutional quality, but does depend on the improvement of institutional quality, or capacity. I suggest allocating aid to countries whose institutions are improving and providing aid packages with the institution and capacity building schemes, so that development effectiveness may be further enhanced. Aid projects with an emphasis on capacity development are introduced in Chapter 7.

Fourth, this study reveals that aid mitigates inequality. I examine the impact on the growth rates of average income of the poorest quintile by the average income of the country and a variable of my conception. I find that only the two variables of social aid and aggregate aid have strong positive effects on the poor. The effect of aid is robust even in the level regressions and the examinations on changes in equality. On one hand, I find that institutional quality as measured by ICRG indicators turned out to be significantly anti-poor in a relative sense, as there are essentially indicators for investors.

Fifth, this study finds that aid works more effectively in countries with pro-poor institutions. I examine the development effectiveness by different groups with the positive or negative pro-poor country fixed-effect, i.e. pro-poor institutions. I find that the effectiveness of social and aggregate aid is positive and more significant in countries with pro-poor institutions. I also find that economic aid tends to be negative in a country with negative pro-poor institutions. This suggests providing aid to a country with pro-poor institutions is a good strategy.

Sixth, this study affirms that aid is good for the poor with the evidence of the significant growth and distribution effects of aid. Employing quintile regressions, I further examine if aid has systematic effects on the poor (Q1) or other quintile income groups (Q2-5) in Chapter 6. Social aid and aggregate aid have positive systematic effects on the Q1 and Q2 at the 1% significance level and the Q3 at the 5% significance level while they have negative systematic effects on the Q5 at the 1% significance level. This proves that aid is indeed good for the poor, and aid contributes to narrowing the gap between the poor and the rich in society. On the other hand,
economic aid does not have systematic effects on the poor, nor any particular income groups. Together with the results of Chapter 5, economic aid is good for the poor through growth effect.

Seventh, this study argues that aid is effective for targeted poverty reduction in a globalized world. I examine if the impact of globalization (trade growth, FDI, and remittance), policies (government expenditure and inflation management), institutional quality (changes of ICRG-Capacity), and other potential factors (government health expenditure, changes of terms of trade, and changes in agriculture raw materials and foods related export) have systematic effects on the poor or particular income groups. I find that none of these have a significant systematic effect for the late 1990s to the 2000s, once average incomes are controlled. I also observe that globalization could have negative effects on the poor. There are some clear tendencies, despite the lack of statistical significance, that trade and FDI benefit only the richest quintile. Aid could play complementary roles to make globalization much more conducive for poverty reduction.

Eighth, this study identifies that various pro-poor country-specific factors, which are rarely included in the current measurement of institutions, would increase development effectiveness. In the case study of Ethiopia in Chapter 7, these include decisive and effective leadership, poverty-targeted development strategies, strong government ownership, the decentralization of authority, and equitable public service delivery. I suggest that policy makers take into consideration not only growth-enhancing institutions, but also pro-poor institutions in allocating aid.

This study makes important contributions to the literature on development effectiveness. The study reveals the significant growth effects of economic aid and the significant distribution effects of social aid and aggregate aid. I argue that the reason why the past cross-country empirics could not confirm the significant impact of aid is not because aid is ineffective, but because they underestimated the impact of aid by using aggregate data and looking only at growth effect. In addition, the study reveals that changes in institutions, and particularly in capacity and pro-poor institutions, could be key determinants of development effectiveness in the long run, unlike previous literature that focuses on policy stances. Furthermore, this study could shed a new light on the literature on globalization and inequality, where the current discourse asserts that there is no factor of globalization that has significant systematic effects on the poor (Dollar & Kraay, 2002; Dollar, Kleineberg, & Kraay, 2013; Milanovic, 2005). This study discovers the significant systematic effects of social aid and aggregate aid on the poor. Aid could play important roles for targeted poverty reduction in this globalized world. This discovery also shows the continuing importance of aid in assisting developing countries to effectively participate in globalization.

Today, we are standing at a critical juncture of the development paradigm shift under globalization. I hope this study will offer some new evidence for policy makers, researchers, practitioners, and people in the development community to reconsider the role of aid in effectively reducing poverty and inequality.