

Discussions
on
**“Aid for Trade, Foreign Direct Investment and
Export Upgrading in Recipient Countries”**

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June, 2016

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1. Summary

- **Background:** At the WTO Ministerial Conference in December 2005, the “AfT Initiative” was launched and many high-income member countries pledged to increase their AfT contributions, particularly for LDCs.
- ✓ ODA has been often criticized on the ground that it is often ineffective and has not contributed to economic growth and poverty reduction.
- ✓ Therefore it is crucial to assess the effectiveness of any kind of foreign aid.

1. Summary

- **Assessment of AfT:**

1. Whether and to what extent the WTO's developing member countries, particularly LDC members, have received more AfT.

eg. Lee, H.-H., D. Park, and M. Shin, (2015), “Do Developing-Country WTO Members Receive More AfT?”, *World Economy*, 38(9), 1462-1485.

2. Whether AfT has increased trade capacities of developing countries, particularly LDCs.

1. Summary

- **Main objective:** Empirically assess whether AfT (and FDI inflows) affect recipient countries' export upgrading in terms of export diversification (overall, extensive margin, and intensive margin) and export quality improvement.
- **Data:** A panel of 86 recipient countries for the period 1995-2010 (5 sub-periods of the 3-year average).
- **Methodology:** System GMM

1. Summary - continued

- **Main findings:**

- (1) Total AfT flows have a strong positive impact on export upgrading. Compared to Non-LDCs, LDCs appear to obtain the most benefit on the diversification of their exports at the intensive margin, and on the improvement of the quality of their exports.
- (2) FDI inflows exert a positive effect on export diversification in host economies, and they also influence positively and strongly export quality upgrading in recipient countries. More importantly, the impact of these financing inflows on the export diversification of LDCs is higher than in Non-LDCs.
- (3) AfT and FDI inflows are substitutes in achieving export diversification in recipient countries, but complementary in their effect on improving the export quality in these countries.

2. Merits of the paper

- ODA has been often criticized on the ground that it is often ineffective and has not contributed to economic growth and poverty reduction.
- Therefore it is crucial to assess the effectiveness of any kind of foreign aid.
- The AfT initiative's objective is to assist developing countries, and especially the LDCs, to expand their trade.
- Therefore, it is crucial to assess the effects of AfT on trade.
- **While related literature mostly focuses on the effects of AfT on the volume of trade (exports or imports), this paper assesses AfT's effects on export upgrading of recipient countries (particularly LDCs).**

3. Overall assessment

- **Is export diversification export upgrading?**
 - ✓ AfT aims to assist developing countries to expand their trade.
 - ✓ AfT should help developing countries to expand the volume of their trade and also to improve the quality of their exports for their sustainable development.
 - ✓ Both a greater export diversification and a greater specialization can be good for developing countries. (Besides, AfT may result in a greater export diversification or a greater specialization.)
- **I would differentiate Non-manufacturing sector (SITC 0-4) and Manufacturing sector (SITC 5-9) .**
- **Empirical part may require a further refinement (See major comments).**

4. Major comments

- **Empirical specification**

$$\begin{aligned} ExpUpg_{it} = & \alpha_0 + \alpha_1 ExpUpg_{it-1} + \alpha_2 AfT_{it} + \alpha_3 InFDI_{it} + \alpha_4 IMP_{it-1} + \alpha_5 GDPCapita_{t-1} + \alpha_6 Termstrade_{it} \\ & + \alpha_7 Pop_{it} + \alpha_8 HumCap_{it-1} + \alpha_9 Reer_{it-1} + \alpha_{10} FinDev_{it-1} + \alpha_{11} RulesLaw_{it-1} + \alpha_{12} RQual_{it-1} + \mu_i + \varepsilon_{it} \end{aligned}$$

- ✓ Arbitrary collection of control variables: why population, terms of trade, etc?
- ✓ Inconsistent combination of contemporaneous and lagged variables in one equation: AfT, FDI_{it}, Termstrade, and Pop are contemporaneous while others are one-period lagged.
- ✓ Arbitrary notation of variables: AfT and IMP are in % of GDP, while FDI is in log. Why? GDP per capita and Pop should be expressed in log.
- ✓ Inclusion of highly correlated variables: RulesLaw and Rqual (0.83)
- ✓ **AfT may influence not only trade but also FDI. (Next page)**

4. Major comments

- **AfT may influence not only trade but also FDI.**
 - ✓ **Selaya and Sunesan (2012):**
 - Aid for social and economic infrastructure is associated with more FDI, while aid for building productive capacity deters investment.
 - ✓ **Donabauer et al (2016):**
 - Aid for economic infrastructure has a strong effect on FDI during 1990-2010 period.
 - ✓ **Kimura and Todo (2010):**
 - Significant positive impact of Japanese infrastructure aid on Japanese investment in recipient countries, which they term a “vanguard effect”.
 - ✓ **Lee and Ries (2016):**
 - AfT has a significant impact on greenfield investment.
- Lee, H.-H. and J. Ries (2016, forthcoming) “Aid for Trade and Greenfield Investment”, *World Development* .

4. Major comments

- **Data on AfT**

- ✓ **Commitments vs. actual disbursements:**

- The authors use AfT commitments, adjusted to mitigate two potential upward bias, but data on commitments are not preferable to be used in a study to assess aid effectiveness.
 - Commitments are not always fulfilled and there may be long lags before the funds are disbursed.
 - DCD/DAC (2014) recommends not to use data on aid disbursements before 2002 because the annual coverage ratio was below 60%.
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- ➔ Would be better to use the recent data on actual disbursements (eg. Lee and Ries, 2016): (2003-2005) (2006-2008) (2009-2011) (2012-2014)
 - ➔ This period corresponds to an increase in AfT due to the 2005 AfT Initiative.
 - ➔ But the export diversification and quality data are available only until 2010.

4. Major comments

- **System GMM**

- ✓ **Endogeneous vs. predetermined vs. exogenous:**

- Endogeneous variables: AfT and lnFDI
- Predetermined variables: IMP, GDPCapita, HumanCap, Reer, FinDev, RulesLaw, and Rqual (with one-period lag)
- Exogenous variables: TermsTrade and Pop

➔ Why?

➔ In GMM, lags of explanatory variables are used as instruments so no need to allow for a lag for predetermined variables.

➔ **Endogeneous vs. predetermined vs. exogenous:**

- Endogeneous variables: AfT, lnFDI, and IMP
- Predetermined variables: GDPCapita, Reer, (with one-period lag)
- Exogenous variables: HumanCap, FinDev, RulesLaw, and Rqual

5. Minor comments

- ✓ **In some equations, AR2 test does not pass**
 - Eg. Columns (3) and (7) in Table 2. Column (3) in Table 4.
- ✓ **In System GMM results, number of instruments should be reported.**
- ✓ **Three categories of AfT are highly correlated:**
 - They should enter the specification individually , not simultaneously together.

References

Donabauer, J. B. Meyer, and P. Nunnenkamp (2016), “Aid, Infrastructure, and FDI: Assessing the Transmission Channel with a New Index of Infrastructure”, *World Development*, 78, 230-245.

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