Aid for Trade, FDI and Export Upgrading

ADB & University of Hong Kong Conference

2-3 June 2016

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WORLD TRADE ORGANIZATION

Hypotheses tested

- Do Aid-for-Trade (AfT) flows contribute to export upgrading in recipient countries ?
- Are AfT flows and FDI substitutable or complementary ?

Findings: in brief

- AfT flows have positive impacts on export upgrading, with strongest effects on LDCs
- Effects of AfT on upgrading depend on type of support (e.g. trade policy support works on intensive margin)
- AfT balances export concentration effects of FDI in LDCs – strong complementarity
- AfT can reduce export concentration by getting conditions right for diversification and attract FDI.

Presentation overview

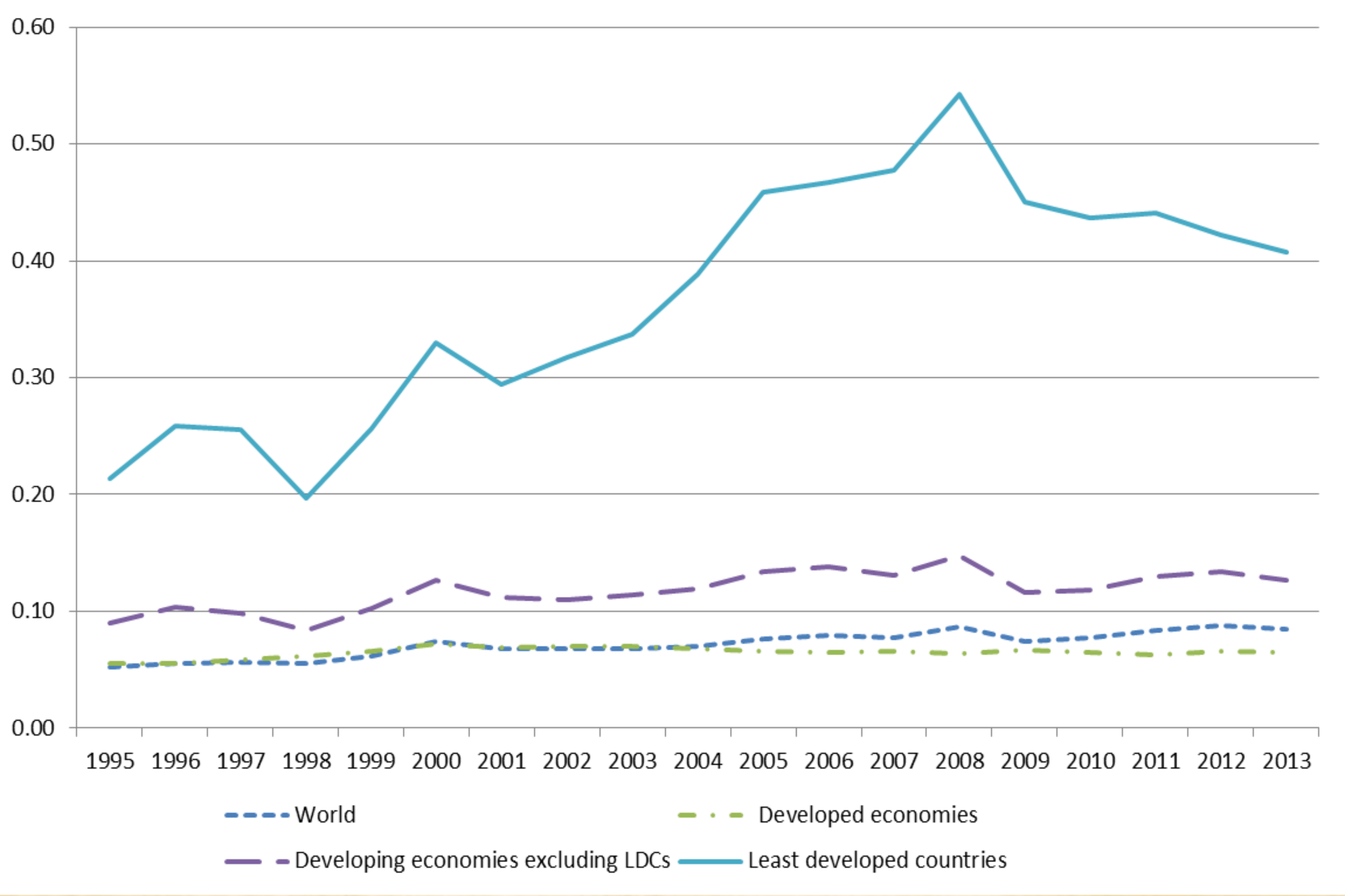
i) Why does export upgrading matter ?
ii) Relationship tested
iii) Estimation results
iv) Conclusions

Export upgrading and development

Economic literature argues variously for:

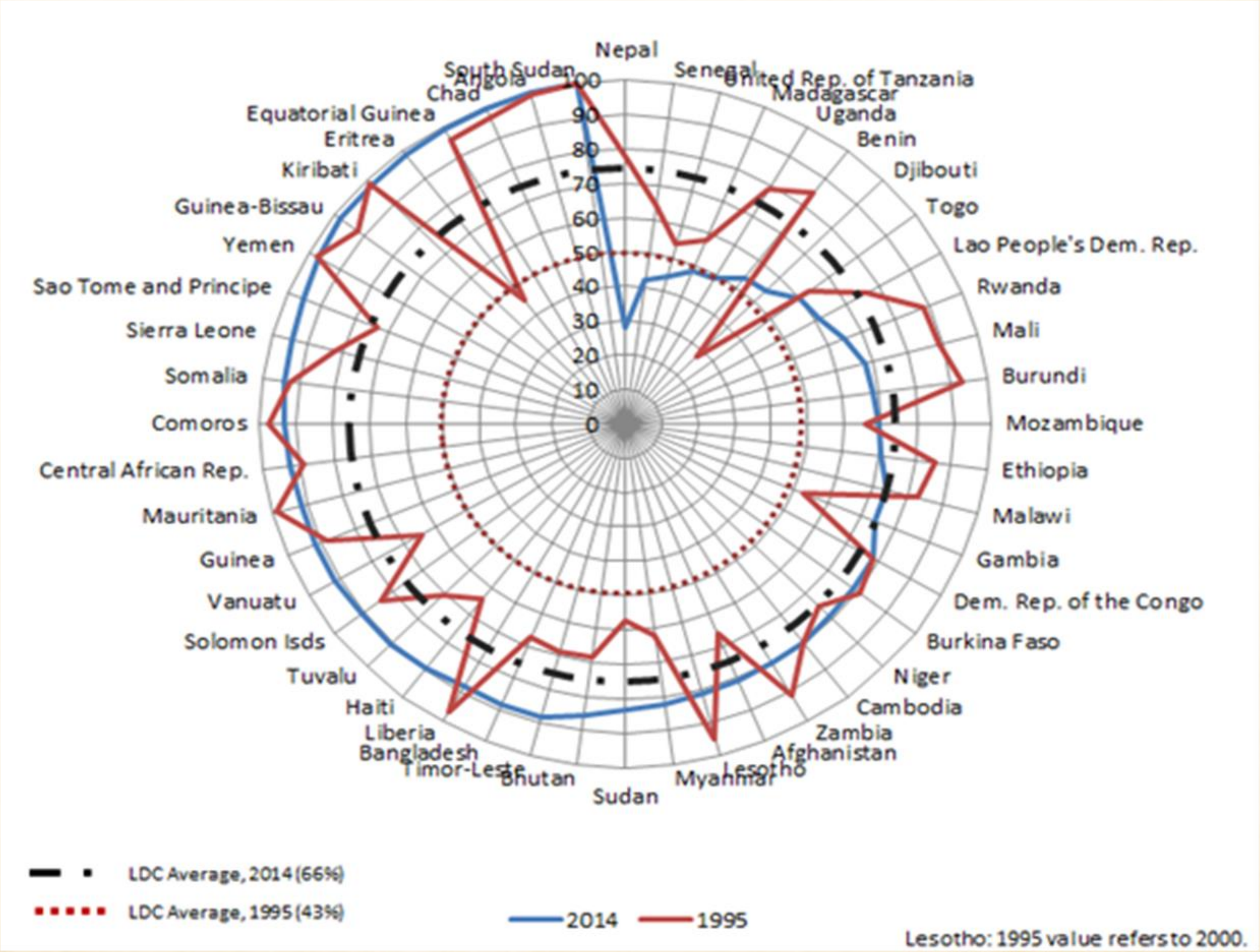
- Export specialization based on comparative advantage;
- Export diversification to avoid dependency and vulnerability to economic shocks;
- Reconciling both approaches e.g. within GVCs specializing in a stage of production across multiple sectors.

Concentration in merchandise exports by income, 1995-2013



Source: WTO

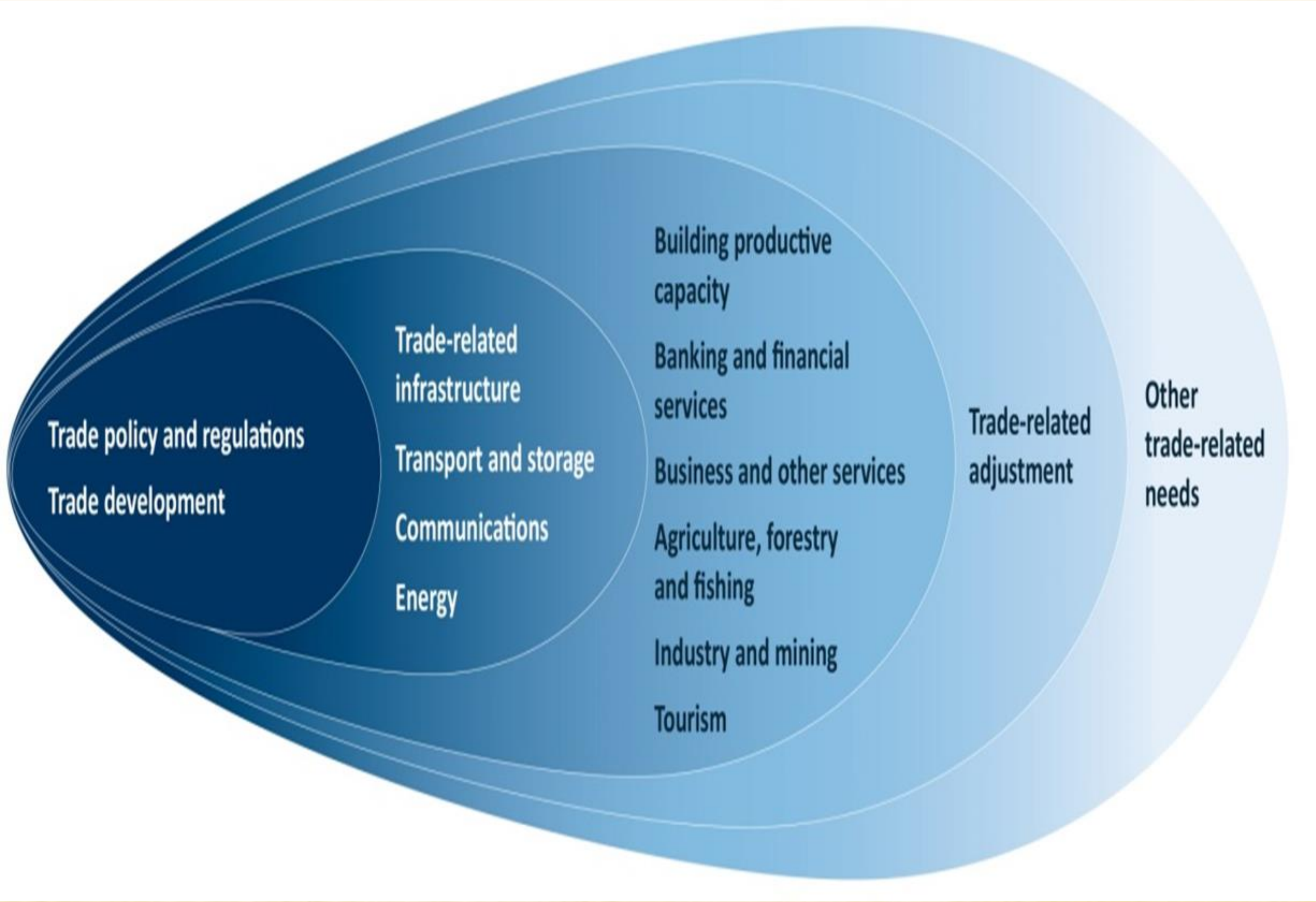
Percentage share of top three LDC products in total merchandise exports, 1995 and 2014



Source: WTO

What is Aid for Trade?

Subset of ODA targetting specific binding constraints



Source: OECD

Complementarity vs substitutability ? Theoretical considerations

- AfT for infrastructure: sector neutral, may reinforce comparative advantage (and attract FDI) ?

- AfT to productive sector: could substitute for FDI?

- AfT to trade policy and regulation: reinforces specialization or contributes to diversification ?

Export upgrading

Three elements to export upgrading:

- Intensive margin – increase in exports of existing product lines
- Extensive margin- increase in products exported and export markets reached
- Quality upgrading – moving to more sophisticated products.

Two models tested and further adapted for LDC specific effects

- Model 1: Export upgrading: IMF diversification index
- Function of AfT inflows, Inward FDI, Imports of goods and services; GDP per capita; Terms of Trade; Population of recipient; Human capital; Real effective exchange rate; Financial development; rule of law and quality.
- Model 2: Substitutability vs complementarity: Same function, but with AfT and net FDI interactions the focus

Data from IMF, UNCTAD and World Bank.

Observations for 86 countries over the period 1995-2005 (discrete three year averages) inc. 23 LDCs

Both models adapted to track LDC specific effects

Results

Export upgrading

- AfT programmes induce export upgrading (intensive, extensive margins and quality)
- Support for trade policy and regulation stimulates exports at intensive margin
- Support for economic infrastructure & productive capacity acts more on extensive margin and quality.

Results

Export upgrading for LDCs

- 1% increase in total AfT (as a % of GDP) associated with 7.3% increase in export diversification index for LDCs and 1.16% in export quality.
- AfT for productive capacity building in LDCs can act as a catalyst for FDI flows to achieve export diversification.

Results

Export upgrading for LDCs

- Higher total AfT to LDCs generates a higher degree of export diversification at the extensive margin in LDCs compared to non-LDCs.
- Same effect is also present for upgrading.
- In contrast, FDI tends to be associated with export concentration

Results

Substitutability vs Complementarity

- AfT and FDI complementary in generating export upgrading at the extensive margin and on export quality. Effects most significant on LDCs.

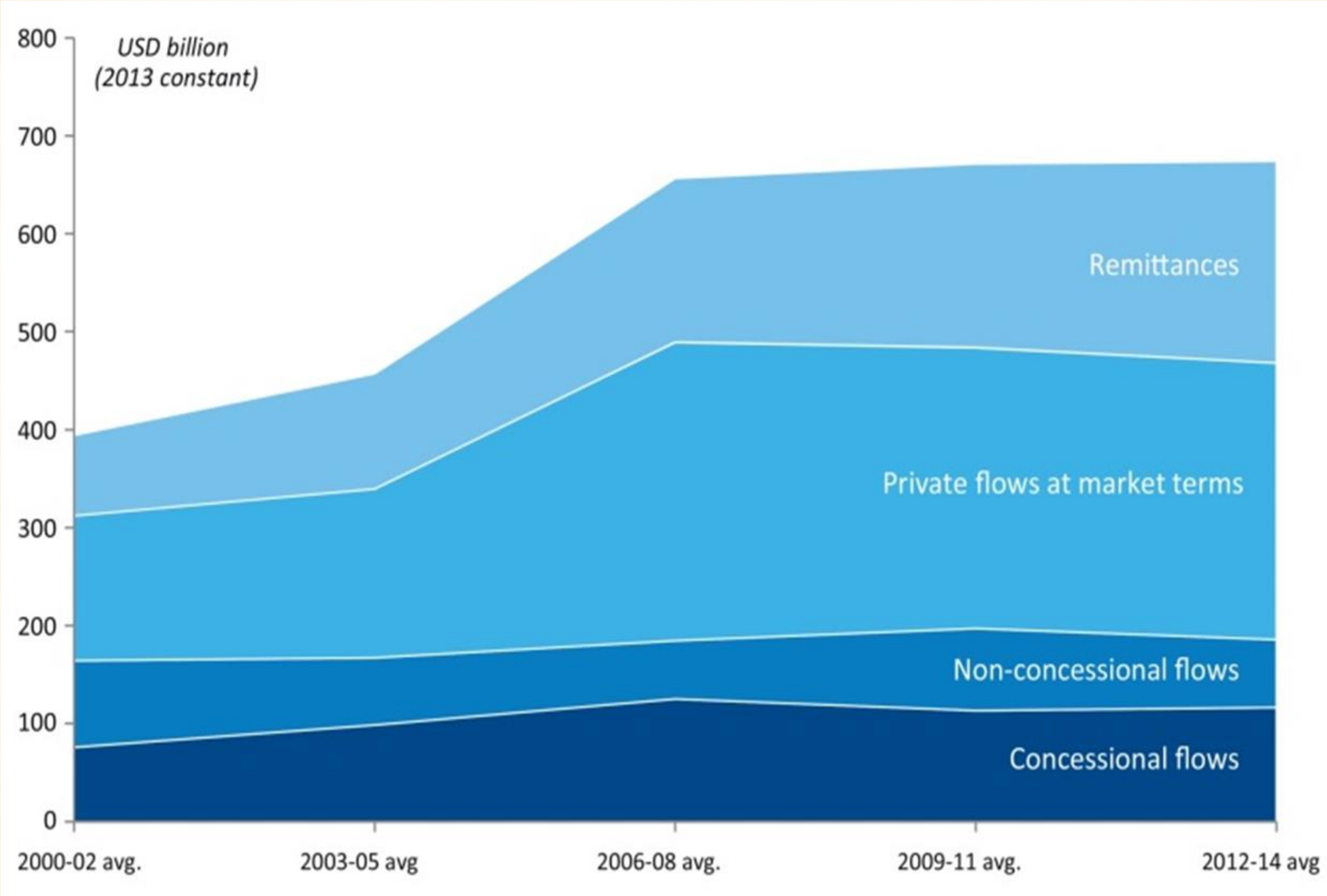
- AfT and FDI substitutable in generating export upgrading at the intensive margin

WTO OMC

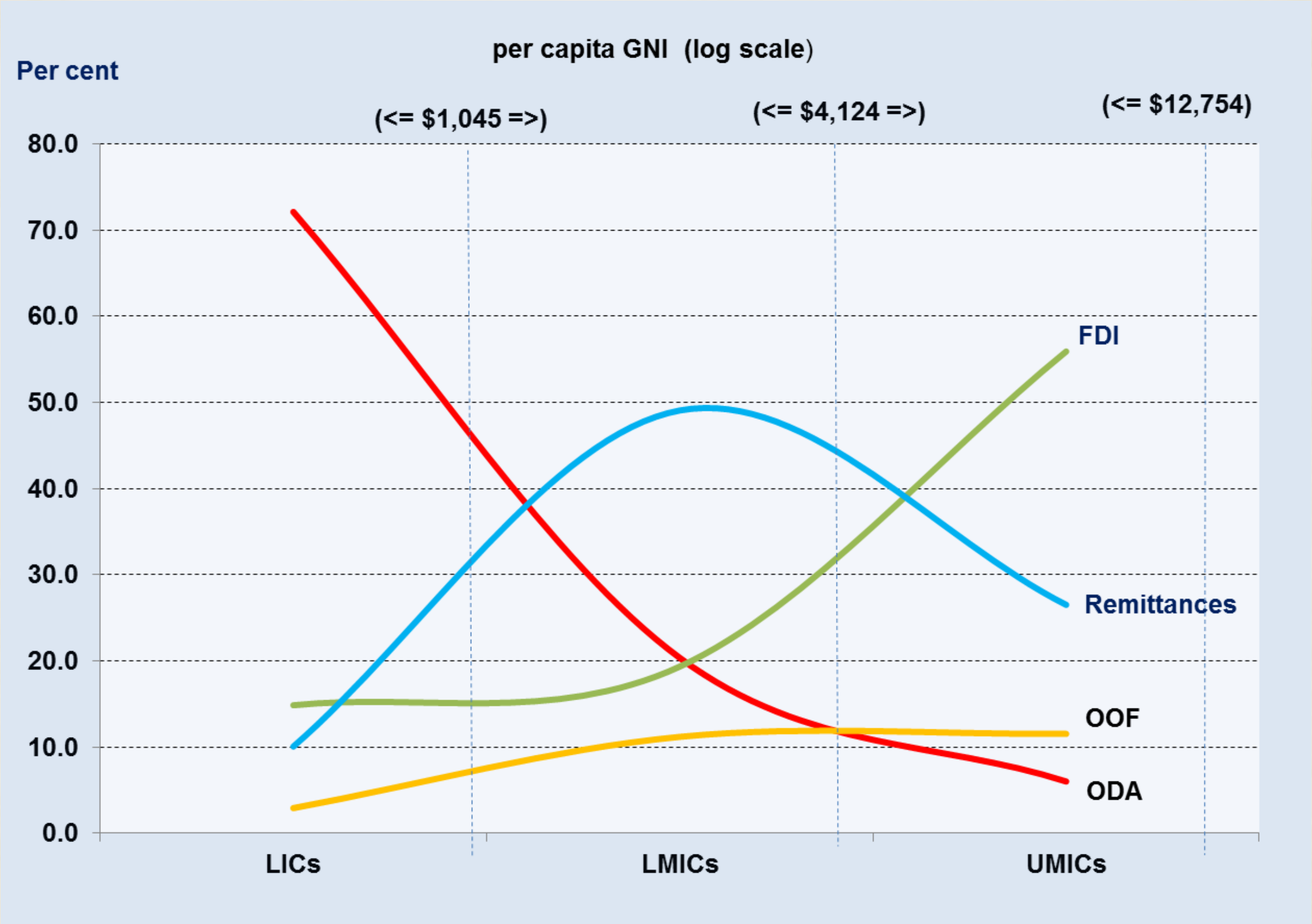
Results

- AfT has positive effects on export upgrading
- Type of AfT offered determines which export upgrading effects predominates
- Stronger effects visible for LDCs
- AfT and FDI complementary for LDCs, less so for non-LDCs in specific support categories

Conclusions

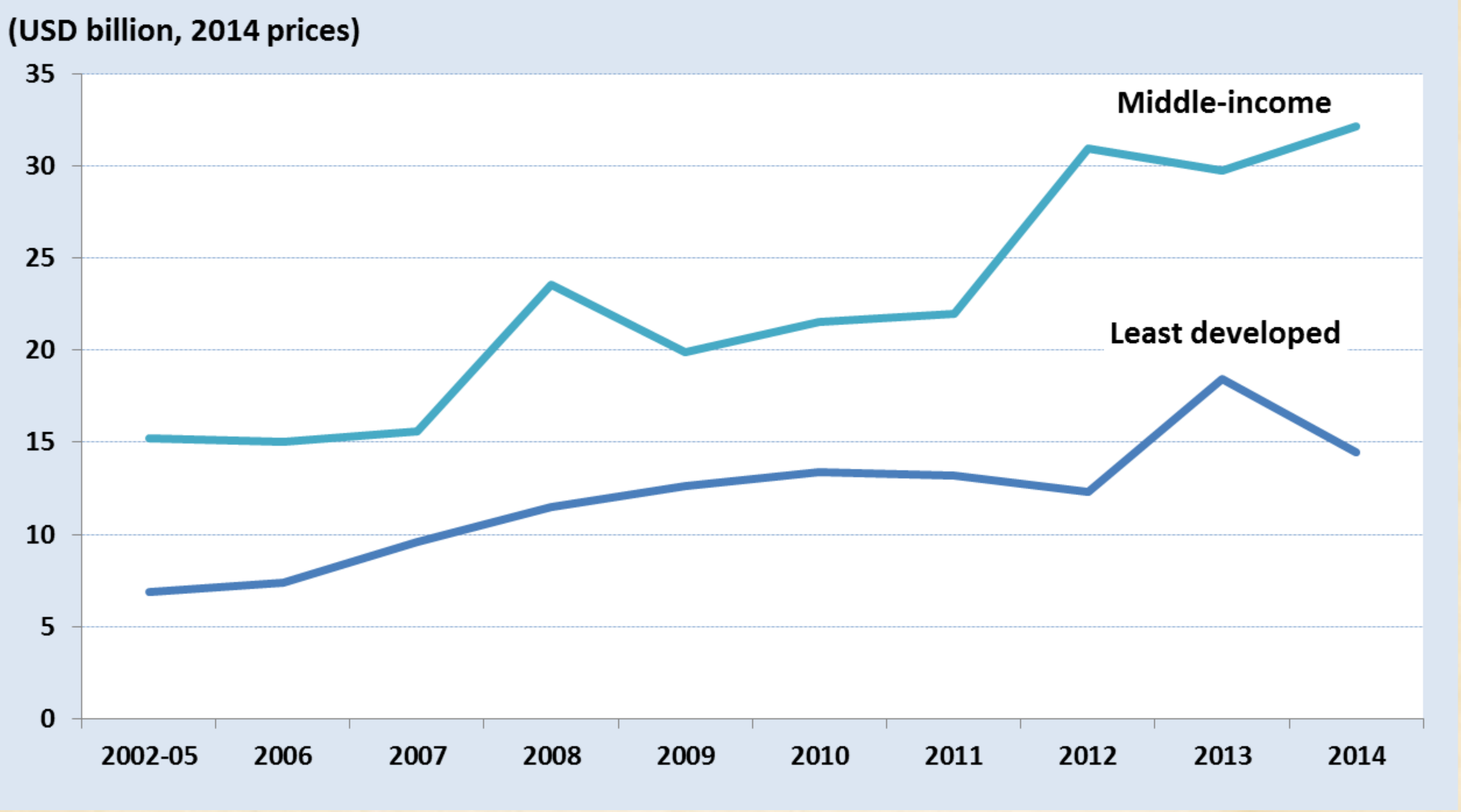


Conclusions



Source: OECD

Conclusions



SINCE BASELINE 2002-05
- **LICs +110%**
- **MICs +111%**

SINCE 2013
- **LICs -21%**
- **MICs + 8%**