Aid for Trade, FDI and Export Upgrading

ADB & University of Hong Kong Conference

2-3 June 2016

Michael Roberts
Aid for Trade Unit
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
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 targeting 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
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%