

# IMPACT OF AID FOR TRADE IN DEVELOPING COUNTRIES OF ASIA

<sup>1</sup>Abdul Aleem Qureshi, <sup>2</sup>Lubna Naz, and <sup>3</sup>Shaista Alam

## ABSTRACT

*In the past few decades, the concept of Aid for Trade (AfT) become prominent the developing countries that received the aid and those countries who donate aid. The idea of 'trade, not aid' and even 'trade as aid' also have limited scope. The current study investigates the impact of AfT in improving overall trade received in different sectors. Data on 5 developing countries collected from OCED AfT database for the period 2002 to 2015. The results suggest that aid received in the agriculture and transport sector have positive and significant effects on trade while banking and financial services and Trade Related Policies (TRP) have insignificant impacts on the trade. Moreover, results reveal that the impact of aid on trade is negligible as the amount disbursed is very low in all sectors. There is need to increase in the amount of aid and to also make better economic policies.*

**Keywords:** *Aid for Trade, Developing Countries, OCED, Trade Related Policies (TRP)*

## INTRODUCTION

After the sixth World Trade Organization (WTO) ministerial Conference, the concept of Aid for Trade (AfT) gained increased attention so that the economies could enhance the capacity to implement agreements of WTO. Moreover, they must build their supply side response to improve overall trade and get benefit from the greater market access. The slogan 'trade, not aid' has now overuse universally as it is recognized that trade leads towards the growth and development.

<sup>1</sup> PhD Scholar, AERC, University of Karachi, Karachi

<sup>2</sup> Faculty, AERC, Karachi

<sup>3</sup> Associate Professor, AERC

Now the concept of AfT has turned out to be popular among trade and donor's communities. To assist and overcome the constraints and the provision of increased global access is considered as one of the major objectives behind the concept of AfT. In spite of the clarity of this objective, it is evident that the performance of AfT in improving trade-related performance is not sufficient.

Doucouliaagos & Paldam (2009) provided that in the past forty years foreign aid have not given any favorable results in general. On the other hand, there are studies available which showed that foreign aid have posed positive impacts in the presence of some special conditions like improved institution and policy environments (Burnside & Dollar, 2000). There is very less literature available on the quantitative evidence about the effects of AfT. Understanding the effectiveness of AfT is not yet developed that what type of AfT actually provides best result in achieving the objective of AfT and what types of AfTs fail.

In last few years majority of the developing countries have faced difficulties in getting benefits from the economic and trade related reforms and as well as in promoting development have revealed that "trade, not aid" or "trade as aid" like remedies also have limits. In today's world the logic of "trade, not aid" or "trade as aid" has been evolved to "AfT". The concept of "AfT" marked a significant progress in making a step forward in accepting trade specific development by the international community that the efforts and reforms must be long lasting and meaningful for trade and development. The literature related to aid is not only complex, but it is very voluminous. It poses a challenge to development economist to literally understand the logic between the aid, trade and development.

## **The AfT Initiative**

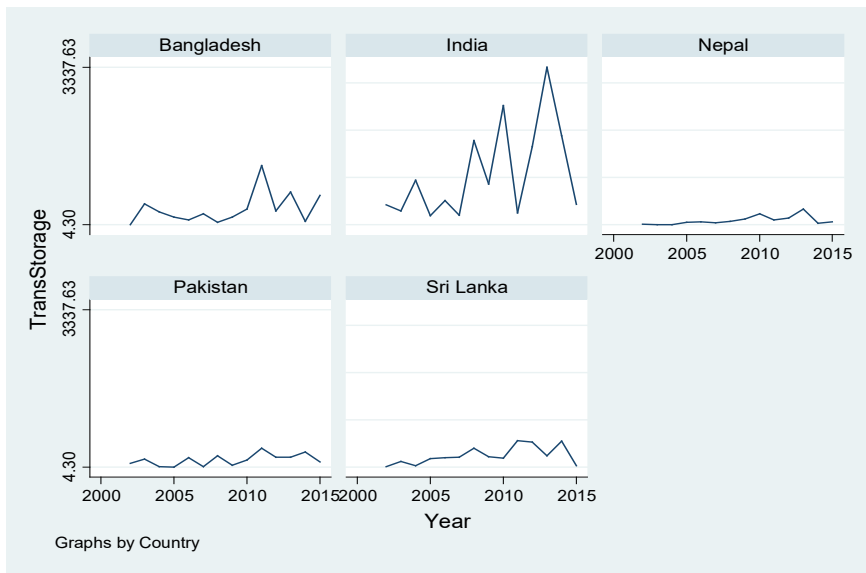
The provision of aid for purpose of development has been practiced for more than half a century along with scrutiny and debate over the effectiveness for the developing countries. Many developing countries were providing aid to developing countries in multiple forms and purposes. Among these purposes the alleviation of poverty and improvement of institutions were two main objectives. Moreover, sometimes financial aid also depends on strategic and political interest of the donor countries which also relates to economic needs of the recipients (Ghimire, 2013).

The WTO decided to continue with liberalization of trade process in the Doha Development Agenda. Stiglitz and Charlton (2006) have given three

main reason about the need of AfT(AfT) facilitation, firstly, to ensure that the Doha Round should go onwards which is political reasons, secondly as a result of the preference erosion an experiment of some arguments especially for the dependent countries are compensation reason, thirdly, AfT represents fairness aspect, as the main winners of Doha Round were possibly be the developed (rich) countries.

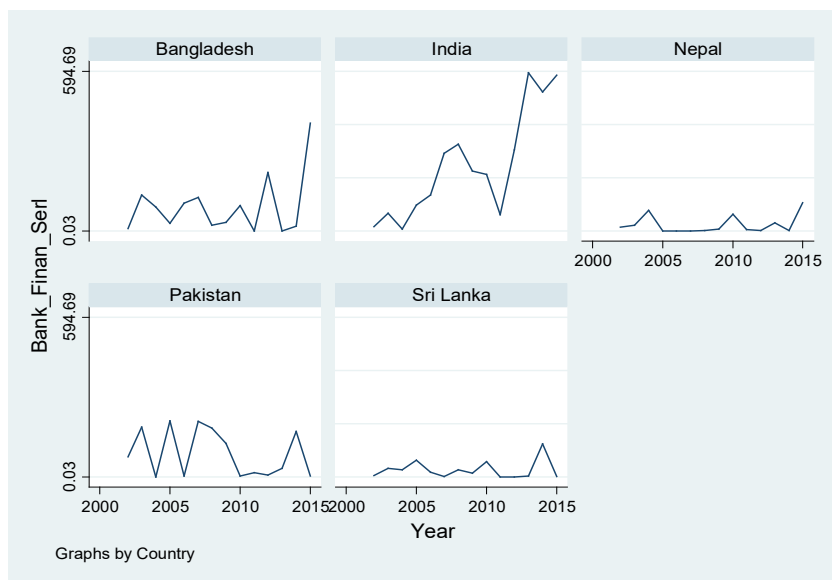
This section shows the trend of Aid received in different sector by different countries from all donor countries. For analysis, trend is drawn between the minimum and maximum values. The analysis covers all aid related variables used in the regression analysis.

Fig 1: The Trend of AfT received in developing countries of Asia aid received for trans storage in different countries



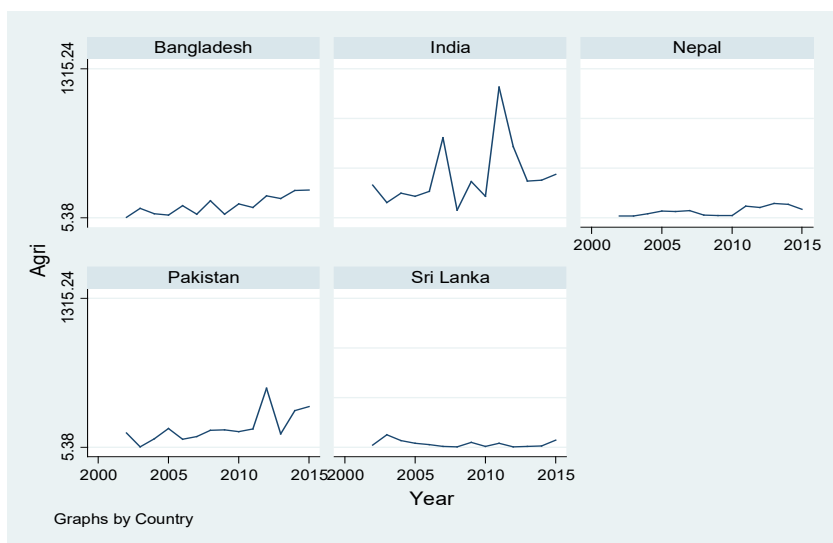
The graphs show the trend of aid received in the trans storage sector. The analysis shows that the aid received in Pakistan, Nepal and Sri Lanka was remain near to the minimum level 4.30 million dollar while in Bangladesh there is an up and down trend. While in India there is in consistent trend, but it reached to highest in 2014 and then decline in 2015.

Fig. 2: Banking and Financial Services



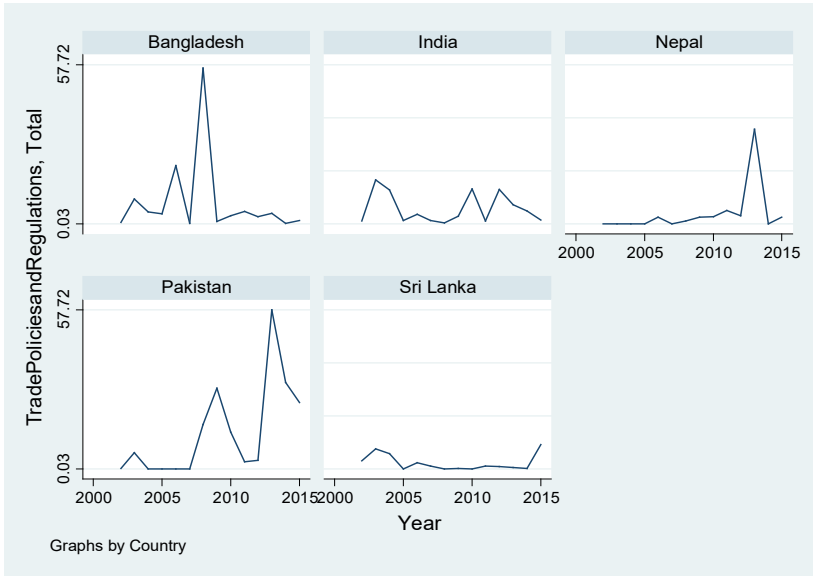
The graphs show the trend of aid received in the banking and financial services. The analysis shows that the aid received in Pakistan there is inconsistent trend and after 2010 touched the lowest level and then improved for 2014. In Nepal and Sri Lanka was remain near to the minimum level 0.030 million dollar while in Bangladesh there is an up and down trend and it reached to highest 2015. While in India there is in consistent upward trend till 2007 but declined for next four years and again forthcoming years shows upward trend.

Fig.3: Aid in Agriculture



The above graph shows the trend of aid received in the agriculture sector, the trend suggests that in Pakistan the amount of aid in the agriculture sector was continuously increasing till the year 2011 and declined for the next two and then increased again. While, in Nepal and Sri Lanka the amount of aid received shows a symmetric pattern and remains closer to around 6 million dollars. On the Other hand, the trend of Bangladesh shows a continuously increasing but inconsistent trend while in India the more inconsistent as compare to Bangladesh.

Fig. 4: Trade Policy and Regulations



The above graph shows the trend of aid received for betterment of trade policy and regulations, the minimum amount received in this sector is .03 million dollars while the highest amount is 57.72 million dollars. The graph suggests that there are huge variations in the aid received by Pakistan and Bangladesh and India, while the trend also shows constant behavior for Sri Lanka. In Nepal the amount of aid was around .03 to .05 million dollars till 2012 and then reached to maximum and then declined again to its minimum in the very next year.

The further topics covered are as follows, detailed review of existing literature presented in section 2 and in section 3 brief theoretical framework on effects of AfT on overall trade is provided, section 4 cover the methodology and model specification used in the research and section 5 sources of data and their definitions section 6 contains the empirical results and discussion and conclusion of the study and policy recommendation were provided in section 7.

## **Literature Review**

There is no vast literature available on the effects of AfT specially as compare to the Burnside and Dollar (2000) argue that the effects of aid on growth are not identifiable when there are other factors involved specially economics policies. moreover, they also contend that aid only raise growth in countries with better policies. Contrary to that Hansen and Tarp (2001) used different econometric specifications and found that aid is effective for growth and that the result do not depends on policy.

In two different studies by Rajan and Subramanian (2005, 2008) they conclude that there is less positive impact of aid on growth. The main finding by them is that they argue that the country's competitiveness is adversely affected by aid, which is reflected that the share of labor-intensive commodities was reduced and also in tradable industries of the manufacturing sector. They also suggest that these are Dutch disease effects, which occur due to the overvaluation of real exchange rate caused by aid inflows.

Doucouliaagos and Paldam (2007) concludes by analyzing 97 different studies based on empirical findings that impact of aid on growth is insignificant. There are numerous other factors that will possibly describe the vagueness of the concept of aid on growth in the previous research efforts. Moreover, Bourguignon and Sundberg (2007) also argues that these diverse results about impact of aid on growth are not surprising because the motives behind aid are not only complex but also diverse in nature. Furthermore, the impact of aid could also depend upon local economic policies, role of institutions, and different other conditions. Hansen and Tarp (2001) suggest that the neoclassical growth model on capital accumulation does not provide a clear theoretical framework for such complex relationship between aid growth. It also does not give any direction about the direction of causality from growth to aid or vice versa, which has make this issue unresolved. McPherson and Rakovski (2001) used different models and found that impact of aid is negative with investment but positive with growth of GDP per capita, While Gomanee, Girma, and Morrissey (2002) reveals that in sub-Saharan African countries a one percentage point in the ratio of aid to GNP contributes one-third of one percentage point to growth. On the other hand, Cali and te Velde (2011) provided investigation of overall impact of AfT. They analyzed that the significant changes in cost of trade of 130 developing countries in the period between 2005-2009, and the changes occurred in the exports of 100 developing countries between 2002 and 2007. The finding suggests that due to facilitation of AfT the cost of trade is reduced. Moreover, by using econometric models and techniques they proved that the AfT resulted in decrease in trade, while aid has positive and significant impact on exports. The spending of aid assistance on economic infrastructure development resulted in export growth. Furthermore, the study

also suggests that measures taken to enhance and improve the productive capacity show insignificant effect on export performance. Helble et al (2009) have used gravity model and presented that a percentage growth of the aid in the trade policy, being equal to 11.7 million dollars and caused 818 million dollars trade expansion globally.

Vijil & Wagner (2010) using econometric method investigated the effects of AfT on the expansion of exports and emphasized on the infrastructure side. The result shows that the 10 percent growth on trade related infrastructure development leads to 1.22% of exports growth in the recipient country and all these are complied with 2.3 percent decline in non-tariffs and tariff barriers. Consequently, authors also contend that the AfT has positive impacts on the export of recipient country. Moreover, according to the study of Burnside and Dollar (2000) aid only benefit those countries that implement appropriately designed and stable policies, and otherwise it is wasted. However, there is no evidence found that foreign aid causes the adoption of “good” macroeconomic policies.

Lemi ( 2017 ) investigated the link for the case of African countries using disaggregated AfT data from China and OECD member countries. The results suggest that flows of aid in all the sectors and for economics infrastructure by OECD have increased the imports and exports for African countries. Pettersson, & Johansson (2011), examined the effects of bilateral AfT on bilateral exports of developing countries and found exports level of donors and recipients increase positively. Moreover, Munemo (2011) also analyzed the impact of overall foreign aid on export diversification and showed that foreign aid can have an anti-export bias due to a Dutch disease effect.

Kiute, et al. ( 2015) examined the impacts of AfT on export performance of developing countries using panel data. The authors found that effect AfT on export performance is insignificant despite having a positive coefficient.

## **Contribution of the Study**

In past studies has evaluated the subject of aid in Pakistan but the aid received for the promotion of trade related activities has not been discussed. The current study has investigated the effects of such aid received in different sectors in Pakistan. Further, this study has also explored the effects of these aid for on overall trade, import and export separately.

## **Theoretical Framework Model Secification**

Although, the scope and specific objective of AfT were recently passed but the available research only analyze the effects that provide the general explanation of

the AfT program or provide empirical analysis of very few countries. Hoekman and Wilson (2010) pointed out that in the current period of uncertain economic condition AfT is necessary, because it is evident that the international trade can assist deprived countries to come out from the economic recession. Additionally, the authors also claimed that economic diversification and improvement in productivity can be achieved through AfT. Developing countries mostly lack the resources that would increase export competitiveness, namely export promotion policies, infrastructure (roads, ports) that may create a favorable business environment for the exporters. These are the ideal sectors in which donor countries invest to improve trade performance Cali, Razzaque & te Velde (2011).

Moreira (2010) argues that the countries with bad infrastructure and weak institutional background underperformed in the international trade. According to him by AfT would be beneficial in providing growth possibilities in the long run. In general, it seems that the AfT has positive impacts on the exports of recipient countries' or cost of trade. While Hühne, Meyer, & Nunnenkamp, (2014) has done a bi-directional analysis which suggests that the effect of AfT and found that AfT not only increases exports of recipient country but also enhances imports from donors. Moreover, the effect tends to increase in exports and dominates the latter, which contradicts the view that donor grants AfT primarily to promote their own export interests.

## **Model Specification**

$$\text{LnTT} = C + \beta_{YYij} + \beta_{YcYcij} + \beta_{\text{dist}} + \beta_{\text{EIC}} + \beta_{\text{BPC}} + \beta_{\text{Dist}} + \mu$$

$$\text{LnExp} = C + \beta_{YYij} + \beta_{YcYcij} + \beta_{\text{dist}} + \beta_{\text{EIC}} + \beta_{\text{BPC}} + \beta_{\text{Dist}} + \mu$$

$$\text{LnImp} = C + \beta_{YYij} + \beta_{YcYcij} + \beta_{\text{dist}} + \beta_{\text{EIC}} + \beta_{\text{BPC}} + \beta_{\text{Dist}} + \mu$$

LnTT= is total trade in millions (import + Export)

Ln exp= Total Exports in millions

Lnimp= Total Imports in millions

GDP= Gross Domestic Product

TRansStor<sup>4</sup>= Aid received in the transport sector

Bank\_fin\_ser= Aid received for bank and other financial services

Industry\_Aid= Aid received for industrial upgradation

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<sup>4</sup> According to OECD definition "Either it is the part of transport or any other sector. Whenever possible, it is reported under the sector in which resource being stored."



Agri\_aid= Aid received in the agriculture sector

The dependent variable for the first model is total trade as it is evident that AfT may improve overall trade in the recipient country. Moreover, aid also influence both export and import performance separately so in the other two models import and export were taken as dependent variables separately that covers the objectives related to effects of AfT on export and import separated models were estimated.

## **Sources of Data and Variable Definitions**

Trade related infrastructure were consisted of transport and storage sector; communication sector and on energy supply in the OECD database as the subsectors of economic infrastructure. While in OECD data set building productive capacity and trade development consisted of banking and financial services, business related and other services, agriculture and industrial subcategories. While data on GDP, Export, Import and FDI is collected from world bank database. Data for the time period 2002 to 2015 of five developing countries includes Pakistan, India, Bangladesh, Sri-Lanka and Nepal is collected from the above-mentioned sources. The results are calculated using pool OLS regression.

## **Assistance for Trade Policy and Regulation**

Resolving arguments of trade negotiation through effective participation and provide them trainings as well. Furthermore, national regulation and its eventually implementations can be unified through ensuring of institutional and technical supports. Under all these categories, assistance is provided to developing countries to get assurance that they must obey international rules and laws and maintain its standard.

## **Trade Development**

In the trade services this area interference will encourage investment and business support services and institutions including E-Commerce, analysis of market analyses and market. development.

## **Trade Related Infrastructure**

The joining of global trading networks which is essential for a country by developing better physical infrastructure like network of roads, seaports, telecommunication and energy network which is essential for a country in anticipating and becoming part of the global trading network.

## Building Productive Capacity

It provides an opportunity to give strength the different sectors of economy by developing/ creating the banking services, tourism, financial institution and better business environment creates an opportunity to strengthen different sectors of the economy.

## Trade-Related adjustments

Through trade reforms and trade liberalization evidently indicates that adjustment to the public budget, provided to cover the costs derived through these trade encouragement indicators.

## Empirical Analysis & Discussion

Table 1: Impact of AfT on Overall Trade

Variables	Coefficient	Standard Error	t-Value	P> t
lgdp	0.69663	0.05420	12.85	0.0000
LfDi	0.11546	0.02971	3.89	0.0000
TPR	-0.00313	0.00223	-1.40	0.161
Agri	0.00058	0.00017	3.41	0.001
Bank_FS	-0.00003	0.00026	-0.12	0.908
Trans_Stor	0.00026	0.00006	4.32	0.0000
Cons	4.31509	0.88974	4.85	0.0000
R2	Wald Chi	P> F		
0.911	3326.19	0.0000		

Authors' Estimate Based on OECD Aid Database

The above table shows the results of different variables that effects the trade for the developing countries. The results show that the impact of lgdp (Gross Domestic Product) is positive and highly significant and the sign of the variable is also according to the theory. Further, it shows that the impact of lfdi also sho positive and significant effect on trade.

For AfT variables, different sector where developing countries are receiving aid are used for analysis and for trade, positive and significant result were found for the aid received in the agriculture and in storage sector (definition given in the above footnote). While other two variables bank financial services and trade related policies (TRP) show negative and insignificant impact on trade.

**Table 2: Impact of AfT on Exports**

Variables	Coefficient	Standard Error	t-Value	P> t
lgdp	.7681746	0.07281	10.55	0.0000
Lfdi	0.1633631	0.03991	4.09	0.0000
TRP	-0.0055575	0.00300	-1.85	0.064
Agri	0.0002583	0.00023	1.13	0.259
Bank_FS	-0.00018	0.00035	-0.52	0.602
Trans_Stor	.0001997	0.00008	2.46	0.0140
cons	0.68878	1.19512	0.58	0.5640
R2	Wald Chi	P> F		
0.8416	2174.33	0.0000		

**Authors' Estimate**

Table 2 shows the effects of AfT on the exports. The estimate suggests that GDP and FDI has positive and significant effects on exports. While the aid received for trade related policy (TRP) and Banking and Financial Services (Bank\_FS) has insignificant effect on the export. The results of aid received in the agriculture (Agri) and trans storage (Trans\_Stor) sector has positive and significant impact on the export. The data suggest that there is a variation in the amount received by different countries. This may be the reason for insignificant result obtained in our analysis. Ghimir (2013) provided the reason for this low and adverse effects of AfT variable on trade and says that there is a possibility that amount received for policy and regulation related variables shows adverse impact due to elimination of trade barriers which may increase competition for domestic firms with newly entered importing firms damaging the overall production potential of exporting firms that is reflected in the overall trade.

**Table 3: Impact of AfT on Imports**

Variables	Coefficient	Standard Error	t-Value	P> t
lgdp	0.657108*	0.056991	11.53	0.0000
lfdi	0.091386*	0.03124	2.93	0.0030

TRP	-0.00164	0.002349	-0.7	0.4860
Agri	0.00075*	0.000179	4.18	0.0000
Bank_FS	2.85E-05	0.000277	0.10	0.9180
Trans_Stor	0.000293*	6.36E-05	4.6	0.0000
cons	5.236001	0.935494	5.6	0.0000
R2	Wald Chi	P> F		
0.9066	2740.18	0.0000		

Authors' Estimate

Table 3 shows the effects of AfT on the imports. The estimate suggests that GDP and FDI has positive and significant effects on exports. While the aid received for trade related policy (TRP) and Banking and Financial Services (Bank\_FS) has insignificant effect on the import. The results of aid received in the agriculture (Agri) and trans storage (Trans\_Stor) sector has positive and significant impact on the imports.

## CONCLUSION

This paper links the relation between AfT and trade and the other qualitative factors. The findings suggest that aid received for purpose of trade facilitation has a negligible, but significant relationship in enhancing trade flows in case of agriculture and trans-storage. The relationship appears to be null for aid received in those sectors that are more dependent on the overall economic policy of the country. Therefore, according to this point of view about aid policy, the donor must recognize the importance each sector while allocating the amount for disbursement and need to review domestic economic policy environment of aid-recipient countries. The results provide an overall indication that the aid received in the production sectors have positive impacts though they are negligible while the aid received in the policy related qualitative sector have insignificant impacts on trade.

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