

5

Policy Implications and Future Research

This paper has a number of key findings. We have argued that Aid for Trade should affect trade directly or indirectly by improving the investment climate in which trade takes place. We found that AfT can have a positive effect on investment climate indicators. We found that AfT that falls into the category of trade policy and regulations has helped to reduce the costs of trading, controlling for a number of other factors such as governance generally, being landlocked and income status. This is a key policy finding because it shows that AfT is effective where it aims to be effective (subject, of course, to the quality of reporting by donors to the OECD CRS database).

The results are clear and show that *Apc* has a robust, positive and non-linear effect on exports. In line with the results shown in Table 4.2, as well as with other findings on the impact of aid on growth (e.g. Hansen and Tarp, 2001; Clemens et al., 2004), this relationship has the shape of an inverted U. Aid has a positive impact on exports at a diminishing rate. The second finding is that it is more difficult to establish a direct relationship between AfT, especially aid to productive capacity, and total exports. We have undertaken a number of regressions which tend to suggest that different types of aid affect exports differently, hence the difficulty in finding an aggregate effect in the literature. But on closer inspection, it seems that aid to productive capacity must be modelled by sector, while aid to infrastructure has a positive or negative effect depending on empirical specifications.

To overcome this problem, we employ a new strategy based on inter-sectoral and intra-sectoral (over time) differences in exports. We divide aid to productive capacities into aid to the different sectors and then relate sectoral aid to sectoral exports. The identification comes from analysing whether sectors that receive more aid relative to other sectors in the same country experience relatively faster growth in their exports (between group component), as well as whether exports of a sector grew faster in years in which that sector received a relatively high level of aid (within group component). The main advantage of this strategy is that it allows us to control for all time varying country factors which may influence exports, such as effective demand, policies, size of the economy, economic fundamentals, country-level shocks, etc. The results based on this new identification strategy are clear and show there is a robust, positive and non-linear effect of *Apc* on exports.

The paper examines other aid categories and new dependent variables. There are a number of policy implications:

- There are a number of pathways through which AfT affects trade;
- AfT has significant and measurable effects in reducing the cost of trading, which is an important investment climate indicator relevant to exporting;

- While the effects of AfT on exports are more ambivalent depending on the specification used, when properly specified, AfT does foster exports in productive sectors, up to a point;
- Aid for infrastructure has significant positive effects at both macro and sectoral level;
- Aid for Africa (if Egypt is excluded) has smaller, and sometimes insignificant, results.

The paper extends the literature on aid and growth by showing that refining the aid category into sub-groups related to AfT and examining effects at a more disaggregated level yields significant results. It started the impact assessment of trade-related aid using a number of outcome variables, as well as different measures of aid. Many extensions of the analysis are possible based on available data, which may bring about further insights into the effects of different types and modalities of aid on different countries, regions and variables. We propose some of these extensions below.

1. One possible extension could be to run a similar analysis to that in Table 4.1, but with panel data to control for country-specific time invariant effects. This would make estimation of the cost-effectiveness of this type of aid more precise.
2. It would also be possible to examine the effects of aid on specific regions and countries, performing the analysis in equation 3 on a subset of countries, such as small islands, landlocked economies, Africa, ACP countries or LDCs, and also on countries which differ in terms of economic specialisation. The methodology described in section 2 is robust enough to also extract consistent policy implications on fairly small subsets of countries. This is important, given the apparently varying effects.
3. Provided that the data in the OECD CRS database do not suffer from classification error at fairly disaggregated levels, we could slice the data further by purpose code and examine the effects of different types of specific trade-related aid on the investment climate and exports.
4. We could examine the impact of AfT on other types of dependent variables, such as the real exchange rate, to test whether and to what extent this aid can prevent Dutch disease type effects.
5. There is a need for more analysis and data on the ‘trading climate’ so that the type of analysis set out in this paper does not need to rely on data collected for investment analysis.