

What is the relation between foreign aid and trade?

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Port of Singapore, Source: Wikipedia.

LONDON, United Kingdom – This essay will discuss the relationship between foreign aid and trade. Major scholars on both topics often find two outcomes: 1) trade openness is commonly part of the constitution of “good” policies that promotes effectiveness of foreign aid, hence endorses growth (Burnside and Dollar, 2000). Furthermore there is a great amount of literature about trade promoting growth directly (Frankel and Romer, 1999; Wacziarg and Welch, 2008; Sachs and Warner, 1995). 2) Foreign aid does not promote growth by its own (Easterly, 2003; Denizer et al, 2014) thus, probably, if trade promotes growth, foreign aid does not have a significant “indirect” effect on trade. This essay will discuss if foreign aid correlates with trade.

According to the institutional measure of the World Bank the Country Policy and Institutional Assessment (CPIA), trade is part of the structural policies criteria (World Bank-IDA). The World Bank is, by far, the greatest organization that deals with foreign aid management and allocation. A priori and according to the World Bank criteria, trade is an element of what a good institution is, hence its correlation should be positive with foreign aid for developing countries that receives it. However, does foreign aid affect future trade? I will apply a model in order to answer this question. The result suggests that for a set of developing countries¹ between 1990-2013, foreign aid correlates positively with future trade; e.g foreign aid applied yesterday will be positively correlated with today’s trade. It is important to mention that I am not looking for causal relations, just a correlation (as an exercise) that can help to visualize how both variables relate across the selected developing countries and time.

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