

Comments on
“Is Foreign Aid a Vanguard of FDI?”

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Contributions

1. This is the first study to reveal that Japan's aid has a vanguard effect on FDI from Japan. This finding is based on the use of bilateral data on foreign aid and FDI, which is clearly distinct from previous studies.
2. This study provided inspiration to our paper. It examines whether Korea's aid with strong similarity to Japan's has also the effect. The effect was discovered also in Korea's aid.
3. This final version becomes strengthened by the addition of robustness checks to the draft. The analyses using 3-year averages and LDC-exclusive sample make this paper more persuasive.
4. In summary this study has high originality in motivation and methodology, and successfully highlights the feature of Japan's aid, as well.

Further Questions

1. Despite its significant results, there are still some doubts on whether Japan's (also Korea's) aid really has the effect to promote FDI from the donor. If concrete channels from aid to FDI are not confirmed in reality, the vanguard effect would remain under the suspicion of spurious relation.

2. The following questions might be raised over the channels.

(1) information transmission: Even without aid, location-searching investors might be able to gain as public information as aid could provide. In addition, negative information (corruption, poor infra) as well as positives may be discovered and transmitted to investors. Then, foreign aid will rather discourage than promote investments .

- (2) risk perception: Potential investors are likely to resort to more precise risk evaluation than subjective perception from aid.
 - (3) donor specific environments: They would promote FDI from Japan, but with the expense of crowding-out of FDI from other donors. This doesn't seem to be desirable.
3. The vanguard effect in Japan's and Korea's aid may come from a feature of their aid distribution, namely high proportions of Asian or middle-income recipients.
- Both aid and FDI from the two countries are concentrated on Asia. Asia happens to be the largest host of FDI among developing regions. The vanguard may be the result of a coincidence of their aid recipient and their FDI host, or Asian uniqueness.

- Also, such a relation could appear if their aids have supported their investors in place. That is, its reverse causality from FDI to aid can not be excluded.
- Even if there is no reverse causality, the two donors may have concentrated aid on countries where it looks promising to attract investment in order to create environments favorable to their investors. Strictly speaking, this is not FDI-promoting aid but simply FDI-preceding aid.
- Current Korea's and former Japan's aid equally shows higher proportion in the middle-income recipient, while lower in LDC. MICs are more likely to attract FDI than LDCs. Japan's recipients in the sample mostly consist of MICs, contrasting with even distribution of France's and Germany's recipients.
- It is necessary to check the existence of stochastic trend or unit-root in foreign aid and FDI.

Closing

1.It is an important finding that Japan's aid has close relationship with its FDI in its recipient. Nevertheless, if the causality doesn't stand firm, the 'vanguard effect' might induce criticism that the two donors' foreign aid has been used to support their own investors. So, great caution is required to interpret the effect.

2.More proper allocations or measures in foreign aid are required to expand their FDI promotion effect so that the two countries' aid can display their distinguished impacts on development via FDI. Consequently, their aids should promote not only their own FDI but also FDI in general. They should promote FDI not only in the Asian middle-income countries but in LDCs and Sub-Saharan Africa.