Selection Bias in Aid Effectiveness:
Evidence from Aid for Trade and Foreign Direct Investment

Wonjun Choi[1]

Abstract

This paper examines whether Aid for Trade promotes foreign direct investment using panel data for 16 major donors and 84 recipients during 2005-2019. Baseline GMM estimates show mixed results with moderate effects for EU donors but no significant effects for Japanese aid. To address potential selection bias, we employ a Bartik-style instrumental variable exploiting donor sectoral specialization and recipient revealed needs. The 2SLS estimates reveal substantial heterogeneity. Only Japanese AfT demonstrates strong causal effects, while other donors show no significant relationships when instrumented. The contrast between GMM and IV estimates suggests Japan systematically targets recipients with lower FDI potential, creating negative selection bias that masks true effects in conventional estimators. These findings highlight the importance of addressing endogeneity in aid effectiveness research and suggest donor strategies shape both aid allocation and outcomes.

[1] Graduate School of Asia-Pacific Studies, Waseda University, Shinjuku-ku, Tokyo, Japan

Correspondence: Wonjun Choi, Waseda University, Nishi-Waseda Bldg.7F, 1-21-1 Nishi-Waseda, Shinjuku-ku, Tokyo 169-0051 Japan, Email: peterchoi@toki.waseda.jp

ORCID

Wonjun Choi https://orcid.org/0009-0003-5129-5339