

Chapter 16

Future Directions in Aid for Trade

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16.1 Introduction

The Aid for Trade (AfT) initiative is at a critical juncture. It has been successful in generating momentum over the past seven years by making donors and developing countries more aware of the role of trade in development and by increasing the amount of funds available for AfT. However, with aid resources under pressure (both the total aid budget and the resources available for AfT declined in 2011), with the nature and scope of development finance flows to developing countries changing rapidly, and with trade patterns continuing to change, the question is how the AfT initiative can remain relevant. We consider this question in this concluding chapter.

In recent years, AfT has evolved from a new initiative linked to the World Trade Organization (WTO) Doha Round of trade negotiations in 2005 into a supply-side instrument for trade capacity building (or ‘decoupled’ AfT). In the next few years we expect to see a ‘third’ generation of AfT: an approach in which ‘connected AfT’ is packaged into a bundle of support that leverages other financial flows, and that is more firmly connected to a country’s public and private actors and, by extension, connects countries to value chains. There are two alternatives: AfT keeps a *narrow* focus on trade facilitation, or AfT is asked to address many *broader* concerns such as social or environmental problems

This chapter examines briefly some elements in the future of the AfT initiative. We trace the progress of the initiative from its inception (section 16.2), covered by Page (2007), to the current phase, in which AfT is largely seen as one specific form of aid (section 16.3). Many bodies such as the Organisation for Economic Co-operation and Development (OECD) and the WTO have monitored the effectiveness of AfT in successive global and regional reviews (see, for example, OECD/WTO 2011). We propose a new type of AfT, which will need to connect more with current trade and investment realities, and we term this ‘third-generation AfT’ (section 16.4). Section 16.5 considers two alternatives for AfT: a narrow and a broad view. Section 16.6 concludes.

16.2 Conception of Aid for Trade: providing global public goods

The AfT initiative emerged at the WTO Doha negotiations, specifically paragraph 57 in the 2005 Hong Kong declaration. AfT was seen to facilitate the implementation of trade agreements and to compensate for preference erosion (e.g. Caribbean rum producers that enjoyed preferences would see these erode over time as other countries gained the same preferences; see Cantore et al. 2012). As originally conceived, AfT

was therefore not normal aid, but it would be provided by non-aid ministries to fund adjustment so that it could help finance the provision of a global public good (GPG), in this case global trade rules (Page 2007).

te Velde (2008) extends a public goods framework to AfT activities. AfT supports two or three categories of public goods (see Table 16.1): (i) governance GPGs in the form of a global system of trade rules; (ii) knowledge GPGs in the form of impact assessments and trade development studies and awareness raising; and (iii) infrastructure, but this is not a pure public good. Different AfT activities as defined by WTO (2006) will have different effects on economic development. For example, infrastructure plays a key role in growth (see, for example, Holland and te Velde 2012). The financing gaps are also clear for infrastructure, but they are also visible for governance and knowledge activities contained in AfT. There is a real deadlock in progress on WTO negotiations and development in global trade rules. Further gaps are in diagnostics of national constraints to trade, but also in the area of regional constraints (see the Chapters 8 and 9 in this volume), impact assessments of changes to trade rules and follow-up.

16.3 Decoupled Aid for Trade: building countries' capacity to trade

A Task Force was established in 2006 to operationalise the AfT concept (WTO 2006). Although the initiative had limited success in creating new global funds, e.g. the emergence of the Enhanced Integrated Framework, it has succeeded quite well in raising donor awareness of the importance of trade, and to some extent awareness of the importance of trade in developing countries. It has also helped to secure significant AfT spending (Figure 16.1), which now accounts for one-third of official development assistance (ODA) as a result of, in particular, a rise in infrastructure spending. In 2011, however, overall AfT funding (and AfT to infrastructure) declined.

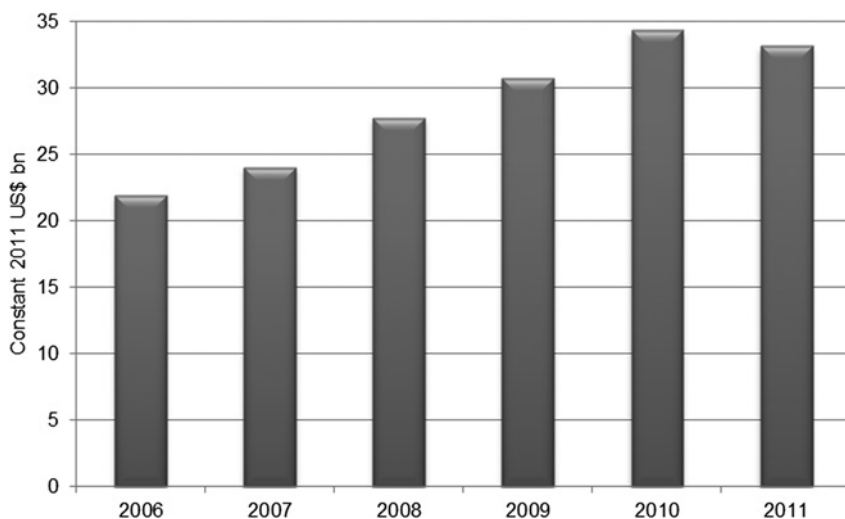
However, with the Doha negotiations grinding to a halt by 2008, the Task Force had already argued that 'AfT is a complement to the Doha Round' (Page 2007) and aid experts established the case for AfT as a normal aid tool that was decoupled from deadlocked trade negotiations. In this second-generation form, AfT is seen as promoting development in the same way as any other type of aid. Its needs were derived from Diagnostic Trade Integration Studies (DTISs), which were integrated to varying extents into Poverty Reduction Strategy Papers (PRSPs), rather than preference erosion costs. This also meant that needs were often identified as aid needs rather than overall investment needs, and often there was no overall investment chapter in the DTIS.

The aid view of AfT led to increased attention focused on the application of traditional aid principles (e.g. harmonisation and alignment) and the monitoring of AfT effectiveness. The third OECD/WTO Aid-for-Trade Global Review (OECD/WTO 2011) discussed the monitoring of AfT at the global level and included a large number of case studies. Overall, studies on AfT suggest a more positive relationship with trade, growth, lower trade costs and investment climate outcomes than other

Table 16.1 A public goods framework for Aid for Trade activities

	AfT activities		
	Governance	Knowledge	Infrastructure
1. Rationale for the provision in public good terms (non-rivalry; non-excludability)	Global trade rules contribute to the provision of governance GPGs and require global approaches	Impact assessment studies, trade policy analysis contribute to knowledge GPGs, some of which are regional. AfT awareness raising is a global activity	Infrastructure tends to be described as a club good
2. How does the public good relate to (economic) development?	Evidence suggests more stable and transparent rules will increase investment and growth; global trade rules will also diminish negative externalities of national trade-related policies	Knowledge and innovation are linked to productivity change Trade helps to set a conducive environment for development	Several studies find that infrastructure is crucial for investment and growth
3. What are the current gaps in provision of the good and at what level (national, regional, global)?	WTO negotiations deadlocked and lack of global rules development, regional networks important and significant lack of national level trade rules	Lack of economic and trade policy knowledge. Lack of relevant trade impact assessment, and lack of knowledge on regional trade constraints	Large gaps in infrastructure as aid decreased and private sector did not fill gap in the past decade, but it is increasingly doing so
4. What are the financing mechanisms to address the gaps (country programmes, regional and global initiatives)?	Global co-ordination local implementation (beyond country programme) or regional implementation in the case of regional trade rules	Knowledge e.g. for trade policy, needs national approach, but also regional , to contribute to regional knowledge PGs) Awareness raising need to include global approach	Regional development banks and regional groupings, national development programmes. Complementary financing sources (public budget, bond issuance, loans, FDI, etc.)

Source: te Velde (2008)

Figure 16.1 Aid for Trade disbursements, 2006–11

Source: Jane Kennan based on data obtained from the OECD Creditor Reporting System (CRS) database (downloaded April 2013)

aid, although there are still gaps in the use of methodologies, methods and indicators in monitoring and evaluating progress. Chapter 2 in this volume, by Massa, provides an overview of the depth and breadth of the quantitative evidence. Moreover, Chapter 6 in this volume, by Basnett and Engel, also finds that conditions and policies within donor and recipient countries, such as the presence of AfT strategies, are also important in driving its effectiveness.

16.4 Connected, ‘third-generation’ Aid for Trade

The context of AfT is now changing fast. There are flows other than AfT which can also raise the capacity to trade. A change in trade patterns means that support needs to take these changes into account. This means that AfT will need to link better with trade and investment constituencies, in addition to satisfying the standard aid principles. Let us consider why and how.

16.4.1 Changing development finance flows

With increased pressures on aid resources (in 2011, AfT fell for the first time since the AfT initiative began in 2005) and considerable growth in other financial resources to developing countries, it has become more important to embed AfT in the context of other flows. We can consider capital flows to sub-Saharan Africa (SSA) as an example (Table 16.2). Aid for trade to SSA was US\$9.2 billion. However, private capital flows to SSA amounted to US\$55 billion, larger than (i) overall ODA to SSA, US\$43 billion in 2011; (ii) remittances to SSA, US\$31 billion in 2011; (iii) Chinese (announced) loans to Africa, US\$7 billion per annum over 2013–15; (iv) International Finance Corporation investments, US\$2.2 billion in SSA in financial

Table 16.2 The changing nature of capital flows to sub-Saharan Africa, 2001–11 (US\$billion)

	2001	2011
Private capital flows		
FDI, net inflows	15	40.9
Bond flows	2	6
Net portfolio equity inflows	-0.9	8.3
Total above	16.1	55.2
Other financial flows		
AfT	2.5	9.2
All ODA aid	14	43
Remittances	4.8	31
IFC investments		2.2
IDA/IBRD credits		36.3

Source: World Development Indicators, author's own calculations (see Hou et al. 2013)

year 2011; or (v) International Development Association/International Bank for Reconstruction and Development credits to SSA, US\$36.3 billion in 2011).

All of these flows, and especially private capital flows, and not only AfT, can help to build trade capacity. The remarkable dynamism around bond flows in Africa is one example. Bond flows to SSA were valued at US\$6 billion in 2011 and experienced much dynamism into 2012 and 2013. Several African countries have now issued bonds and others are considering doing so in 2013. Bond yields in Zambia – where the US\$750 million bond issue (to finance infrastructure) in September 2012 was reportedly oversubscribed 15 times – were, at 5.4 per cent, lower than in some European countries (Greece, Portugal and Spain) in the past year. Nigeria, Angola, Ghana, Kenya and Rwanda together plan to issue US\$4 billion of bonds in 2013. A US\$400 million bond in Rwanda in 2013 was oversubscribed seven times. The bond would be used to finance transport services and infrastructure, both of which support trade capacity, in addition to AfT.

Given the existence of these other financial flows, sometimes with similar purposes, the next step is to examine how AfT, or aid more generally, can leverage in these other flows, or at least connect to these flows to avoid duplication. Indeed, one underemphasised aspect of AfT is its ability to leverage in other official flows through blending loan and grants, e.g. for infrastructure (Gavas et al. 2011). If developing countries want to attract significant resources to build trade capacity, e.g. to cover their infrastructure needs, they need to think outside the traditional AfT box and consider how grants can leverage in other resources (e.g. loans or private finance) and attract a blended bundle of investment for trade finance. Experience suggests that aid grants can indeed leverage in substantial amounts of other finance.

For the EU blending schemes, Gavas et al. (2011) estimate that one unit of grants leverages in five or six units of loans (for both the EU-Africa Infrastructure Trust Fund and the Neighbourhood Investment Fund) and another 15 units of other finance. Moreover, Development Finance Institutions (DFIs) (which provide ODA and Other

Official Flows [OOF] with the aim of supporting the private sector) are backed by implicit and explicit subsidies and these can help to mobilise additional capital, including for infrastructure. Some US\$33 billion of DFI investment is invested in the private sector each year. Around a third of this goes to infrastructure; some is classified as ODA, some as OOF. Every \$1 from the International Finance Corporation (IFC) leverages about \$3 from others.

Another study (te Velde 2007) suggests how home-country measures, including 'investment-related aid', can leverage in UK foreign direct investment (FDI). It examines a number of measures for promoting outward FDI. Some measures are classified as development co-operation, whereas others are not, since they may be primarily aimed at developing the home country rather than host developing countries. An example of the former is the UK–Asian Development Bank (ADB) Private Sector Guarantee partnership, whereby a £6 million grant of aid is expected to leverage in £268 million of private investment for solar power in India. Exim banks are examples of the latter, since they provide guarantees and loans to promote private sector investment abroad. Emerging economies, such as China, but also some developed countries such as Japan, have long supported their investors with packages of support that includes aid. This has, in turn, led to other significant flows to developing countries that have boosted their trade.

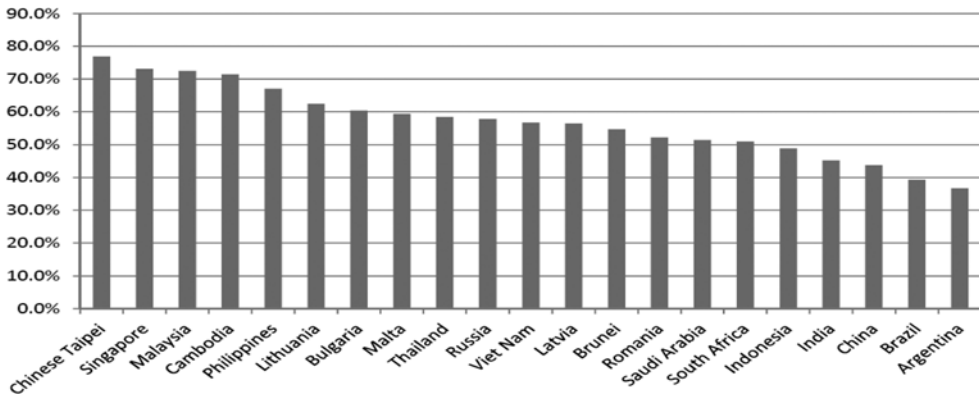
In the future we cannot consider AfT in isolation of other financial flows and we shall need to examine the leverage effect and examine 'investment for trade'. For example, the currently ongoing DTIS for Cambodia is planned to include an investment chapter. Trade diagnostics remain important but the solution to the trade-related problems will now need to include a range of policies, institutions and a range of financial flows which more often appear in packages rather than separate blocks of aid.

16.4.2 Changing trade patterns

te Velde et al. (2013) discuss increasing fragmentation of production across borders as a new feature of global trade. This type of trade is often co-ordinated by lead firms within global value chains (GVCs) and involves the development of trade and FDI. Global manufacturing is now characterised by trade in tasks between countries which specialise in particular segments of a given value chain. Since the rise of the East Asian newly industrialised countries (NICs), and more recently China, there have been considerable shifts in the geography of both global manufacturing production as well as employment. Baldwin (2007) uses the term 'factory Asia' to describe the Asian region which is deeply integrated into regional and international value chains.

Economic data do not directly measure the importance of GVCs in a country's exports. The OECD (2012), however, has developed a database and index which can measure indirectly the importance of imports and intermediate exports in total exports. The participation index measures to what extent countries are involved in vertically fragmented production. This is approximated by the sum of (i) the value of imported inputs in the overall exports of a country and (ii) the percentage of exported goods and services used as imported inputs to produce other countries' exports. The shares added describe the participation of a country in GVCs, both as a user of foreign

Figure 16.2 Participation in global value chains (foreign value added and domestic value added used in third-country exports, as a share of gross exports)



Source: OECD (2012)

inputs and as a supplier of intermediate goods and services used in other countries' exports. Figure 16.2 shows that as much as 50 per cent of exports in many countries is related to participation in GVCs, with smaller countries at the top of the scale and larger countries near the bottom.

The consolidation across key value chain nodes (marketing and retailing) suggests that all types of trade are moving towards more hierarchical and buyer-driven types of GVC governance structures. The challenge for policy-makers in developed and developing countries is how to capture the economic and social benefits derived from participation in value chains. This depends on effective governance structures, both in terms of how firms interact with each other but also in relation to how governments interact with firms. This means that, for AfT to be effective, it might need to move from general support to specific support for particular niches in the chain. Thus, AfT should connect better to other actors, and focus on the most binding constraints along a value chain or trade corridor (e.g. fewer delays and hence lower trade costs at the Chirundu border post between Zambia and Zimbabwe). There is also increased emphasis on connecting AfT to global value chains by supporting effective state-business relations that can improve the relevance and effectiveness of AfT.

16.5 Other perspectives on Aid for Trade: narrow and broad views

There are several other perspectives on AfT, which may be grouped into narrow and broad views. In the narrow view, AfT returns to a very specific role, focusing mainly on Aid for Trade facilitation (e.g. supporting customs procedures). Aid for Trade could be used in this way to support negotiations on trade facilitation and ensure that countries can take part in GVCs, as this requires appropriate import and export capacities.

In the broad view, there is a bottom-up approach to trade. In this view, trade plays a part in the solutions to specific challenges. For example, trade and diversification is a

route out of economic crises, so AfT should help to diversify countries and focus on industrial development. Alternatively, trade is a solution to global food insecurity, providing access to food or scarce natural resources virtually, through trade, and AfT would support this process. Trade can also help the spread of ideas, technology and innovation required to combat climate change. Aid for Trade can help this process and address the adjustment costs when trade flows adjust to climate change. In yet another view, trade reform can provide employment and opportunities for the poorest only when complementary AfT is in place.

16.6 Conclusions

This chapter has sought to imagine possible future directions for the AfT initiative. We summarise five views in Table 16.3, mention their objectives and describe the essence of each.

Table 16.3 Five future directions on Aid for Trade

Perspective on AfT	Objectives	Comment
First-generation AfT	Financial transfers to ensure countries benefit from (implementing) global trade rules, providing a global public good	Origin of AfT initiative (Article 57 in 2005 Hong Kong Ministerial)
Second-generation AfT	AfT as one type of aid to developing countries, and aid effectiveness principles rule	Important in raising attention on trade in the development community (2006–10), but limited links with trade and investment communities
Third-generation AfT	Connected AfT connects to new actors to account for changes in trade patterns (by focusing on niches) and capital flows (by focusing on leverage)	Connected to modern patterns of trade, investment, finance and business. Offers packages of ‘investment for trade’ (loans, grants, private capital flows), building trade capacity that can help countries link to value chains
AfT: narrow view	AfT addresses trade facilitation, directly helping trade	Focused view accounting for changes in trade patterns but risks losing touch with modern developments in financial flows
AfT: broad view	AfT addresses broad problems such as food security, climate change and social opportunities	AfT initiative loses focus and may risk losing its importance in coming years

Although each of the various AfT concepts has some relevance today, it is very likely that there will be more emphasis on third-generation AfT in the coming years. Third-generation AfT is more connected, involves learning from emerging economies, offers packages of support ('investment for trade'), albeit untied, to connect poor countries to value chains and is managed and facilitated by actors who are well connected to domestic state and business sectors. This renewed type of AfT can help effectiveness of AfT in times of resource constraints, leverage in other financial flows of great value and make more comprehensive connections amongst countries, actors and flows.

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