

# trade hot topics

## Assessing the Effectiveness of Aid for Trade

Edwin Laurent and Mohammad A Razzaque\*

### Background

Aid for Trade (AfT) is financial and technical assistance provided to developing countries that enhances their ability to produce and trade more efficiently and competitively. As a consequence they are able to participate more fully and effectively in global trade. It is this underlying but specific trade purpose that distinguishes AfT from the rest of traditional overseas development assistance. AfT came under renewed focus under World Trade Organization (WTO)-sponsored Doha Round of multilateral trade negotiations, as many developing countries realised that their lack of supply-side capacity prevented them from sharing in the expansion of global trade that has occurred in recent years.

The subject of AfT became a priority area of the Commonwealth Secretariat's work programme on international trade immediately after it was formally discussed by WTO members at their Hong Kong Ministerial Conference in 2005.<sup>1</sup> Since the establishment of the WTO's role in monitoring AfT flows, the Commonwealth Secretariat's work in the area, until now, has mainly focused on understanding effectiveness and impact. It has undertaken and commissioned several studies to assess the quantitative evidence. Along with the

attempts made to examine the impact of both overall AfT flows and their various types, comparative effectiveness assessment has also been carried out by studying different groups of countries such as the small and vulnerable economies (SVEs) and Sub-Saharan Africa. This issue of *Commonwealth Trade Hot Topics* provides a summary of the key findings of a number of Commonwealth Secretariat-sponsored studies.

### Analytical framework

While the specific term 'Aid for Trade' is relatively new in multilateral trade policy discourse, the concept is not. The Organisation for Economic Co-operation and Development (OECD) has long been reporting data on such flows to developing countries that are comparable to the six categories of trade-related assistance identified by the WTO (viz. trade policy and regulations; trade development; trade-related infrastructure; building productive capacity including private sector development; and trade-related adjustment

<sup>1</sup> Among others, the Commonwealth commissioned a major study, undertaken by the Nobel Laureate and economist, Professor Joseph Stiglitz, triggering further meaningful discussions on various aspects of the Aid for Trade initiative. The study proposed a set of general principles for an AfT mechanism, identified the areas where such assistance would be required, and put forward recommendations for its better and more effective utilisation.

\* The authors are respectively Adviser and Head, and Economic Adviser, International Trade and Regional Co-operation Section, Economic Affairs Division, Commonwealth Secretariat, London, UK. This article draws on the findings of a number of Secretariat-sponsored studies. The views expressed here are those of the authors, and do not necessarily reflect those of the Commonwealth Secretariat.

including support for adjustment associated with changes in international trade regimes; and other trade-related needs). This allowed Commonwealth studies examining the overall impact of AfT and also of its various types to use fairly long time-series information over a large cross-section of countries.

The research was undertaken by constructing a theoretically consistent analytical framework to understand the routes through which AfT contributes to export performance. This framework was then utilised in building an empirical specification, linking trade-related indicators to AfT and its various components while controlling for a host of other factors that can also affect countries' performance. Three types of impact were analysed: (a) the impact of aid for trade facilitation on the cost of trading (as measured by the time and costs of importing and exporting); (b) the impact of aid to economic infrastructure and aid to productive capacity on total exports; and (c) the impact of aid to economic infrastructure and aid to productive capacity on sectoral exports. While the AfT data by recipient countries came from the OECD Creditor Reporting System (CRS) database on aid disbursements, the information on the cost and time of trading, aggregate and sector-specific exports, and other investment climate-related variables were compiled from different World Bank sources.

### Results — AfT effectiveness in the overall sample of developing countries

The first analytical exercise was carried out using time series data across the set of all developing countries for which the required information was available to empirically test the association between AfT flows and export performance and trade facilitation-related indicators. The results provide clear evidence that aid for trade facilitation (ATF) has a statistically significant impact on the cost of trading. A 100 per cent increase in ATF is associated with a decrease in the costs of importing by 5 per cent. Using the estimates and data, it is found for instance that an increase in ATF of US\$390,000 would be associated with a US\$82 reduction in the costs of unloading a 20-foot container of goods from a vessel, clearing them through customs, loading them on to a truck and transporting them to the factory or wholesale depot. This cost-reducing effect is robust to controlling for other relevant factors as well as to using different indicators of cost of trading (e.g., costs of exporting and time to importing).

The results also suggest that aid to economic infrastructure is particularly beneficial for mining

and manufacturing exports, while it has almost no significant effect for tourism, except in the case of small economies, and a marginally positive impact on food exports. These findings may be consistent with the importance of transport and energy infrastructure in mining and manufacturing production relative to the other sectors. Although not statistically significant, the impact of aid to productive capacity is generally positive across sectors. On the other hand, aid to mining exports appears to have a negative effect, which would require further scrutiny.

Overall AfT is also found to have a positive and significant impact on exports from the group of developing countries as a whole. In particular, doubling of AfT is associated on average with a 3.5 per cent increase in merchandise exports by the recipient country. The estimates suggest that a US\$86 million increase in aid to economic infrastructure (i.e., a 100% increase at the mean) is associated with a US\$650 million increase in real exports after one year and by US\$750 million after two years. When the effects on sectoral exports are considered, some positive effects of aid to productive capacity are captured, which is likely to be due to an allocation skewed towards already well performing sectors.

### Results for the small and vulnerable economies (SVEs)

The discussions around Aid for Trade have tended to treat beneficiaries as a fairly homogeneous group of developing countries. However, groups of recipient countries differ according to a variety of factors, including their inherent characteristics, and needs, which are important to acknowledge in devising any AfT strategy. One group of countries that have not, in our view, received adequate attention despite their special and unique development challenges is that of the small and vulnerable economies. Given their peculiar development challenges and their massive dependence on international trade for economic growth, the need for well designed and effective trade-related assistance cannot be overemphasised. For this reason, the Commonwealth Secretariat has undertaken an assessment of AfT effectiveness in SVEs.

Results from the statistical analysis suggest that aid for trade facilitation is likely to have a more significant cost-reducing effect on the costs of handling imports and exports in SVEs than in the rest of the developing countries. This finding is consistent with these countries' having on average higher unit

transaction costs than other developing countries (as these are spread over smaller volumes of exports). The results further suggest that aid to economic infrastructure increases overall exports more in SVEs than in other developing countries, although the effects fail to appear as statistically significant. On the other hand, aid to productive capacity is found to have no significant effect on SVE exports.

In the case of SVEs, sectoral aid seems to have a positive impact on tourism and mineral exports, which is larger in SVEs than in non-SVEs. This is an important result considering the relevance of tourism in the export basket of SVEs. On the other hand, among others, food and manufacturing exports by SVEs do not appear to benefit from higher AfT.

### Results for Sub-Saharan Africa

A further study sponsored by the Commonwealth Secretariat focuses on the impact of AfT on another group of developing countries, for which the trade performance is particularly important, that is, countries in the Sub-Saharan Africa (SSA) region. Their disappointing trade performance in the last four decades has been recognised by many as one of the main factors for the relatively poor economic performance. Sub-Saharan Africa, on average, has higher transport costs than compared to all other developing countries, and such costs are thought to be a major constraint to trade and growth in the region. Given these types of constraints, the kind of assistance provided by AfT could be especially relevant to address those supply-side constraints which prevent these countries from effectively participating in world trade.

The findings in the Commonwealth study suggest that aid to trade facilitation has helped reduce the cost of trading in SSA, which is of similar magnitude to the other developing countries. Among the main SSA regional economic communities, such effects are found to be the strongest in the Southern African Development Community (SADC). On the other hand, aid for trade policy and regulation, which also encompasses training support for officials, has a significantly more pronounced impact on the cost of trading in SSA than in other developing countries.

In terms of the broad impact of AfT on exports, the estimates of the returns to aid to economic infrastructure on exports are found to be much larger in SSA than in the other developing countries, while the opposite is true for aid to productive

capacity. The statistical exercise seems to suggest that SSA benefited significantly from infrastructure investments, but not from direct support to its productive sectors. It is mainly SADC (rather than other regions) that seems to drive this differential pattern of aid to economic infrastructure and aid to productive capacity in SSA. The analysis further suggests that part of the beneficial effect of aid to economic infrastructure in SSA occurs through the facilitation of intra-SSA trade. Finally, the estimates point to the importance of soft infrastructure investments, particularly in finance and business services, as returns from AfT to these sectors in SSA have been much greater than those that resulted from resources provided for transport, storage and energy projects. However, the results also suggest that infrastructure support including transport and energy is important.

### Lessons learned and recommendations for more effective use of AfT

The empirical results, therefore, provide some interesting and useful evidence of the effectiveness of AfT. The favourable effect of aid for trade facilitation in reducing the costs and time of trading in developing countries is robust and consistent. This effect is significant both for SVEs as well as SSA. AfT aimed to facilitate the cross-border trading operations is thus likely to yield a high return on the investment and enhance overall competitiveness of the economies. Given the evidence, aid to trade facilitation should continue to be an important component of AfT.

The findings also highlight a clearly differential impact of the two main components of AfT on developing countries' exports: while aid in support of economic infrastructure exerts a strongly positive influence on exports, aid to enhance productive capacity fails to register a similar effect. This differential pattern is accentuated in the case of SSA, in line with the importance of the constraints that the dearth of infrastructure imposes on these countries' ability to trade. While this finding may suggest a reconsideration of the AfT allocation, it is very important to further examine the lack of effectiveness of aid to productive capacity.<sup>2</sup> Certain

<sup>2</sup> There are, however, case studies that have found AfT to help develop productive capacity and support export growth. A notable example is the expansion of the volume of Rum from the Caribbean that resulted from the provision of financial assistance by the European Union, which enabled Caribbean exporters not only to expand production volume, but also to move up the value chain producing and exporting bottled and branded Rums and marketing them more efficiently in Europe.

productive sectors such as commodities and other traditional activities in SVEs and SSA suffer from lack of dynamism, and thus the development of productive capacity may only be valuable if it is focused on the dynamic sectors with stronger linkages effects for the rest of the economy.

The empirical results provide a confirmation of the importance of supporting infrastructure development for developing countries' ability to trade. This is true not only for hard infrastructure (such as energy and transport infrastructure), but also for soft ones such as financial and business infrastructure.

As far as SVEs are concerned, donors could consider introducing AfT programmes addressing specific trade-related constraints faced by SVEs. Currently, the AfT has got overall focus on infrastructure and sectoral development which does not give adequate attention to the specific needs of small states. For example, while greater connectivity by way of improved road and transport networks has been an important area of regional AfT interventions elsewhere, such an approach for small island states that suffer from remoteness and isolation would not be appropriate. AfT designs therefore need to be more innovative for these countries along with the traditional projects of developing infrastructures and improving the efficiency of the existing ones.

The review of the trends of AfT flows undertaken in Commonwealth studies shows that assistance provided under one component of aid for trade, known as the support for trade-related adjustment costs, has been negligible. An important aim of AfT is to help developing countries adjust to multilateral trade liberalisation processes. There can be various adjustment requirements, ranging from tackling export shortfalls to capacity development for dealing with new trade measures and provisions, where support would be required. Among these, adjustment support for the loss of trade preferences has become one of the most critical issues for many small and vulnerable economies and to some extent for the Sub-Saharan African countries. The assessment presented in one of the Commonwealth studies shows that potential absolute loss of exports due to preference erosion could be in the range of US\$162 million — US\$654 million, which is about 15 to 29 per cent of total such losses for developing countries as a whole. For certain SVEs such as Belize, Dominica, Jamaica, Mauritius, St Lucia, St Vincent and the Grenadines,

and Sao Tome and Principe, adjustment challenges due to preference erosion are likely to be very high. Under this circumstance, AfT support for trade adjustment would be extremely important for small states. Similar support for certain SSA countries would also be very helpful.

The dissemination of the findings from Commonwealth Secretariat-sponsored studies in different forums, involving policy-makers, trade negotiators, parliamentarians and civil society groups, has also contributed to further understanding of the factors influencing the AfT effectiveness. Among others, many consider institutional weakness as one of the major factors constraining the mainstreaming of aid for trade in national development strategies and its operationalisation. Institutional building has also been recognised as essential to enhance the ownership of aid for trade. Most stakeholders are also of the view that significant information gaps exist as currently there is no comprehensive database on AfT at the country or regional level. As a result, it is believed that the evaluation of AfT flows and their obligation is not adequately known. It is, therefore, important for countries to develop and strengthen databases of different types of aid for trade and projects where these funds are being utilised to enable the evaluation and monitoring of AfT. Because of the absence of a recipient country specific database, the monitoring of AfT is thought to remain primarily a donor-driven initiative. There is also a need for country-specific case studies on AfT to help recipient countries learn lessons and share experiences from each other on the best practices in AfT projects.

<sup>3</sup> Cali, M, Razzaque, M A and te Velde, D W (2011). *Effectiveness of Aid for Trade in Small and Vulnerable Economies: An Empirical Assessment*. Economic Paper No. 91. London: Commonwealth Secretariat.

## Selected publications of the Commonwealth Secretariat on Aid for Trade

- Calì, M, Razzaque, M A and te Velde, D W (2011). *Effectiveness of Aid for Trade in Small and Vulnerable Economies: An Empirical Assessment*. London: Commonwealth Secretariat.
- Turner, L and Tracy, A (2011). 'Regional Aid for Trade and Aid Effectiveness: Examples from East and West Africa'. Commonwealth Secretariat.
- Onguglo, B (2010). 'Aid for Trade: Policy Issues for ACP States', *Commonwealth Trade Hot Topics*, Issue 75. Commonwealth Secretariat.
- Calì, M and te Velde, D W (2009). 'Aid for Trade in Small and Vulnerable Economies', *Commonwealth Trade Hot Topics*, Issue 59. Commonwealth Secretariat.
- Calì, M and te Velde, D W (2008). 'The Effectiveness of Aid for Trade: Some Empirical Evidence', *Commonwealth Trade Hot Topics*, Issue 50. Commonwealth Secretariat.
- Calì, M and te Velde, D W (2008). *Towards a Quantitative Assessment of Aid for Trade*. Economic Paper No. 83. London: Commonwealth Secretariat.
- Turner, L (2008). *Quantifying Aid for Trade: A Case Study of Tanzania*. Economic Paper No. 82. London: Commonwealth Secretariat.
- Stiglitz, J and Charlton, A (2006). *Aid for Trade*. Commonwealth Discussion Paper, and also published as Chapter 2 in Mbirimi, I (ed) (2007), *After Hong Kong: Some Key Issues for Developing Countries*. London: Commonwealth Secretariat.
- Stiglitz, J (2004). *An Agenda for the Development Round of Trade Negotiations in the Aftermath of Cancun*. London: Commonwealth Secretariat.

# International Trade & Regional Co-operation Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade and Regional Co-operation (ITRC) Section of the Economic Affairs Division (EAD) of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth — an association of 54 independent states, comprising large and small, developed and developing, landlocked and island economies — facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITRC is entrusted with the responsibilities of undertaking policy-oriented research and analysis on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITRC approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on two highly vulnerable Commonwealth constituencies — least developed countries (LDCs) and small states.

## Scope of ITRC Work

ITRC undertakes activities principally in three broad areas:

- It supports Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote development friendly outcomes, notably their economic growth through expanded trade.
- It conducts policy research and consultations increase understanding of the changing of the international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance the more beneficial participation of Commonwealth developing country members, particularly small states and LDCs.

## ITRC Recent Activities

ITRC's most recent activities focus on assisting member states in the WTO Doha Round and the Economic Partnership Agreement (EPA) negotiations involving the African, Caribbean and Pacific countries (ACP) the European Union (EU), undertaking analytical research on a range of trade policy and development issues, and supporting workshops/dialogues for facilitating consensus-building on issues of Commonwealth members' interest, exchange of ideas, and disseminating results from informed analysis.

## Selected Recent Meetings/Workshops supported by ITRC

9 March 2011: Consultative Meeting on Trade Effects of Rules on Procurement for Commonwealth ACP members held in London, UK.

8 March 2011: Consultative Meeting on Making Trade in Services Supportive of Development in Commonwealth Small and Low-Income countries, held in London, UK.

16-18 February 2011: Conference on Regional Integration titled 'Caribbean Community and the Commonwealth: Collective Responsibility in the Twenty First-Century', held in Kingston, Jamaica.

17-19 December 2010: 3rd South Asian Economic Summit titled, Regional Economic Integration, Climate Change and Food Security Agenda for the Decade 2011-2020, held in Kathmandu, Nepal.

25-26 November 2010: Regional Seminar on Trade Policy for Commonwealth Caribbean Parliamentarians, held in St. Kitts & Nevis.

24-26 November 2010: International Dialogue titled, Exploring a New Global Partnership for the LDCs in the Context of the UN LDC IV, held in Dhaka, Bangladesh.

15-17 November 2010: Workshop on Competitiveness Strategies with Special Reference to African and Indian Ocean Small States, held in Port Louis, Mauritius.

3 November 2010: Pre-LDC IV African Civil Society Forum, held in Arusha, Tanzania.

16 September 2010: WTO Public Forum Session on Africa in international trade: impediments and opportunities, in Geneva, Switzerland.

28 June 2010: Consultation Meeting on WTO Accession, held in Brussels, Belgium

26 June 2010: Workshop on Policy Barriers in Intraregional Trade in South Asia, held in Dhaka, Bangladesh

## Selected ITRC Publications

Collier, P. (2011). *Catching Up: What LDCs Can Do, and How Others Can Help*, London: Commonwealth Secretariat.

Calì, M., Razzaque, M. A. and Te Velde, D. W. (2011). *Effectiveness of Aid for Trade in Small and Vulnerable Economies*, Economic Paper No. 91, London: Commonwealth Secretariat.

Calì, M with Kennan, J (2010). *The Global Financial Crisis and Trade Prospects in Small States*, Economic Paper, London: Commonwealth Secretariat.

Milner, C., Morrissey, O. and Zgovu, E. (2010). *Policy Responses to Trade Preference Erosion: Options for Developing Countries*. London: Commonwealth Secretariat.

Jones, E., Deere-Birkbeck, C. and Woods, N. (2009). *Maneuvering at the Margins: Constraints Faced by Small States in International Trade Negotiations*. London: Commonwealth Secretariat.

Razzaque, M. A. (ed) (2009). *Trade, Migration and Labour Mobility*. London: Cameron May.

Srinivasan, T N (2009). *LDCs, Landlocked Developing Countries and Small States in the Global Economic System*. London: Commonwealth Secretariat.

Stevens, C et al. (2009). *The CARIFORUM and Pacific ACP Economic Partnership Agreements: Challenges Ahead?*, Economic Paper No. 87, London: Commonwealth Secretariat.

Winters, L A et al. (2009). *An EU-India Free Trade Agreement: Reflections on the Implications for Excluded Countries*. London: Commonwealth Secretariat.

Calì, Massimiliano and te Velde, Dirk Willem (2008). *'Towards a Quantitative Assessment of Aid for Trade'*. Economic Paper, London: Commonwealth Secretariat.

Grynberg, Roman and Newton, Samantha (eds) (2008). *Commodity Prices and Development*. Oxford University Press.

Milner, Chris (2008). *Trading on Commonwealth Ties: A Review of the Structure of Commonwealth Trade and the Scope for Developing Linkages and Trade in the Commonwealth*. London: Commonwealth Secretariat.

Turner, L (2008). *'Quantifying Aid for Trade: A Case Study of Tanzania'*. Economic Paper, London: Commonwealth Secretariat.

Qalo, Veniana (ed) (2008). *Bilateralism and Development: Emerging Trade Patterns*. London: Cameron May.

Grynberg, Roman and Bilal, Sanoussi (eds) (2007). *Navigating New Waters: A Reader on ACP-EU Trade Negotiations*. London: Commonwealth Secretariat.

Razzaque, Mohammad A and Laurent, Edwin (eds) (2007). *Global Rice and Agricultural Trade Liberalisation: Poverty and Welfare Implications for South Asia*. London: Commonwealth Secretariat.

## Selected Ongoing Policy Research Projects

- Aid for trade in small states and Sub-Saharan Africa
- Trade and climate change issues for LDCs
- Rise of emerging developing countries and implications for Sub-Saharan Africa and small vulnerable economies (SVEs)
- Commonwealth Investment Framework Agreement
- Trade effects of Government Procurements on developing countries
- Development issues under EPAs
- Development aspects of trade-related issues and trade in services
- Regional trading arrangements in South Asia and their implications
- Trade in services issues for small states and low-income countries
- Fiscal implications of Pacific trading arrangements
- Issues in the context of the Fourth UN Conference on LDCs
- The development impact of the Doha Round on least developed countries (LDCs)
- The impact on small vulnerable economies (SVEs) of the Doha negotiations on agriculture, non-agricultural market access (NAMA), trade in services and development issues
- Non-tariff barriers in South Asia and Sub-Saharan Africa
- Textiles and clothing trade after the end of the Multi-fibre Arrangements
- Global value chains and the impact on growth in developing countries
- LDCs and SVEs in South-South trade



## Subjects of the Previous Ten Issues of the Commonwealth Trade Hot Topics Series

Issue 85: Delivering on Development: A New Ten-Year Programme of Action for LDCs

Issue 84: Doha Round and Securing a Development-Friendly Istanbul Programme of Action for LDCs: A WTO Perspective

Issue 83: Natural Resource Exploitation: Challenges and Opportunities for LDCs

Issue 82: Policy Linkages of Investor-State Dispute Settlement

Issue 81: Helping LDCs to Catch Up

Issue 80: Impact of China and India on SSA Countries: Opportunities, Challenges and Policies

Issue 79: Competitiveness Impacts of Climate Change on LDC's export trade

Issue 78: Opportunities and Challenges for Intra-ACP Trade in Fish and Fishery Products

Issue 77: The Lisbon Treaty and Commonwealth Developing Countries: Implications for ACP-EU trade and trade negotiations

Issue 76: Changing EU Policies and ACP Exports

 **COMMONWEALTH**

trade  
hot topics

ISSN: 2071-8527 (print) ISSN: 2071-9914 (online)

Series editor: Dr Mohammad A Razzaque

Produced by the Economic Affairs Division of the Commonwealth Secretariat

For further information or to contribute to the Series, please email [m.razzaque@commonwealth.int](mailto:m.razzaque@commonwealth.int)