

## **Aid for Trade: A Diversity of Issues and Viewpoints<sup>1</sup>**

### **1. Aid for Trade: The Context**

There is a great deal of uncertainty among both developed and developing countries about the new Aid for Trade (AFT) initiative. Among developing countries in particular, there is unease about the timing of AFT and the fact that the development dimension of the Doha Round is still to be addressed. AFT has emerged at a time when there is an urgency to complete negotiations on market access in the Doha Round. The question that many developing countries are therefore asking is: are we being offered aid in exchange for opening markets?

The AFT initiative was announced at the 6th Ministerial Conference in Hong Kong, China (13-18 December 2005). Paragraph 57 of the Ministerial Declaration states that:

*'Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade.'*

Pursuant to the Declaration, an Aid for Trade Task Force was set up in February 2006 to come up with recommendations by July 2006 on how to operationalise AFT. The WTO Director-General has also been consulting with WTO Members, the International Financial Institutions, Regional Development Banks and other relevant organizations on mechanisms to secure additional financial resources for AFT. The Task Force is chaired by the Permanent Representative of Sweden, Ambassador Mia Horn Af Rantzien, acting in her personal capacity. Its 13 members are from Barbados, Brazil, Canada, China, Colombia, the European Union, Japan, India, Thailand, the United States and the coordinators of the ACP Group, the African Group and the LDC Group.

To date, much of the discussions on AFT have been taking place among donors, several of whom have conflicting views on the subject. Issues that are of primary importance to them include how much resources they should allocate, what types of activities they should fund and who should manage the funds.

For the most part developing countries, and trade officials from capitals in particular, are not fully aware of what AFT really is and hence, what the implications might be for them. This is not surprising since discussions are only now taking place on agreeing on a definition for AFT, its scope, implementation mechanisms and other areas such as resource availability and country eligibility.

Potential beneficiaries are treading cautiously in the on-going discussions on AFT. Memories of the Uruguay Round are still fresh in their minds. Countries recall the heavy commitments they were forced to make in areas such as SPS, Customs Valuation, TRIMS and TRIPS and the assistance that was promised to help them meet

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<sup>1</sup> Report of the COMSEC/UNCTAD Meeting on Aid for Trade, Geneva, Switzerland, 21-22 March 2006 by Elizabeth Parsan.

their obligations. The aid never materialized. The “best endeavors” provisions in the Uruguay Round Agreements turned out to be weak and ineffective and many countries are still struggling to fulfill their commitments. It is within this context that they are listening keenly to the global talks on AFT where concepts like “predictability of resources,” “frontloading aid” and “multi-year commitments” are being addressed.

The Doha Round is still in progress and developing countries are active participants. Like in all other aspects of the negotiations, they are fully prepared to engage in the current discussions on AFT. However, they want to be assured that:

- AFT is not being used as a carrot to induce them to open up their markets; and that
- AFT will not deflect attention away from achieving the development dimension of the Doha Round.

Ideally, developing countries want:

- A fair and balanced outcome from the Doha Round that reflects their development concerns; and
- An AFT package that will help them mitigate the adverse effects of the Doha Round and explore new trading opportunities.

## 2. Aid, Trade and Development

One question that trade officials and development experts are constantly asking, and for which there appears to be no ready answer is:

*‘Where do we draw the line between aid for trade and aid for development?’*

This question has implications for at least two areas that are currently being explored: (a) the types of activities that an AFT package should cover; and (b) the notion that AFT expenditure should be *additional* to existing general development expenditure. For example, the construction of rural roads can be presented as an AFT project to facilitate the transport of vegetables; or, it can be a development project to help promote rural communities.

The short answer to the above question is that it may not be possible to draw a dividing line between ‘aid for trade’ and ‘aid for development.’ If trade is critically important for development, then aid for trade merges into broad support for development. But trade may not be considered critical for a country’s development. Or other factors, such as education and training, may also be needed to raise levels of development. It is in this context that questions are being raised regarding the primacy of an AFT initiative.

Several development agencies, among them the World Bank and the IMF, argue that AFT needs to be looked at within a much broader development context. As such, their interpretation of the Hong Kong Ministerial Declaration is somewhat different from the WTO, whose concerns are more narrowly focused on the implementation of trade agreements.

### *AFT and the WTO*

At the start of the Doha Round, Ministers recognized the role of sustainably financed technical assistance and capacity-building programmes. The 2001 Doha Ministerial Declaration stated that:

*‘technical co-operation and capacity building are core elements of the development dimension of the multilateral trading system.’*

Over the past few years some 40 bilateral and multilateral donors have been providing Trade-Related Technical Assistance (TRTA) to developing countries. In 2004, the annual OECD/WTO TRTA reported commitments of US\$811 million for “Trade Policy and Regulations,” US\$2.2 billion for “Trade Development” and US\$9.3 billion for infrastructure (transport, energy, and telecommunications).

Despite the increased attention given to TRTA, the Hong Kong Ministerial Declaration changed the focus of AFT from being “*core elements* of the development dimension of the multilateral trading system” to a “*valuable complement to the Doha Development Agenda.*” In other words, the role of AFT appears to have been diluted somewhat.

The Hong Kong Ministerial Declaration clearly states that the purpose of AFT is to assist with implementation of the WTO agreements. The Declaration recognizes that developing countries, especially the LDCs, will not be able to exploit the increased market access from the Doha Round because of constraints on the supply side. Accordingly, it specifically mentions that AFT should be used “to build developing countries’ supply-side capacity and trade-related infrastructure.”

Supply-side capacity-building can cover an almost limitless set of activities because of the wide range of constraints that face businesses and governments. But the areas of emphasis typically include technology and finance, business support services, managerial and technical skills, transportation, storage facilities and market information. Trade-related infrastructure can cover physical infrastructure such as transportation systems – roads, ports, dams and irrigation, and communication systems as well as institutional infrastructure such as laws and regulations to ensure an enabling environment for business.

### ***AFT and Development***

Many development experts, among them the World Bank and the IMF, view AFT within a much broader context than the exploitation of new trading opportunities associated with the Doha Round. They argue that trade liberalization is a complex process that creates both winners and losers. Whereas it can open up new trading possibilities, it can also destroy markets, industries and even entire economies. The costs of adjusting to a more open trading environment may be tremendous, especially for small countries that are heavily dependent on external trade. Adjustment costs must therefore be taken into account in any AFT package.

The Hong Kong Ministerial Declaration did not explicitly mention adjustment costs. But if AFT is to be used as an instrument of development policy, it should help to meet the costs that are associated with adjusting to open markets. Adjustment costs cover a wide range that fall into several categories as follows:

- costs of preference erosion, which particularly affect countries dependent on exports of sugar, bananas, textiles, tobacco, fisheries and cocoa
- costs resulting from increases in food prices. Given the cuts or elimination of subsidies in food-exporting countries, these are likely to affect net food importing countries.
- costs of compliance to product standard requirements, which include areas such as sanitary and phytosanitary measures.
- costs of implementing WTO agreements such as TRIMS, TRIPS, GATS and others which require changes in policies and legislation.
- costs in tariff revenue as a result of tariff reductions; and
- costs related to factors of production such as capital and labor that could remain idle for long periods of time during the adjustment process or not recover at all.

The building of supply capacity and infrastructure are considered to be important not just for trade, but more generally for development. Indeed, many aid agencies have been providing this type of assistance for decades. They support an AFT package that emphasizes supply-side capacity building and infrastructure but stress that such assistance is needed on an on-going basis and, in fact, can be quite independent of the Doha Round.

An AFT package that incorporates both adjustment costs and supply side capacity could generate tremendous developmental benefits. But in order for these to be realized fully, aid must be linked to countries’ broader development programs such as their national development strategies or poverty reduction strategies. This will allow the targeting of local priorities to promote national development rather than donor priorities. Country ownership is considered to be a key principle of an effective AFT program.

One attempt at mainstreaming trade into countries’ development strategies is the Integrated Framework (IF). The IF was devised in 1996 at the WTO Singapore Ministerial Meeting to better integrate LDCs into the multilateral trading system. It is managed by six agencies, the World Bank, WTO, UNCTAD, UNDP, ITC and IMF, and involves 28 LDCs and 17 bilateral and multilateral donors. Unfortunately, the IF faces major challenges that include financing, country ownership and governance.

### **3. The Scope for AFT: Broad or Narrow?**

One of the most contentious issues surrounding AFT relates to its coverage. Should it encompass both adjustment costs and supply-side capacity building or only supply-side capacity building as specified in the Hong Kong Ministerial Declaration? When the Aid for Trade Task Force submits its report in July, there will undoubtedly be specific recommendations on this aspect of AFT. Most observers believe, however, that countries and donors should explore the broadest possible package and not rule out any options. Developing countries face different economic circumstances and a “one size fits all” approach will not be suitable.

Generally, there is widespread acceptance of the role of supply-side capacity building in AFT. But it is the adjustment costs that are the subject of much controversy.

#### ***Adjustment Costs***

Several donors and trade experts do not accept that AFT should be used to finance adjustment costs. Their main arguments are as follows:

- AFT should not be used to compensate countries for losses but to help them explore new trading opportunities. Compensation is an expense not a gain.
- Adjustment costs may not be that large. Preferences affect only certain countries, LDCs are not expected to liberalize and implementation periods for trade liberalization will be long.
- The funding for AFT will not be large enough to accommodate financing of adjustment costs. Countries should therefore be realistic and focus only on supply side capacity-building.
- There is already a mechanism in place to finance adjustment costs. The IMF’s Trade Integration Mechanism (TIM) was devised in 2004 to help countries expecting balance of payments difficulties to cope with the effects of trade liberalization. TIM operates through the IMF’s existing facilities where the usual IMF policy conditionality and terms of lending apply. To date, only two countries – Bangladesh and the Dominican Republic – have used this facility.

The case for including adjustment costs in an AFT package is based on empirical evidence that highlights the severe impacts that the adjustment process will have on developing countries, especially small developing countries. For example, Mauritius, a country that had embraced trade liberalization and been regarded as a “success story,” is now suffering serious losses as a result of preference erosion in its sugar and textiles industries. It recently approached the World Bank and the IMF for assistance in adjusting to the new trading environment.

The adjustment process for developing countries is likely to be very difficult. By and large, the majority of countries have narrow production structures; their credit and other markets are weaker; and they have fewer social safety nets. Further, whereas the benefits of multilateral reform may come decades after their introduction, adjustment costs in terms of job losses and reductions in government revenue are immediate and upfront.

#### ***Supply-Side Capacity Building***

There is overwhelming support for providing assistance to developing countries to build their productive capacities and expand their trade-related infrastructure. One main issue here, however, relates to the difficulties in conceptualizing and hence, implementing assistance for this purpose.

#### ***A Question of Definition***

Unfortunately, there are no definitions for “supply-side capacity” and “trade-related infrastructure.” The number of interventions for building a country’s supply capacity is extensive and could vary widely, depending on individual country circumstances. Also, infrastructure required by some countries to support trade may not fit the usual definition of trade-related infrastructure. For example, water and sanitation systems are very important for some countries’ trade and development. But the OECD excludes such infrastructural support from its definition of trade-related infrastructure. It will therefore be a major challenge to decide which specific supply side capacity-building activities and trade-related infrastructure should form part of an AFT package.

### *The Pivotal Role of the Private Sector*

In the past, much of the trade-related assistance given to countries has been channeled to the public sector. Fortunately, this is now changing because it is the private sector that is directly involved in production and trading activities. The supply capacity and competitiveness in developing countries tend to be very limited. With a deficient policy framework, poor infrastructure, limited access to technology and weak financial sectors, trade liberalization will do little or nothing for businesses. Many studies show that access to finance may be the most critical for helping to build a productive capacity. More generally, the unfavorable business environment in many developing countries contributes to a high cost of doing business. This may range from setting up a business to transporting goods from plants to ports.

Once a supply capacity exists, the role of trade-related infrastructure becomes critical. The existence of efficient transport and communications links with external markets and adequate regulatory reform facilitate the movement of goods and reduce the cost of trade-related transactions. The competitiveness of firms could also be enhanced by having good institutional infrastructure such as effective customs authorities, efficient port authorities and competent inspection and certifying bodies.

AFT could play an important role in the diversification of countries' production structures by helping them to build their capacities in high-value items, explore new and dynamic areas in both goods and services, and promote the development of SMEs, including those in the informal sector.

Increasingly, aid agencies are designing trade programs to directly benefit the private sector. Bilateral efforts are also on the rise, among which is the European Union's private sector programs negotiated under the Cotonou Agreement. Other examples of AFT-type programs include the excellent work being undertaken by regional development banks such as the Inter American Development Bank and the African Development Bank, and international agencies such as the World Bank's IFC, and UN agencies such as UNCTAD and the ITC. Several of these programs are carried out as part of regional integration initiatives, but most are typically part of larger programs aimed at increasing growth and reducing poverty. The more beneficial AFT programs, however, are the ones which involve a co-ordinated approach. One example of this is the Strategies and Preparedness for Globalization Program in India. This £5 million initiative is being undertaken by UNCTAD, DFID and the Government of India, with close involvement of exporters, industry associations and various service providers.

### *The Supportive Role of the Public Sector*

Part of the business enabling environment that Governments can provide is the formulation of a comprehensive trade policy framework and modern regulations to govern trade. The serious lack of trade policy capacity in developing countries came to the fore at the start of the Doha Round. Countries simply did not have the technical expertise, funding or skills to adequately represent the interests of business in negotiating fora. Attempts by donor agencies to train government officials, though laudable, have been both insufficient and in several cases, not of the quality needed.

Aid for trade should aim to build research capabilities and trade-related knowledge networks. Training for government officials should include not only the formulation of trade policy but also the building of capacity to implement new trade agreements and carry out the terms of the agreements.

## **4. The Resources Issue**

### ***Volume and type***

Since the start of the discussions on AFT, one question on everybody's lips has been: *how much?* To date, no commitments have been made. At the Hong Kong Ministerial in December 2005, however, the following announcements were made:

- Japan: US\$10 billion over a three-year period focused on Asia-Africa trade and investment;
- USA: annual aid-for-trade grants of US\$2.7 billion by 2010; and
- EU: annual trade-related spending (excluding infrastructure) of 2 billion euros by 2010.

In addition to the above, the World Bank recently recommended the setting up of a Fund of US\$200 - \$500 million to finance capacity building projects in LDCs.

The Hong Kong Ministerial Declaration mentioned that funds would be available through grants and concessionary loans. By and large, however, developing countries, especially those that are severely debt-ridden, are pressing for grant funding. They argue that rich countries stand to benefit tremendously from the Doha Round and should use part of these gains to fund their adjustment and efforts to increase their productive capacity and trade competitiveness.

### ***Additionality (or “fresh money”)***

The WTO Director-General has been holding discussions over the past few months with the International Financial Institutions, Regional Development Banks and Member Countries to ascertain how much funds can be expected for an AFT package. Central to this discussion is the issue of additionality, which implies that AFT should supplement and not replace existing aid commitments. Given the earlier point made about the difficulties in separating “aid for trade” from “aid for development,” this will present a formidable task.

Developing countries are fearful that donors will shuffle around funds and create a new fund using existing money, under the label of “Aid for Trade.” They do not want donors to divert funds away from existing programs or simply rename them. AFT must be “fresh money.”

### ***Access and Predictability***

Despite the aid “pronouncements” at the Hong Kong Ministerial, potential beneficiaries are not optimistic about gaining access to large amounts of funding. In the past, promises of aid have not materialized; and since the International Conference on Financing for Development in Monterrey, the amounts of aid flowing to low-income countries have been very small. Even when funds are committed, access to funds has been hampered by strict conditionalities and/or cumbersome administrative procedures. Developing countries want assurances that:

- funds allocated to AFT will be reserved for this purpose;
- there will be no cumbersome administrative procedures involved in AFT;
- AFT will not be subject to stringent conditionalities, particularly macro-economic and political; and that
- AFT will consist of long-term financing, which will be predictable over time.

### ***Country Eligibility***

Although the Ministerial Declaration refers to all developing countries as potential beneficiaries of AFT, emphasis is placed on the LDCs. There is, indeed, a clear case for assistance to the poorest countries. However, criteria will have to be set up to determine which countries will be eligible for aid and in what form and quantities. If income is used as a criterion, then middle-income and other developing countries that stand to lose substantially may not qualify for aid. However, if all “losers” are eligible for assistance, poorer countries may feel that resources are being diverted away from them. AFT should not create dissonance and divisiveness among countries.

Ultimately, the allocation of funds among countries may have to be guided by varying sets of criteria such as the extent to which countries and areas are affected, their levels of income and trade, and their innovativeness in the use of funds.

## **5. A (New?) Co-ordinating Mechanism**

The issue of how best to co-ordinate and deliver aid is an important one because of the implications for its effectiveness. Although discussions on this issue are mainly taking place among aid donors, it is imperative that developing countries are consulted since they are the ultimate aid beneficiaries.

### ***Aid Effectiveness***

In the past, poor co-ordination among donors has hampered the effectiveness of aid. In many cases, countries have been given assistance according to the priorities of donors rather than their own country priorities. Having to face the reality of “this is what the money can be used for,” countries have often ended up with projects that are

wholly inappropriate. Further, competition among donors, particularly among the bilaterals and other non-specialized agencies has led to a serious duplication of activities and a colossal waste of resources. The implications have been particularly severe for poor countries, whose limited staff in government agencies often have to spend huge amounts of time managing diffuse sets of projects, each with its own conditionalities, procedures and reporting requirements. In short, for many countries the transaction costs of aid are simply too high.

The consequences of inadequate donor co-ordination are seen in the types of trade-related activities currently undertaken. A perusal of the OECD DAC/WTO TRTA database reveals that for many countries, aid is given for scores of seemingly unrelated activities and there is a heavy concentration on trade policy and regulations. Funding for trade development is often quite limited.

If AFT is to be effective, that is, if it is to increase the competitiveness of developing countries over time, it is important that donors adhere to the guidelines set out in the Paris Declaration on Aid Effectiveness made in 2005. In this regard, two specific guidelines are worthy of mention:

- Increasing alignment of aid with partner countries' priorities, systems and procedures and helping to strengthen their capacities; and
- Eliminating duplication of efforts and rationalizing donor activities to make them as cost-effective as possible.

Of course, aid effectiveness is not only dependent on donors' actions. Developing countries have their part to play in formulating development strategies to which AFT can be linked. They must also work towards building robust in-country structures to receive, disburse and report upon aid. Effective donor co-ordination combined with comprehensive strategy-formulation and in-country co-ordination of aid should produce good results.

### ***Options for a Mechanism to Co-ordinate AFT***

It is widely agreed that the present, fragmented approach to TRTA is inefficient and a mechanism for harmonizing aid must be found. A co-ordinated approach will facilitate coherence in the delivery of AFT and contribute to its effectiveness and efficiency. It will also enable better monitoring and evaluation.

Over the past 2-3 years, many options have been put forward for the co-ordination of AFT, ranging from the reform of existing funds to the creation of entirely new funds. Options for the latter include a new stand-alone fund dedicated to AFT and a Special Fund for Diversification to benefit preference dependent countries. By and large, however, it is increasingly being suggested that it will be easier, less costly and more effective to consider reforms of existing funds. In this regard, two options are worthy of mention:

- An enhanced IF and;
- A Global Trade Facility

To date, the IF represents the best example of a co-ordinated approach to AFT. Unfortunately, however, the IF has not had a successful record. This has mainly been due to funding problems, but issues of governance and lack of country ownership have also hampered its smooth operation. Proponents of the IF argue, however, that if it can be sufficiently resourced and appropriate modifications made, an enhanced IF offers the best framework for AFT. The World Bank, the IMF and the UN agencies are strongly supporting this approach.

A second suggestion for co-coordinating aid, put forward by Nobel Prize Winner, Joseph Stiglitz is the creation of a Global Trade Facility (GTF). The proposal is to retain the concept of the IF but have a different governance structure and location. This will mean, for example, instead of it being controlled by six different institutions, its management would be more firmly concentrated in the World Bank. The arrangement will be similar to that of the Global Environment Fund that is located in the Bank but not governed by it. One advantage of the GTF will be the potentially strong linkage with the Bank's other lending activities, particularly its private sector arm, the IFC. Funds for AFT will be allocated to the GTF, as part of binding commitments written into the Final Doha Round Agreement.

The choice of a co-ordinating mechanism will obviously require multi-stakeholder discussions. Decision-making on this issue should be guided by the need to deliver aid effectively and efficiently.

## 6. Future Areas for Investigation

From the above, it is clear that a great deal of research and analysis is needed if AFT is to be designed and implemented in a meaningful way. Frameworks for assistance may need to be drawn up for individual countries/regions. The amount of work that needs to be carried out may be quite large. A few key areas that require investigation are mentioned below.

### *On the Donors Side*

- (a) Lessons from past experience of administering AFT-type programs: Bilateral, regional and international perspectives.
- (b) Innovative ways of financing adjustment costs and supply capacity.
- (c) Measures to fulfill the Paris Declaration on Aid Effectiveness.
- (d) Mechanisms for channeling aid – whether through public or private sector.
- (e) Simple monitoring and evaluation frameworks for AFT.

### *On the Beneficiaries Side*

- (a) Stocktaking of existing AFT-type projects and their funding sources.
- (b) Firm level surveys/studies that illustrate the impact of trade liberalization. These should include quantitative estimates of adjustment costs.
- (c) Identification of supply-side capacity needs – to be prepared by the private sector.
- (d) Identification of gaps in funding for trade projects in development plans, national export strategies, competitiveness plans and other frameworks.
- (e) Studies of aid effectiveness from the recipients' point of view.
- (f) Monitoring and evaluation frameworks suitable for developing countries.

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