

Assessing Aid for Trade

Effectiveness, Current Issues and Future Directions

Edited by Mohammad A Razzaque and Dirk Willem te Velde



Commonwealth Secretariat



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Commonwealth Secretariat
Marlborough House
Pall Mall
London SW1Y 5HX
United Kingdom

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Published by the Commonwealth Secretariat
Edited by Prepress Projects Limited
Typeset by Techset Composition
Cover design by Tattersall, Hammarling & Silk
Printed by Hobbs the Printers, Totton, Hampshire

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Copies of this publication may be obtained from

Publications Section
Commonwealth Secretariat
Marlborough House
Pall Mall
London SW1Y 5HX
United Kingdom
Tel: +44 (0)20 7747 6534
Fax: +44 (0)20 7839 9081
Email: publications@commonwealth.int
Web: www.thecommonwealth.org/publications

A catalogue record for this publication is available from the British Library.

ISBN (paperback): 978-1-84929-106-4
ISBN (e-book): 978-1-84859-164-6

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Abbreviations and acronyms

ACP	African, Caribbean and Pacific
AfT	Aid for Trade
ASEAN	Association of Southeast Asian Nations
COMESA	Common Market for Eastern and Southern Africa
CRS	Creditor Reporting System
DAC	Development Assistance Committee
DFID	Department for International Development (UK)
DTIS	Diagnostic Trade Integration Study
EAC	East African Community
EAP	East Asia and Pacific
EC	European Commission
ECA	Europe and Central Asia
ECOWAS	Economic Community of West African States
EDF	European Development Fund
EDI	Electronic Data Interchange
EIF	Enhanced Integrated Framework
EPA	Economic Partnership Agreement
FDI	foreign direct investment
FE	fixed-effect
GDP	gross domestic product
GVC	global value chain
ICT	information and communication technology
IF	Integrated Framework
IFI	international financial institution
IMF	International Monetary Fund
JITAP	Joint Integrated Technical Assistance Program
LAC	Latin America and Caribbean
LDC	least developed country
LIC	low-income country

LMIC	lower-middle-income country
M&E	monitoring and evaluation
MDC	Maputo Development Corridor
MDG	Millennium Development Goal
MENA	Middle East and North Africa
MNC	multinational corporation
NGO	non-governmental organisation
NSC	North–South Corridor
NTB	non-tariff barrier
ODA	overseas development assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PPP	public–private partnership
REER	real effective exchange rate
SAARC	South Asian Association for Regional Cooperation
SADC	Southern African Development Community
SAS	South Asia
SFA	Special Framework for Assistance
SPA	Special Programme of Assistance
SPS	sanitary and phytosanitary
SSA	sub-Saharan Africa
STABEX	Stabilisation of Export Earnings
SVE	small and vulnerable economy
SWAp	sector-wide approach
TIM	Trade Integration Mechanism
TMSA	TradeMark Southern Africa
TPR	trade policy and regulation
TRA	trade-related adjustment
UEMOA	West African Economic and Monetary Union
UMIC	upper-middle-income country
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

Contributors

Vinaye Ancharaz is Senior Development Economist at the International Centre for Trade and Sustainable Development (ICTSD), with responsibilities for the Aid for Trade programme and the Competitiveness and Development programme. He was previously a Principal Research Economist at the African Development Bank and a Senior Lecturer at the University of Mauritius, where he was a WTO chair-holder. He has researched and published extensively in the area of international trade and development in various peer-reviewed journals, policy briefs and periodicals, including ICTSD's *Bridges* and *Bridges Africa*. Dr Ancharaz holds a BSc (Hons) in economics from the University of Mauritius and MSc and PhD degrees in international economics from Brandeis University.

Christophe Bellmann holds an MBA in international relations and has more than 18 years' experience working in the field of trade from a sustainable development perspective. In his current position as Programmes Director at the International Centre for Trade and Sustainable Development (ICTSD) he is responsible for the design and implementation of research, dialogue and capacity building programmes. Before joining ICTSD, he has worked for the Swiss Coalition of Development Organisations where he was responsible for activities on multilateral trade and sustainable development issues. He has also worked as a Research Associate at the Economic Commission for Latin America and the Caribbean (ECLAC) in Santiago, Chile. He has edited and published a wide range of books, articles and opinion pieces on trade and sustainable development.

Bruce Byiers is a development economist with a DPhil from the University of Sussex, UK. Originally from Scotland, since May 2011 he has been a Policy Officer in the Trade and Economic Transformation team at the European Centre for Development Policy Management (ECDPM). His work focuses mostly on promoting private sector development that increasingly relates to the growing call to 'engage the private sector for development', as well as domestic resource mobilisation, private sector investment in agriculture under CAADP, regional integration initiatives, Aid for Trade and trade facilitation. He has worked in Mozambique, Brazil, Rwanda and Lesotho as well as shorter work missions in Tanzania, Zambia and Côte d'Ivoire.

Yurendra Basnett is a Research Fellow leading on trade and development policies at the International Economic Development Group, Overseas Development Institute (ODI). He has advised bilateral donors, international development organisations and developing country governments on Aid for Trade in Asia, Pacific and Africa. His recent research analysed barriers and suggested policy options on improving the effectiveness of Aid for Trade. His new research at ODI seeks to contribute to the discussion on the

future of Aid for Trade, and will focus on broader issues of how Aid for Trade can increase productive capacities and alleviate natural resource scarcities. He is also reading for his PhD in political economy of development at the University of Cambridge.

Clara Brandi is an economist and political scientist in the Department of World Economy and Development Financing at the German Development Institute (Deutsches Institut für Entwicklungspolitik [DIE]). She studied economics at the University of Wisconsin, Madison, and at the Albert-Ludwigs-Universität, Freiburg, where her Master's thesis won the Friedrich-August-von-Hayek-Award. As Michael Wills Scholar, she completed the MPhil in Politics at the University of Oxford. She received her PhD from the European University Institute, Florence. Her main research interests include international trade and interlinkages between trade, development and climate change. Prior to joining DIE, she worked for the WHO Department of Ethics, Equity, Trade and Human Rights, the United Nations Development Programme, the German Federal Ministry of Economics and Technology, the International Labour Organization and the European Parliament.

Massimiliano Calì is a trade economist in the World Bank's International Trade Department. His current and recent work focuses on trade in fragile countries, on the relationship between economics and conflict and on Aid for Trade. Prior to joining the Bank, he served as an economic advisor to the Palestinian Ministry of National Economy, as a research fellow with the Overseas Development Institute, and as an economist with the Italian embassy to Bolivia. His research has been published in journals, book chapters and official reports. He holds a PhD in economic geography from the London School of Economics.

Andrew Charlton is an economist who has worked for the London School of Economics, the United Nations and the Boston Consulting Group. Between 2008 and 2010 he was senior economic adviser to the prime minister of Australia. During that time he served as Australia's senior official to the G20 summits and as the prime minister's representative to the Copenhagen Climate Conference. He received his doctorate in economics from Oxford University, where he studied as a Rhodes Scholar. He is the author of *Man-Made World: Choosing between Progress and Planet* (2011), *Ozonomics* (2007) and the co-author of *Fair Trade for All* (2005).

Jakob Engel is a Research Officer at the Overseas Development Institute, a London-based think-tank working on international development and humanitarian policy. He specialises in trade policy, economic geography and the political economy of institutional reform at the national and transnational level, and has published and presented on a variety of trade-related issues, including trade preferences and preferential trade agreements, regional integration, agricultural trade and food security, as well as intellectual property rights and technology transfer. He was previously a policy advisor for the UK Government's Trade Policy Unit, and has worked as a consultant for several developing country governments, bilateral and multilateral donor agencies, and philanthropic foundations.

Anna Fink is an economist with more than six years' experience and specialises in trade and regional integration. She is currently working in Fiji as an ODI Fellow for

the Secretariat of the Pacific Community on issues related to regional agricultural production and trade. Prior to that she spent three years with Saana Consulting where she supported the development and evaluation of national and regional level Aid for Trade programmes and policies with a particular emphasis on the COMESA and EAC regional blocs. She has previously lived and worked in Tanzania, South Africa and Peru and can work in multiple languages including Swahili.

Paolo Ghisu is Programme Officer for the Aid for Trade programme and the Competitiveness and Development programme at the International Centre for Trade and Sustainable Development (ICTSD). He co-ordinates research on Aid for Trade and has published various articles on trade and sustainable development. Before joining ICTSD, he worked as intern in the Human Rights Department of the Permanent Mission of Italy in Geneva. He holds a Master's in international relations with a major in international economics and a BS in economics from the University of Trento. He also studied and performed research at the University of Melbourne on rural development and ethnic minority policies in China. Previously, he conducted field research in Tanzania, where he undertook monitoring and assessment of rural development projects in the Kipengere Range.

Emily Jones is Deputy Director of the Global Economic Governance Programme, University of Oxford, UK. Her research focuses on the global trade governance and the political economy of trade negotiations involving developing countries. She recently published *Negotiating Against the Odds: A Guide for Trade Negotiators From Developing Countries* (2013). Prior to academia, she has been an Overseas Development Institute fellow in Ghana's Ministry of Trade and Industry, Associate Professional Officer at the UK Department for International Development in Brazil, and a trade advisor at Oxfam GB. She holds an MSc from London School of Oriental and African Studies and a DPhil from the University of Oxford.

Marie-Agnes Jouanjean a research officer at the Overseas Development Institute (ODI). She is a development and trade economist as well as agronomist. She holds a PhD in international economics, GEM at Sciences Po, Paris and worked in collaboration with KULeuven, LICOS. She holds a combination of experiences both at an academic level and at an operational level working for international organisations such as the European Commission, World Bank, OECD and UNIDO, think tanks and NGOs. She has most recently worked on food standards, non-tariff barriers and Aid for Trade in agriculture. She also has expertise on value chain analysis, agricultural systems, rural livelihoods, food security and poverty dynamics.

Jodie Keane has been a Research Fellow with the Trade Program, International Economic Development Group, Overseas Development Institute (ODI) since 2007. She is a trade policy analyst and economist working on EU Trade Policy with Developing Countries. Her research interests include new trade-new growth theory, comparative analysis of global value chains (GVCs), regional integration, and climate change. She is currently registered as a PhD candidate in development economics at SOAS, University of London, and her thesis title is 'A comparative analysis of the new trade-new growth nexus for low skilled manufactures and high

value agricultural goods exporters'. This research includes a comparison of GVCs and tests for learning by doing.

Dan Lui is a Programme Associate at the European Centre for Development Policy Management (ECDPM), Maastricht and Brussels. He holds a Master's degree in development economics from SOAS, University of London. Prior to joining ECDPM he spent four years working in the Pacific islands, firstly at the Ministry of Trade and Industry in Vanuatu, before moving to the Pacific Islands Forum Secretariat in Suva, Fiji, where he was closely involved in co-ordinating regional positions for the Economic Partnership Agreements (EPAs). Since joining ECDPM in 2008, he has worked closely with the African Union, UNECA, regional economic communities and national governments in the ACP and beyond on a range of issues, including evaluating and monitoring the effects of EPA trade agreements, the Aid for Trade initiative, financing development and economic governance.

Isabella Massa is Research Fellow at the Overseas Development Institute (ODI) where she leads the international finance stream of work of the International Economic Development Group. Before joining ODI, she worked at the International Monetary Fund, and developed extensive academic experience as researcher and instructor in different international universities. Her research interests focus on private capital flows, financial development and economic growth. She has published in prestigious academic journals and authored various books and book chapters. She has been cited in leading newspapers. She holds a PhD in economics and organisation from Ca' Foscari University in Venice, Italy.

Sacha Silva is a trade and development economist. He has advised public and private institutions on trade policy and negotiation issues (particularly in the WTO, regional and bilateral context), economic governance, regional integration, and development financing. His work experience includes extensive technical support to the African, Caribbean and Pacific (ACP) group of developing countries in negotiating their trade relations with the European Union, Canada, United States, Australia and New Zealand. Sacha has worked as a consultant for, inter alia, the Caribbean Community's Regional Negotiating Machinery, the Pacific Islands Forum Secretariat, Commonwealth Secretariat, UNCTAD, and the Asian Development Bank. He holds a Bachelor's degree in political science and economics from the University of California at Berkeley and an MSc in global market economics from the London School of Economics. Sacha speaks English, French and Spanish.

Joseph Stiglitz is Professor at Columbia University, the winner of the 2001 Nobel Memorial Prize in Economics, and a lead author of the 1995 IPCC report, which shared the 2007 Nobel Peace Prize. He was chairman of the US Council of Economic Advisors under President Clinton and chief economist and senior vice president of the World Bank for 1997–2000. Stiglitz received the John Bates Clark Medal, awarded biennially to the American economist under 40 who has made the most significant contribution to the subject. He was a Fulbright Scholar at Cambridge University, held the Drummond Professorship at All Souls College Oxford, and has also taught at MIT, Yale, Stanford and Princeton. At Columbia, he co-chairs the Committee on Global

Thought and is co-founder and co-president of the Initiative for Policy Dialogue. He is also president of the International Economic Association, co-chair of the Commission on the Measurement of Economic Performance and Social Progress and chair of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System. He is the author most recently of *The Price of Inequality: How Today's Divided Society Endangers Our Future* (2013).

Liz Turner is a trade economist with over 15 years' experience in consulting and research on trade, regional integration and economic development. As Principal Consultant at Saana Consulting, she is responsible for leading Saana's work in East and Southern Africa, as well as the aid effectiveness practice. She has designed, implemented and evaluated numerous Aid for Trade projects, programmes, policies and strategies. Liz has actively contributed to ongoing debates on Aid for Trade at the international level, as well as producing more than 30 reports and publications. She has worked with numerous international, regional and national institutions (including numerous government departments in East Africa as well as in the UK, Denmark and Finland; regional organisations such as the East African Community Secretariat and ECOWAS Commission; and international organisations including the OECD, UN and WTO).

Collin Zhuawu is currently Research Officer in the International Trade and Regional Co-operation Section, Economic Affairs Division, Commonwealth Secretariat. He previously taught at the University of Zimbabwe, Warwick University and the University of Birmingham. He has also been involved in WTO negotiations and negotiations between Africa, the Caribbean and Pacific countries and the EU as an official for the Zimbabwe Ministry of Industry and International Trade and as a mission intern for the WTO. He holds a PhD from the University of Birmingham.

Dirk Willem te Velde is Head of Programme of the International Economic Development Group at the Overseas Development Institute, which he joined in 2000. He currently leads an Aid for Trade project on the effectiveness of AfT for the Bill and Melinda Gates Foundation. He has advised donor agencies (e.g. DFID, Sida, and Dutch Ministry of Foreign Affairs), parliaments (e.g. EU, UK, Cambodia) and multilateral bodies (World Bank, European Commission, UNCTAD, UNDESA, UNIDO, ILO, WTO LDC group) on economic development. He has led research teams providing policy advice on trade, growth and investment and the global financial crisis in sub-Saharan Africa (e.g. Malawi, Botswana), Asia (e.g. Cambodia) and the Caribbean. He has written and edited several books, more than 25 journal articles and 40 book chapters related to aid, trade, finance and growth issues. He holds a PhD from Birkbeck College, University of London.

Mohammad A. Razzaque is currently Adviser & Head, International Trade and Regional Co-operation Section, Economic Affairs Division, Commonwealth Secretariat. His primary area of work includes applied trade policy analysis. He has written extensively on trade and development issues, edited several volumes, and managed a large number of multi-country projects. His recent work involves Aid for

Trade and understanding supply chains under South–South co-operation. He is the editor of *Commonwealth Trade Hot Topics*, a flagship publication of the Commonwealth Secretariat, which aims to communicate technical trade policy issues to wider readership. Dr Razzaque holds a PhD from the University of Sussex and has previously taught at the University of Dhaka, Bangladesh.

Chapter 1

Aid for Trade: Effectiveness, Current Issues and Future Directions – An Overview

Mohammad A. Razzaque and Dirk Willem te Velde

1.1 Background

For several decades now a large number of developing countries have striven for a development strategy that would ensure sustained economic growth, result in employment opportunities and eliminate poverty. Nearly all countries have now shifted from an inward-looking approach to an outward-oriented trade-led growth and development approach, with the export sector receiving policy support and, among other things, foreign investment being promoted. A salient feature of this trade-focused growth and development approach has been marked by developing countries' increasingly active participation in multilateral and regional trade negotiations. Unilateral liberalisation and regional and multilateral trade agreements led to new international trade policies, although there is a long way to go to achieve the desirable development outcomes.

Along with this renewed emphasis on trade and overall improved participation of developing countries in the global trading system, there have been concerns about the widely differing impact of trade liberalisation across countries. In particular, enhanced export supply response with the objective of better integrating into the global economy and benefiting from the process of globalisation continues to represent a severe challenge for the world's poorest, smallest and most vulnerable economies. Most of these countries lack basic infrastructure, skilled human resources and managerial capacity; these shortfalls keep them from responding to trading opportunities. Preferential access to export markets alone has generally failed to trigger supply response because of very weak productive capacity and competitiveness. In addition, various multilateral and regional trade liberalisation schemes involving major importing markets have also implied loss of preferences, further weakening the supply-side strength in many low-income and small states.

After the launch of the World Trade Organization's (WTO) Doha Round of multilateral trade talks, there was an increasing recognition that many developing countries had failed to take advantage of their liberalised trade regimes and to benefit from the growth in world trade and commercial activities. This led to the demand for more systematic support towards building supply-side capacity and helping poor and vulnerable countries deal with trade-related adjustments along with development-friendly trade preferential mechanisms that the recipient countries could use in the absence of stringent preconditions (e.g. those related to non-tariff measures and rules

of origin requirements). There was a consensus about these needs, particularly when the Doha Round put a lot of emphasis on ‘development’.

It goes without saying that financial and technical assistance from multilateral and bilateral donors, with the objective of facilitating the integration of developing countries into the global economy through initiatives that expand trade, have been in operation since foreign aid was first considered to be a means of supporting growth and development. Under the Doha Round, technical assistance for trade capacity building became a prominent issue; the Hong Kong Ministerial Declaration in 2005 called for ‘Aid for Trade’ (AfT) to help developing countries 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 boost trade capacity. AfT emerged during a period of increased aid commitments with the clear purpose of providing *additional* funding (i.e. on top of existing aid commitments) to developing countries’ trade-related needs. A WTO Task Force, which was set up to recommend the operationalisation of the AfT initiative, identified six categories of support: trade policy and regulations; trade development; trade-related infrastructure; building productive capacity (including private sector development); trade-related adjustment (including support for adjustment associated with changes in international trade regimes); and other trade-related needs. Since then these categories of support have been used to monitor AfT flows.

Although AfT was meant to lead to new and additional funding streams, it has basically become a grouping, within existing aid, of financial and technical assistance to help promote supply-side and trade capacity in recipient countries. It is this underlying but specific trade purpose that distinguishes AfT from the rest of traditional official development assistance (ODA). Although as old as ODA, AfT came under renewed focus under the Doha Round, with many observers considering it as one of the very few concrete development outcomes to have resulted from this very long-running negotiation round so far.

One important impact of such assistance being discussed at the WTO-led multilateral forum has been development partners’ greater response and engagement with the related stakeholders to make trade components of their programmes more prominent. Virtually all donors (bilateral and multilateral) have always had more or less formalised trade-related programmes. They have supported AfT activities for many years under the rubric of infrastructure projects, assistance to customs, support to productive sectors and the like, without putting these activities grouped under a single heading. It has been commonplace for different units within the same donor organisation to carry out different trade or related components. The AfT initiative has provided a great deal of momentum for donors to unify their trade-related activities within their internal structure.

The regular review of the AfT activities (by the WTO) has also ensured a continued focus on AfT. As a result, there has been conspicuous sharing of information and discussion of issues with regard to donors’ commitments vis-à-vis disbursements, the effectiveness of the support available, and issues of interest to developing countries. Because of the heightened attention, donors have taken special care about

their commitments on AfT. It has been estimated that around US\$200 billion of development funding has been mobilised for it since 2005. Notwithstanding the possibility of certain types of support being reclassified as AfT and the fact that trade-related assistance would have continued even without such high-profile global focus, most observers agree that the AfT initiative has generated momentum in securing more trade support. Although the additionality of resource flows remains an issue, as most development partners have failed to fulfil various international commitments on development assistance, AfT resources have grown considerably.

Many would rightly argue that it is the effectiveness of the support provided that is most important for developmental impact, be it through trade or other means. The literature on the relationship between general development assistance and development shows the difficulties associated with measuring impact and mixed evidence. Nevertheless, one very encouraging feature of the policy discourse surrounding the AfT initiative has been the emphasis on understanding the results of the support provided. Both the development partners and the recipients are taking greater caution in designing better planning and implementation mechanisms to utilise the provided resources well. A number of countries and regions have developed and are in the process of preparing regional and national AfT strategies to achieve coherent and improved outcomes. The need to assess and demonstrate the results has also received special attention in the WTO-led reviews. Although the challenges associated with impact evaluation remain and technical frontiers need to be overcome, the focus on delivering the results cannot be overemphasised.

The policy discourse on AfT is vibrant and dynamic. Policy-makers, trade negotiators and other stakeholders regularly pay attention to the design of AfT projects; the trends in AfT flows and various AfT components; results and outcomes; topical issues as programmes are implemented; sharing experiences and best practices; and other aspects. The context of AfT is changing continuously as developing country trade is affected by the emergence of global value chains and as the financing environment becomes more diversified. All of these issues shape ideas for further consideration as ways forward.

The Commonwealth Secretariat and researchers from the Overseas Development Institutes (ODI) have been closely following the issues related to AfT since the initiative was launched in the WTO's Hong Kong Ministerial Declaration. On several occasions the two organisations have collaborated to study the developments, to identify the issues for analysis and to provide objective assessments. In the collaborative research, special emphasis was placed on understanding the effectiveness of the support provided, along with other broad issues for policy consideration. The results of technical analysis and following the developments of topical issues have helped offer informed policy inputs and perspectives on future directions. This volume brings together several technical studies that resulted from such collaboration (Chapters 3, 4 and 5). It also contains a number of chapters that resulted from projects independently implemented by the two organisations, often in collaboration with others. Chapters 9, 10, 13 and 15 emerged out of Commonwealth Secretariat initiatives while Chapters 2, 6, 8, 11, 12, 14 and 16 are related to a project co-ordinated by the ODI, in collaboration with the German Development Institute and the European

Centre for Development Policy Management. Finally, Chapter 7 is based on a project undertaken by the International Centre for Trade and Sustainable developed and is included here to complement some of the findings highlighted in the analysis by the Commonwealth Secretariat and the ODI.

1.2 Chapters in the volume

The 16 chapters compiled into this volume are organised into three parts: effectiveness (Part I), current issues (Part II) and future directions (Part III).

1.2.1 Part I: Effectiveness

After this overview, the six chapters in Part I focus on the effectiveness of AfT from two angles. They first contribute to the quantitative analysis of AfT (Chapters 2–5) and then examine the details of instruments and donor and recipient country incentives around AfT activities in more detail (Chapters 6–7). To begin with, in Chapter 2 Isabella Massa provides a brief survey of the quantitative studies on AfT that have emerged over the last five years. Evidence on the impacts of AfT on the trade performance of recipient countries is scarce, but a number of papers, including the chapters in this volume, have contributed to enrich this. The chapter focuses on a broader sample of research on the effectiveness of AfT than was available in previous reviews. It also provides an in-depth analysis of the different empirical methodologies used, highlighting their strengths and weaknesses in terms of econometric techniques and AfT variables selection, as well as in terms of country and sector coverage. Moreover, the chapter categorises the literature findings by looking at differences of the impact of AfT by type of aid flow, recipient country income level, recipient sector of aid and recipient country geographical region.

The review shows that several econometric techniques with different degrees of sophistication have been used to assess the impact of AfT on trade and other economic performance in recipient countries, especially at the macro level. The methodologies include gravity model specifications, difference-in-difference estimations, panel data estimations and various econometric regression techniques. Each technique has its own advantages and disadvantages. The review confirms that AfT can be effective, with a positive and economically relevant impact. However, the impacts vary considerably depending on the type of AfT intervention, the income level and geographical region of the recipient country and the sector to which AfT flows are directed. Four key issues need to be addressed in the future: (i) the evidence on the impact of specific AfT interventions or instruments is still limited; (ii) differences in AfT effectiveness by productive sector have been considered only to a limited extent; (iii) the evidence on the actual effects of AfT at the micro level is scarce; and (iv) databases on AfT need to be improved.

Chapters 3–5 are an outgrowth of Commonwealth–ODI projects that aim to empirically assess the effectiveness of AfT and thus have contributed significantly to the quantitative literature on AfT from 2008 onwards. Although the specific terminology ‘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. This allowed Commonwealth–ODI 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 empirical studies were 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 economic performance. Generally, three types of impact were analysed: (a) the impact of Aid for Trade facilitation (*Atf*) 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. Whereas 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 sources.

Chapter 3, by Massimiliano Calì and Dirk Willem te Velde, was the first paper that conceptualised the above empirical exercise and implemented it for a group of developing countries for which the required data were available. The results provide some clear-cut evidence that that *Atf* has a statistically significant negative 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. 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 for importing).

AfT is also found to have an overall positive and significant impact on exports on the group of developing countries as a whole. In particular, an additional 100 per cent of AfT is associated on average with a 3.5 per cent increase in merchandise exports by the recipient country. This effect is entirely driven by aid to economic infrastructure; the other main category of AfT, aid to productive capacity, appears to have no discernible effect on the aggregate exports. When the effects on sectoral exports are considered, some positive effects of aid to productive capacity are captured, which are likely to be due to an allocation skewed towards already well-performing sectors.

The results also suggest that aid to economic infrastructure is particularly beneficial for mining and manufacturing exports, whereas it has almost no effect on tourism 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.

Chapter 4, by Massimiliano Calì, Mohammad A. Razzaque and Dirk Willem te Velde, undertakes the empirical assessment focusing on small and vulnerable economies

(SVEs).¹ The discussions around AfT 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 and needs, which are important to acknowledge in the discourse on AfT policy. One such group is SVEs, which face special and unique development challenges because of their smallness, remoteness and isolation, and high costs of trading combined with their massive dependence on international trade for economic growth. Building on the analytical framework mentioned above, the results from the statistical analysis suggest that *Atf* is likely to have a more significant cost-reducing effect on the costs of handling imports and exports in SVEs than in other developing countries. This finding is consistent with these countries having, on average, higher unit transaction costs on exports 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 for SVEs fail to appear as statistically significant. On the other hand, aid to productive capacity is found to have no significant effect on SVE exports. The analysis shows that sectoral aid seems to have a positive impact on tourism and mineral exports; however, on manufacturing exports there is no impact.

In Chapter 5, Massimiliano Calì and Mohammad A. Razzaque extend the analysis to sub-Saharan Africa (SSA). Once again, the findings suggest that *Atf* has a cost-reducing impact on the costs of trading in SSA, of similar magnitude to that in the other developing countries. Among the main SSA regional economic communities, *Atf* is found to have had the strongest effects in the Southern African Development Community (SADC). On the other hand, Aid for Trade policy and regulation (a broader category of AfT, which encompasses assistance for trade policy formulation and regulation, and training support for officials, etc., thereby influencing the processing of trade) has a significantly more negative impact on the cost of trading in SSA than in the other developing countries. That is, the favourable effects of Aid for Trade policy and regulation are more pronounced in SSA.

In terms of the broad impact of AfT on exports, the returns to aid to economic infrastructure on exports are much larger in SSA than in other developing countries, while the opposite is true for aid to productive capacity. It looks as if SSA benefits significantly from infrastructure investments, but not from direct support to its productive sectors. It is mainly the 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 helping intra-SSA trade. Finally, the estimates point to the importance of soft infrastructure investments (in finance and business services) in developing countries, and in SSA in particular relative to other developing countries. However, the overall results also suggest that other forms of infrastructure support, including transport and energy, are important as well, especially in SSA.

Alongside the quantitative analyses, there are more qualitative ways of examining effectiveness. Based on an ODI project, Chapter 6, by Yurendra Basnett and Jakob

Engel, draws on country and donor experiences of AfT to better understand what enables greater effectiveness and what kind of factors constrain it. It analyses where barriers to effectiveness emerge, and examines circumstances that affect outcomes at each phase of the AfT project or programming cycle. The authors define four phases in the AfT cycle: (i) determining AfT priorities including the identification of binding trade-related constraints to growth; (ii) structuring AfT delivery, examining particularly what we know about the different delivery instruments; (iii) the design and implementation of projects and programmes, focusing on delivery of national and regional AfT programmes; and (iv) monitoring and evaluation (M&E), including different methodologies used and how this informs ongoing and future programmes at the global, regional, national and project levels.

Although growing empirical and qualitative evidence indicates that AfT can have a positive overall impact, the authors suggest that many individual projects are failing to deliver results. Improving the effectiveness of AfT requires not only the identification of the most binding constraints to trade, but also the tackling of the bottlenecks within donor and recipient institutions that impede successful implementation of projects at various stages throughout the project cycles. This requires an understanding of the nature and causes of co-ordination failures and information asymmetries specific to the institutional structure and political economy of recipient countries and regions, as well as donor agencies.

Chapter 7, by Vinaye Ancharaz, Paolo Ghisu and Christophe Bellmann, is a contribution that has summarised the main findings of several country case studies on AfT undertaken by the International Centre for Trade and Sustainable Development (ICTSD). The approach taken in this chapter is qualitative in nature and broadly based on the Paris principles of aid effectiveness, through which it offers fresh insights into the dynamics of AfT on the ground. The methodology uses a combination of quantitative indicators and information gathered from interviewing key stakeholders. The findings suggest that AfT works best when flows are additional and predictable, projects are owned by the recipients' countries, donor objectives are aligned with host governments, and when local absorptive capacity exists, among other requirements. The chapter also provides important implications for AfT evaluations.

The main conclusions of Part I are that (i) AfT can be effective, but its impact depends on a variety of factors including sector and type of AfT and donor and recipient country characteristics and (ii) econometric research, case studies and syntheses are powerful ways to help evaluation of AfT, but we do need to continue to improve the way we do these.

1.2.2 Part II: Current issues

Part II of the volume, containing seven chapters (Chapters 8–14), provides analyses of some selected current issues relevant to the effectiveness and relevance of AfT in the future, including such issues as regional AfT, global value chains, infrastructure development for agriculture, AfT adjustment and lessons from emerging economies in aiding exports.

Chapter 8, by Bruce Byiers and Dan Lui, part of the study co-ordinated by the ODI, argues that, whereas donors traditionally focused their development co-operation at country level, assistance for regional trade-related projects has gained in significance in recent years, consistent with both the observations of the AfT Task Force and the desires of SSA countries that regard a deeper level of regional integration as a stepping stone towards integrating into the global economy. A regional 'corridor approach' has emerged as a key policy approach linking countries and development actors and creating regional supply chains. This approach emphasises tackling regional barriers to trade in an integrated and coherent manner, complementing liberalisation commitments with a combination of physical and 'soft' infrastructure investments as well as addressing productive capacity constraints in sectors such as agriculture, in part through encouraging large-scale investments by the international private sector.

The authors conclude that the corridor approach can focus efforts to overcome some of the problems associated with broader regional programmes. In the context of the declining importance of aid, an approach that works with the private sector not only to increase financial resources but also to align interests appears to be a useful approach to maximising the effectiveness of AfT as a catalyst for broader public and private investment.

Chapter 9, by Liz Turner and Anna Fink, came out of a Commonwealth Secretariat sponsored project, providing an exploratory assessment of regional AfT initiatives in the context of East and West Africa. It aims to understand the extent to which aid effectiveness principles are applied, through the use of case studies. By outlining challenges and opportunities faced in delivering such programmes, it explores the main implementers of regional AfT programmes including regional economic communities, partner states and development partners.

Collin Zhuawu, in Chapter 10, which is an outgrowth of a Commonwealth Secretariat project, highlights the main issues of global value chains (GVCs) for least developed countries (LDCs) and SVEs and the potential use of AfT in supporting them. The author points out that participation in GVCs has become increasingly important for SVEs and LDCs because of the critical importance of the private sector as an engine for economic growth, sustainable development and poverty reduction. GVCs are seen as an important route to markets for export products and services, offering new opportunities to firms. Among other things, the chapter argues that effective and meaningful participation can be realised when LDCs and SVEs use their positions in supply chains (e.g. as producers of raw material) as a basis for moving up the chains through value added processing and build their productive capacity in order to join the GVCs. On both occasions, AfT has an important role to play.

Chapter 11, by Jodie Keane, as part of the study co-ordinated by the ODI, examines the role of AfT in assisting the integration of agricultural producers in SSA into high-value agricultural GVCs. The GVC approach is a distinct methodological tool that focuses on the dynamics of inter-firm linkages and international industrial organisation jointly, rather than considering the production and export of goods separately. The chapter focuses on cut flowers in Kenya, where interventions to facilitate trade and

producers' integration within GVCs have been ongoing since before the term Aid for Trade was agreed among WTO members.

The chapter describes the evolution of the cut flower GVC, which requires a greater consideration of power asymmetries between firms. In a globalising world, where GVCs are increasingly important, the ability to shift goods in and out is essential to a country's competitiveness, and infrastructure and low tariffs matter. Yet the cut flower industry also faces a set of non-tariff barriers, such as the need to satisfy stringent private sector standards in Dutch auction houses. Thus, efforts to reduce costs of certification and overcome other non-tariff barriers, which can prevent traders from accessing external markets, need to be undertaken whilst considering the private relations that exist between firms operating within GVCs. For example, a key question relevant to AfT is how the flower growers can achieve the mutual recognition of standards by Dutch auction houses (which operate as a private members' club).

Chapter 12, by Marie-Agnes Jouanjean, also part of the same study, reviews the recent literature on the impact of rural infrastructure on agricultural productivity, trade and poverty. It confirms that rural roads are important for poverty reduction, increasing agricultural productivity and market access. Although there is little evidence that roads have a direct impact on the poorest communities, studies do suggest that communities benefit from indirect job creation. Road quality is also very important for trade, with evidence suggesting that rural feeder roads are particularly important for poor rural households. Although roads, and in particular rural feeder roads, are regarded as a necessary condition, they are still not sufficient to guarantee any escape from poverty.

Indeed, the chapter argues that AfT-supported projects for rural infrastructure should be appraised in a more holistic way, by combining investments in hard infrastructure with investments in soft infrastructure (e.g. institutions for competition, extension services and inspection of standards) to address systemic inefficiencies that reduce the competitiveness of agricultural value chains. Soft infrastructure is crucial in fostering agricultural productivity and to help subsistence farmers overcome their constraints and connect to the market. Consumers and farmers will both benefit significantly when transport and transaction costs are reduced simultaneously.

Since the start of the AfT initiative in 2005, efforts by donors, partner agencies and recipients to strengthen trade capacity and improve trade-related infrastructure have been driven by the public sector. As part of the AfT initiative's shift in focus to the issue of including producers from developing countries in GVCs, the chapters in this volume on GVCs by Marie-Agnes Jouanjean, Jodie Keane and Collin Zhuawu suggest that the scope of the initiative should be better at including the private sector.

In Chapter 13, which resulted from a Commonwealth Secretariat project, Sacha Silva assesses why one component of AfT, known as the support for trade-related adjustments, has not been utilised much. There can be various adjustment requirements, ranging from tackling export shortfalls to capacity development for dealing with new trade measures and provisions. Nevertheless, the adjustment support remains negligible. This light emphasis on adjustment needs in the AfT debate is at

odds with a heavy trade negotiations agenda for SVEs and LDCs on several different levels: national/unilateral trade reforms, bilateral and multilateral agreements, and regional integration commitments.

The chapter points out that one main reason for low utilisation of such assistance could be the problem of defining 'adjustment'. Another potential reason could be the AfT reporting system's bias away from emphasising trade-related adjustment (TRA) needs. The top recipients of AfT are mostly large, non-LDC and non-SVE developing countries; for many of the top recipients, AfT priorities are dominated by non-TRA categories, such as the need to improve infrastructure or address gaps in trade facilitation. Yet another reason is argued to be donors' reluctance to fund programmes with an explicit focus on adjustment. The author argues that AfT recipient countries need to ensure that discussions of support for adjustment costs are central to policy debates. They should also seek to influence the AfT debate by referring to best practice case studies and current innovative approaches to supporting TRA.

A final chapter in Part II, Chapter 14, by Clara Brandi, as part of the project co-ordinated by the ODI, examines potential lessons from the emerging powers in making AfT more effective. It notes that emerging economies have successfully supported their trade performance. The specific contribution of the chapter is to examine how China, India and Brazil have facilitated trade, focusing on the provision of infrastructure and trade facilitation. Based on a review of the current literature, the chapter also reviews which lessons might be learned from these experiences in low-income countries (LICs).

The lessons for LICs in infrastructure development and financing include (i) establishing a favourable institutional environment for infrastructure development, for example a new Development Bank for Infrastructure; (ii) looking for domestic institutional investors (for example, pension funds are expected to increase rapidly and could fund infrastructure if they are permitted to diversify into bonds issued by private insurance companies); (iv) looking for foreign investment; and (v) supporting public-private partnerships and private participation in infrastructure.

A number of trade facilitation reforms were considered beneficial: (i) taking account of political economy challenges for trade facilitation; (ii) supporting the harmonisation of documentary requirements across countries; (iii) prioritising paperless trade, with a focus on electronic data interchange (EDI) and national and regional single window facilities; (iv) minimising physical inspections, in particular through adoption of risk management techniques; (v) considering industry- and sector-specific trade facilitation initiatives, such as for agricultural products or low-valued exports; and (vi) including trade facilitation issues in bilateral and regional free trade agreements.

In conclusion, the chapters in Part II suggest there are a number of trends and issues that can make AfT more effective at present and keep AfT relevant in years to come. These include a stronger emphasis on targeted regional programmes that help co-ordinate relevant actors; more emphasis on the emergence of GVCs, emphasising the need for both soft and hard infrastructure; and a better integration of the private sector in the various aspects of AfT, including the need for AfT to address ever more

demanding standards. Although each country will need a specific AfT strategy, it is important to bear in mind that other countries, including Brazil, China and India, may have useful lessons for the smaller, poorer and more vulnerable economies.

1.2.3 Part III: Future directions

Part III in this volume, containing two chapters, provides some future directions and perspectives for AfT. Joseph Stiglitz and Andrew Charlton, in a Report prepared for the Commonwealth Secretariat, a summary discussion of which is printed here as Chapter 15, ask the questions whether AfT has delivered on its promise and whether it has delivered incremental resources to developing countries, complementing pro-development liberalisation and unlocking genuine progress in multilateral trade reform. They argue that the AfT initiative may well be primarily a reallocation rather than an increase in assistance, and constitutes a relabelling rather than a fundamental reform of the global trade and development framework.

Stiglitz and Charlton consider alternative means to improve trade outcomes for developing countries. They propose that a ‘right to trade’ and a ‘right to development’ be enshrined within the WTO’s dispute settlement system. These rights would give developing countries increased opportunity within current and future trade agreements to expand their trade and safeguard their development. They further argue that AfT funds should be consolidated into a more coherent and predictable framework and propose that dedicated funds should be committed by rich countries to a Global Trade Facility and dispersed through a transparent and competitive process. These proposals, according to the authors, would contribute to creating a genuinely pro-development trade liberalisation agenda, giving developing countries greater scope to eliminate the international trade barriers and domestic capacity constraints that limit their ability to pursue export-led development pathways.

The draft report by Stiglitz and Charlton was discussed in a Commonwealth Roundtable, held in London, resulting in a rich discussion involving academics, senior trade negotiators, policy-makers and experts. Chapter 15 is a summary of the Roundtable discussion including major issues raised and discussed, prepared by Emily Jones.

Finally, Chapter 16, by Dirk Willem te Velde, examines the future of the AfT initiative. The chapter traces the progress of the initiative from its inception (first-generation AfT aimed at supporting the implementation of trade agreements) to the current phase (second-generation AfT mainly seen as one form or group of aid activities). It then proposes a range of possible future directions. In the narrow view, AfT returns to a very specific role focusing mainly on *Atf*, taking into account developments in GVC analysis. In the broad view, AfT follows a bottom-up approach to trade. In this view, trade plays a part in the solutions to a wide range of trade-related development challenges such as food security, job generation and climate change. The chapter concludes by arguing 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 in that that aid is not constrained by procurement rules that tie procurement of goods

and services legally to the aid provider, 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 the effectiveness of AfT in times of resource constraints, leverage in other financial flows of great value and make connections more comprehensive amongst countries, actors and flows.

1.3 Concluding remarks

Aid for Trade has become an important trade and development initiative that aims to support the beneficial participation of developing countries in global trade. Since its launch in the WTO Hong Kong Ministerial Conference, the initiative has attracted intense interest amongst developing countries who have, in some cases, allocated more aid and domestic resources in favour of trade.

The chapters brought together in this volume analyse a range of issues relating to AfT policy discourse including its effectiveness, selected topical issues and future directions. The empirical assessments and qualitative discussions based on country cases show that there are certain areas where AfT flows have significant favourable effects on recipient countries. Particularly, the effects of AfT in reducing trading costs have been very robust. There is also quantitative evidence of increased aid to economic infrastructure having a positive impact on export performance. However, the aid to productive capacity that has been provided does not seem to have had a noticeable impact. These results generally hold true for both SSA and SVEs.

In the light of these results, although one may suggest a reconsideration of the AfT allocation across activities and sectors, it is, nonetheless, very important to further examine the lack of effectiveness of aid to productive capacity and consider whether and how AfT can help industrial policy. Recipient country- and region-specific factors should also be taken into consideration in allocating AfT resources and to make the AfT initiative more demand-driven and accountable. In this regard it is important to mention that effectiveness needs to be verified further using a range of detailed assessment techniques.

One issue that merits special mention is that it may be a good idea to consider AfT programmes to address the specific trade-related constraints faced by SVEs. Currently, the AfT has an overall focus on infrastructure and sectoral development, which may not give adequate attention to the specific needs of small states. For example, whereas 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. Addressing TRA needs, particularly those arising from loss of trade preferences (as highlighted in Chapter 4 below), could be extremely helpful for SVEs.

The Commonwealth Secretariat and the ODI have been engaged with policy-makers, trade negotiators, practitioners and civil society groups dealing with AfT. This has also contributed to a further understanding of the factors influencing the effectiveness of

AfT. Many consider institutional weakness as one of the major factors constraining the mainstreaming of AfT in national development strategies and its operationalisation. Institution building has also been recognised as essential to enhance the ownership of AfT. 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. It is, therefore, important for countries to develop and strengthen databases of different types of AfT and projects where these funds are being utilised, to enable the evaluation and monitoring of AfT. This is particularly the case because many southern countries, especially large emerging economies, have become significant sources of AfT. Currently, AfT sourced from these countries is not systematically recorded in a global database. Because there is no database specific to recipient countries, 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.

In conclusion, whilst the AfT initiative has generated much dynamism in recent years, policy-makers and researchers will need to consider a range of issues discussed in this volume in order for the AfT initiative to continue to show impacts and remain relevant. First, whilst AfT is generally regarded as broadly effective, its impact depends on a variety of factors including sector and type of AfT and donor and country characteristics. The econometric research, case studies and syntheses will need to be continuously updated to evaluate the specifics of the AfT initiative as more data become available, econometric techniques are updated and circumstances change. Second, we need to ensure that AfT adapts to the new trade and investment realities of emerging value chains and an increasingly diversified financing environment in which AfT through ODA is declining in importance. This includes a stronger emphasis on targeted regional programmes, more emphasis on how soft and hard infrastructure can be combined to support the development of GVCs, and a better integration of the private sectors in the various aspects of AfT. Finally, it is in this light that we think that a successful continuation of the AfT initiative will depend on whether or not it can successfully increase the impact of AfT in times of resource constraints, leverage in other financial flows relevant to trade capacity building, embracing the concept of ‘investment for trade’, and connect private producers in poor countries to value chains, managed and facilitated in close co-ordination with domestic state and business sectors.

Note

- 1 This volume uses the Commonwealth Secretariat’s definition of small and vulnerable economies (SVEs) and/or small states as those countries with a population size of 1.5 million people or fewer, plus some larger countries that share many characteristics of SVEs/small states. See Chapter 4 for details.

PART I. EFFECTIVENESS OF AID FOR TRADE

Chapter 2

Impact of Aid for Trade: A Survey of Empirical Evidence¹

Isabella Massa

2.1 Introduction

The amount of Aid for Trade (AfT) assistance provided over the past few years is considerable. AfT is recognised as an important development tool facilitating the integration of developing countries into the global economy through initiatives that expand trade capacity.

Evidence on the impacts of AfT on the trade performance of recipient countries is still scanty, however. Indeed, very few studies have provided an empirical assessment of the effectiveness of AfT, partly because of data limitations. This chapter reviews these studies. Unlike previous surveys of the AfT literature (e.g. Hoekman and Wilson 2010; Suwa-Eisenmann and Verdier 2007; Vijil et al. 2011), this section focuses on a broader sample of research on the effectiveness of AfT. It also provides an in-depth analysis of the different empirical methodologies used, highlighting their strengths and weaknesses in terms of econometric techniques and AfT variables selection, as well as in terms of country and sector coverage. Moreover, the chapter categorises the literature findings by looking at differences in AfT impact by type of aid flow, recipient country income level, recipient sector of aid and recipient country geographical region.

The chapter is structured as follows. Section 2.2 discusses the definition and measurement issues of the AfT variables. Section 2.3 and Section 2.4 analyse respectively the country coverage and sector coverage of the reviewed studies. In Section 2.5, the different empirical estimation approaches used are examined. Section 2.6 summarises the findings of the reviewed studies on the effectiveness of AfT. Finally, Section 2.7 concludes.

2.2 Aid for Trade variables: definition and measurement issues

The concept of AfT is broad and not easy to define. This (together with data limitations) makes it difficult to measure its impact and effectiveness, and leads researchers to prefer using data-driven definitions rather than looking into AfT definitional issues. Most of the papers reviewed rely on the following six categories of AfT, proposed by the World Trade Organization (WTO) AfT Task Force (WTO 2006), in order to define the AfT variable(s) in the quantitative studies:

- **aid directed to trade policy and regulations**, which includes training of trade officials, analysis of proposals and positions and their impact on national

stakeholders, technical and institutional support to facilitate the implementation of trade agreements and compliance with rules and standards;

- **aid directed to trade development**, such as investment and trade promotion, support in different trade sectors and trade finance, market analysis and development;
- **aid directed to trade-related infrastructure**, including physical infrastructure to connect domestic and foreign markets;
- **aid directed to building productive capacity**, meaning investments in industries and specific sectors so that countries are able to diversify production and exports;
- **aid directed to trade-related adjustment**, which comprises complementary measures absorbing some of the costs linked to tariff reductions or declining terms of trade to make developing countries benefit from trade liberalisation; and
- **aid directed to other trade-related needs**.

However, it is important to note that the degree of aggregation of the above aid flows is heterogeneous across the studies. Some focus on AfT at an aggregated level; others take into account one or more specific categories of AfT to shed light on the impact of specific interventions on the ground. A few authors even consider one item from one category or create specific AfT items aggregating single components of different categories. Busse et al. (2011), for example, started focusing on total AfT given by the sum of all six categories, and then restricted their analysis to one category (aid directed to trade policy and regulations) and AfT directed to one item of that category (trade facilitation).

Cali and te Velde (2011), instead, studied the impact of AfT on trade costs by focusing on the Aid for Trade policy and regulation category and one of its sub-categories (trade facilitation), and then examined the impacts of AfT on recipient countries' exports by taking into account two other categories of AfT, namely aid disbursed to economic infrastructure and aid disbursed to productive capacity.

Ivanic et al. (2006) consider an alternative aggregation of aid flows, creating a trade facilitation variable by aggregating a selected number of items from three AfT categories: aid for infrastructure (e.g. port/road improvements); Aid for Trade development; and Aid for Trade policy (e.g. customs reforms). Helble et al. (2009), on the other hand, look at the effectiveness of trade facilitation by defining the trade facilitation variable in four different ways. First, in a narrow sense, trade facilitation is defined as a subset of the Aid for Trade policy and regulations category. Second, and in a broader sense, trade facilitation is computed as the sum of aid flows from the trade development and economic infrastructure categories. Third, a *hard* trade facilitation variable and a *soft* trade facilitation variable are created by including, respectively, funds directed towards investment into infrastructure projects (e.g. upgrading of ports and construction of new roads) and towards building trade-related institutional capacity (e.g. training of customs officials and streamlining customs procedures).

Ferro et al. (2011) also use a particular aggregation of aid flows, creating their AfT variable by combining single items from two different categories (Aid for Trade-related infrastructure and aid to production capacity) to evaluate the impact of aid to the services sector. Vijil and Wagner (2010), instead, assess the effectiveness of AfT in trade performance, directly using two categories as AfT variables: Aid for Trade policy and regulations and aid to trade-related infrastructure.

Among all the categories used in the above-mentioned studies, only Aid for Trade policy and regulations and Aid for Trade-related infrastructure appear to have received adequate attention. Very few studies look at the effectiveness of Aid for Trade development (Ivanic et al. 2006; Helble et al. 2009) and aid for productive capacity (Cali and te Velde 2011). Moreover, trade facilitation receives considerable attention in the range of studies analysed, albeit with heterogeneous definitions of this variable. In some cases, trade facilitation is identified with the corresponding item within the AfT policy and regulations category; in others, it is computed as the sum of selected single items spread across the different categories of AfT. This makes it hard to compare the results of the studies assessing the effectiveness of trade facilitation.

Next to those studies that identify the AfT variable(s) by referring to the WTO categories, there are research works that assess the effectiveness of AfT by looking at other factors. Brenton and von Uexkull (2009), Lederman et al. (2010) and Volpe Martincus (2011), for example, refer to export promotion programmes. Gourdon et al. (2011) look at a specific type of export promotion instrument: a matching grant. Finally, Portugal-Perez and Wilson (2010) use factor analysis to create four new indicators of trade facilitation: physical infrastructure; information and communication technology (ICT); border and transport efficiency; and business and regulatory environment.

In terms of sources of AfT data, most of the studies (i.e. Busse et al. 2011; Cali and te Velde 2011; Ferro et al. 2011; Helble et al. 2009; Ivanic et al. 2006; Vijil and Wagner 2010) use the Organisation for Economic Co-operation and Development (OECD) Creditor Reporting System (CRS) database, which has the advantage of providing data for a relatively long time span (from the mid-1970s onwards). Nevertheless, data until 1994 have substantial gaps. Most of the quantitative studies relying on the CRS database therefore use as a time horizon only a few years in the 2000s, with the exception of Helble et al. (2009) and Ivanic et al. (2006), who use longer time spans. The CRS database has also the advantage of accounting for both aid commitments and aid disbursements data. Note that most of the studies relying on the CRS database use aid disbursement data (e.g. Busse et al. 2011; Cali and te Velde 2011; Ferro et al. 2011), with the exception of Vijil and Wagner (2010), who use aid commitments data. Moreover, the CRS database reports data related to several dimensions of AfT, in particular for AfT and trade-related adjustment. However, a number of limitations should also be highlighted. First, the CRS database includes only aid flows allocated by countries that are members of the Development Assistance Committee (DAC); thus it leaves out funds from key donors such as China and many of the multilateral agencies that provide assistance, particularly on trade policy and regulations (Turner 2008). Second, it takes into account only flows given on concessional financial terms.

Third, OECD data on AfT are also likely to overestimate the actual volume of AfT for DAC members, since they include projects that may have no objectives related to trade or little potential impact on a country's capacity to trade (*ibid.*).

Another important source of data used in econometric analyses to track AfT flows, but to a much lesser extent, is the trade-related technical assistance and trade capacity-building database constructed jointly by the OECD and the WTO. This database, used by, for example, Brenton and von Uexkull (2009), provides very detailed information but only for the period 2000–06. This may constrain the period of analysis even further compared with the CRS database. Moreover, it covers only two categories of AfT (trade policy and regulations and trade development). The reliability of the database has also been questioned, particularly as significant data discrepancies have been found when compared with other datasets (Turner 2008).

Finally, those studies that investigate the effectiveness of export promotion programmes or instruments (Brenton and von Uexkull 2009; Gourdon et al. 2011; Lederman et al. 2010; Volpe Martincus 2011) make use of survey data. Portugal-Perez and Wilson (2010), instead, rely on data sourced from the World Bank's databases (Doing Business and WDI) as well as from the World Economic Forum (WEF) and Transparency International.

2.3 Country coverage

The studies reviewed vary considerably in terms of country coverage. Several cover more than 100 countries (Calì and te Velde 2011; Ferro et al. 2011; Helble et al. 2009; Lederman et al. 2010; Portugal-Perez and Wilson 2010); others cover a rather small sample of countries (e.g. 48 countries in Brenton and von Uexkull 2009) or even only one (e.g. Tunisia in Volpe Martincus 2011).

A number of studies cover both developed and developing countries (Helble et al. 2009; Lederman et al. 2010; Portugal-Perez and Wilson 2010) but, given the nature of AfT, several studies have a specific focus on developing economies (Brenton and von Uexkull 2009; Busse et al. 2011; Calì and te Velde 2011; Ferro et al. 2011; Gourdon et al. 2011; Volpe Martincus 2011).

Moreover, in order to investigate whether there are differences in AfT effectiveness among groups of countries, some studies aggregate economies into special groups using different criteria. Some classify countries by income level: Ferro et al. (2011) distinguish between low-income countries (LICs), lower-middle-income countries (LMICs) and upper-middle-income countries (UMICs). Other studies, such as that by Brenton and von Uexkull (2009), look separately at least developed countries (LDCs) and non-LDCs, and also compare top 20 aid recipients with the rest of the economies. Moreover, there are studies that look at the impacts of AfT in different geographical regions. For example, Ivanic et al. (2006) distinguish among seven sub-samples of countries: (1) developed economies; (2) East Asia and Pacific (EAP); (3) Europe and Central Asia (ECA); (4) Latin America and Caribbean (LAC); (5) Middle East and North Africa (MENA); (6) South Asia (SAS); and (7) sub-Saharan Africa (SSA). In a similar way,

Ferro et al. (2011) focus on six developing regions. Portugal-Perez and Wilson (2010) also simulate the trade effects of trade facilitation on six different regions.

Finally, it is worth mentioning that a few recent studies have started focusing on AfT effectiveness looking at countries belonging to only one region. For example, Volpe Martincus (2011) assess the impact of trade promotion in the Latin American region looking at Argentina, Chile, Colombia, Costa Rica, Peru and Uruguay.

2.4 Sector coverage

Sectoral analyses of AfT effectiveness are very scanty. Indeed, only five out of eleven studies reviewed evaluate the impacts that AfT may have in terms of improving trade-related performance in particular productive sectors. The majority of these look simultaneously at two or more sectors (Brenton and von Uexkull 2009; Cali and te Velde 2011; Ivanic et al. 2006; Portugal-Perez and Wilson 2010), and only one study focuses on a single sector: the services sector (Ferro et al. 2011).

Among the sectors covered, researchers tend to focus mainly on agriculture and manufacturing, probably because of the availability and frequency of data. The mining and services sectors also gain some attention (e.g. Cali and te Velde 2011; Portugal-Perez and Wilson 2010 for mining; Cali and te Velde 2011; Ferro et al. 2011; Ivanic et al. 2006; Portugal-Perez and Wilson 2010 for services).

It is also important that only one of the studies reviewed evaluates the impact of aid flows directed to specific sub-sectors. Ferro et al. (2011) look separately at five different dimensions of the services sector: transport, communications, energy, banking/financial services and business services.

This suggests a clear need to expand the scope of existing research to better understand the various degrees of effectiveness that AfT interventions might achieve in different productive sectors and sub-sectors. Annex 2.1 summarises the estimation methodologies and technical aspects of the studies reviewed.

2.5 Estimation approaches

The growing number of econometric studies on AfT's impact, although they are not unanimous, do indicate that AfT has been effective at increasing exports and reducing the costs of trading. A number of econometric techniques are used, with various degrees of sophistication, to assess the effectiveness of AfT. Although some studies use cross-section analysis, most tend to use variants of panel data, favouring macro- rather than micro-analysis. In what follows, we provide a quick overview of the econometric models used and their inherent advantages and disadvantages. We also discuss some of the theoretical models used as a basis of a few empirical studies.

2.5.1 Gravity models

Ivanic et al. (2006), Helble et al. (2009) and Portugal-Perez and Wilson (2010) use as a theoretical base for their studies the gravity model.² This specification has become

almost a 'classic' in trade studies. The gravity model facilitates interpretation of econometric results by providing a clear theoretical framework, and its flexibility allows researchers to extend the model by adding new variables and testing new hypotheses. Furthermore, it can be used to study macro and micro scenarios, as well as single-period cross-sections or panels. Of course, the usual caveats attached to every theoretical model apply. Ivanic et al. (2006) use a two-step approach. First, they compute an extended gravity model to obtain estimates of the effects that trade-promoting aid might have on transaction costs. They then feed these estimates into a computable general equilibrium (CGE) model to obtain projections of global trade transaction costs and their effects on welfare. This is a strong point, since it uses estimates rather than subjective shocks to obtain projections from the CGE model. However, the accuracy of the projections depends on the accuracy of the estimates obtained through the gravity model.

The precise type of econometric methodology used by Ivanic et al. (2006) to estimate the gravity model specification is not entirely clear, so we can provide only a general description of the weaknesses inherent to this type of model. The first drawback is related to the excessive reliance on dummy variables, which may distort the final outcome. Moreover, the effects that AfT flows might have on trade performance or economic growth are not immediate, and it takes time for full influence. For this reason, when including AfT variables, most empirical studies use varying periods' lagged values of AfT. Finally, endogeneity remains a major concern.

Helble et al. (2009) extend the traditional gravity model to accommodate AfT facilitation flows. The estimation methodology is a fixed-effects panel data study, and they use four main components. The first addresses the relationship between AfT facilitation and trade flows. The second assesses this relationship across various country groups to highlight possible different effects among countries. The third studies the lagged effects of aid. The last component investigates how the relationship between AfT facilitation and trade might vary with the type of aid flow. The fixed-effects panel data methodology is widely used, although it does not satisfactorily address endogeneity issues and possible biases owing to zero values within the sample. That said, the authors' decision to analyse the impact of AfT facilitation in different groups of countries, taking into account different types of aid flows, provides useful insights and helps address the extreme heterogeneity (in terms of both type of countries and aid flows) that often characterises trade studies.

Portugal-Perez and Wilson (2010) also use an extended gravity model to study the effects of a series of trade facilitation indicators. Their methodology is a two-stage Heckman selection model. This allows correcting for selection and is particularly useful to deal with the excessive number of zeros that characterise the gravity model specifications, as well as the scarcity or incompleteness of AfT data. The study also uses Tobit and Poisson regressions to check the robustness of results. To address possible endogeneity/causality problems, the authors use the lags of their trade facilitation indicators. This is a valid alternative, although the inclusion of lagged variables implies a reduction of the overall sample used in the regression analysis. Indeed, the more the lags the smaller the sample becomes.

2.5.2 Control groups

Another branch of the empirical literature studying the effectiveness of AfT has focused mainly on difference-in-difference (DID) estimations.³ These types of models are used traditionally in public health to determine whether a particular treatment or medicine is effective or not. In its simplest version, the model observes two groups of individuals (countries or firms) over two or more time periods (weeks, months or years). The two groups must share similar characteristics, with the difference that one receives the prescribed treatment or policy (in our case AfT) while the other continues business as usual. This model is particularly attractive, since it allows better isolation of any potential effects that AfT might have on a particular exporting sector or group of countries.

Brenton and von Uexkull (2009) use a DID model to estimate the impacts that export development programmes might have on export performance. To obtain their estimates, the authors use fixed-effects regressions with a series of dummy variables that represent the inclusion or absence of export development programmes in a particular country. As discussed earlier, excessive zeros in trade samples can affect the outcome. The authors are aware of this and use also a Poisson fixed-effects estimator to check the robustness of their results, which allows for better predictions. However, little is done to address endogeneity problems, and the authors omit the use of alternative control variables that would reinforce the credibility of any result.

Summarising, DID models are a good alternative to traditional gravity models, but the use of econometric techniques to estimate them should be more thorough and take care not to neglect potential causality/endogeneity issues.

2.5.3 Miscellaneous

In addition to the research mentioned above, the literature also offers a series of studies analysing linear relationships between AfT and other variables of interest. These studies rely more on the robustness of standard econometric techniques rather than theoretical trade models. This is acceptable, even though the interpretation or justification of the estimates is more burdensome.

Busse et al. (2011) use fixed-effects panel data estimations to study the effects of AfT and trade facilitation on the costs of trading. The authors also take care to differentiate between LDCs and non-LDCs. This approach facilitates the identification of significant differences among countries or groups of countries. Overall, the estimation technique is fairly standard and the usual limitations apply. Endogeneity cannot be addressed unless instrument variables are introduced.

Ferro et al. (2011) follow a different approach and propose a new framework to study AfT effectiveness. They reverse traditional specifications, use aid as the dependent variable and try to explain changes in aid flows through a series of dummies that identify specific business sectors, rule of law, country stability and others. This approach seems promising, and should be taken into account in future research. With respect to the econometric technique used to estimate this specification, the authors apply a standard ordinary least squares (OLS) regression. They do, however,

address causality issues to some extent by replacing the dependent variable with other, previously independent, variables. Nevertheless, the estimation is on the weak side and alternative techniques are available.

Vijil and Wagner (2010) derive an equation that explains total value of exports of a country using a classic symmetric constant elasticity of substitution (CES) function.⁴ Then they introduce aid-related variables to explain changes in export values. Using this relationship, they proceed to log-linearise it and then to estimate it using OLS and a two-stage least squares (2SLS) regression. This approach is simple and neat, and allows the researcher a theoretical background that facilitates the interpretation of the results. Moreover, the use of OLS followed by 2SLS provides a good robustness test and addresses endogeneity problems satisfactorily. The drawbacks of this model are that it fails to take into account possible fixed effects and to deal with zero values in the sample.

Cali and te Velde (2011) also use a CES utility function to derive their trade specification. The novelty of their approach relies on the fact that they divide AfT into four main categories: (1) AfT facilitation; (2) AfT policy and regulation; (3) aid to economic infrastructure; and (4) aid to productive capacity. This classification allows better disentangling of aid effects on specific sectors or areas. The estimation technique used is a generalised method of moments (GMM). This technique is particularly robust; it addresses endogeneity issues and allows more efficient estimation of big samples. Drawbacks remain in the excessive number of zeros within AfT samples and the difficulty in choosing adequate instrumental variables for the GMM regressions. The technique is also sensitive to the sample size. If the sample is relatively small, results should be treated with caution.

Volpe Martincus (2011) studies the impact of export promotion programmes in six Latin American countries. He employs a DID and matching-DID methodology, whose advantages and disadvantages we discussed above. However, this study is innovative in the sense that it pursues a micro-based approach. It uses national firm-level data and controls for differences in trends among firms. This is a good option for future AfT studies.

Finally, Gourdon et al. (2011) also use the DID methodology to study the effects of specific export promotion instruments, focusing on Tunisian firms. A single-country approach allows better understanding of AfT, since it avoids biases resulting from other countries. However, such studies need enough data over time to provide better insights into the effects that AfT could have. A particular feature of this article is that it covers both service firms and manufacturing firms, providing a clear comparison of the varying effects that AfT might have on both.

Overall, empirical studies on the effectiveness of AfT have applied a number of econometric techniques (see also Annex 2.1), each with its own advantages and disadvantages. Therefore, the researcher should ponder well before choosing the model that best suits a particular sample. Regardless of the econometric technique, other important issues are the definition of the AfT variable(s) being used and the type of sub-samples or groups of countries analysed. Considering AfT as a dummy variable or measuring it by monetary amounts makes a difference when deciding what

methodology to use. Furthermore, analysing regions, groups of countries or productive sectors separately might make more sense than aggregating different AfT flows into one single variable. Indeed, the heterogeneity among countries and sectors makes it difficult to isolate AfT effects when studied in an aggregate manner.

2.6 Empirical findings on Aid for Trade effectiveness

Taken together, the existing empirical literature tends to confirm that AfT can be effective at both the macro and the micro level. Nevertheless, its impacts may vary considerably depending on a number of factors, as we analyse below.

2.6.1 Type of Aid for Trade flow

A number of quantitative studies suggest that alternative types of AfT may have different impacts at the macro level on trade-related performance and growth. Ivanic et al. (2006), for example, study the role of three categories of trade-promoting aid (aid for infrastructure, for trade development and for trade policy) as well as trade facilitation to reduce trade transaction costs of recipient countries and to generate trade welfare gains. Taken together, the three categories of aid are found to reduce worldwide trade costs by 0.2 per cent and to generate a total welfare gain of US\$18.5 billion, but empirical evidence suggests that not all types of AfT have the same impact. Indeed, the authors find that aid directed to trade policy is the most effective in lowering trade costs of the importer and exporter; trade facilitation is also found to have a significant and large impact on the trade costs of the exporter. Moreover, in terms of welfare impacts, it is found that trade facilitation is the type of AfT that generates the highest welfare gain (US\$24.8 billion). The return to trade facilitation aid is also found to be the greatest among the types of AfT considered.

In a similar way, Busse et al. (2011) empirically examine the impact of total AfT, aid directed to trade policy and regulations and trade facilitation on trade costs in developing countries as well as on the time of trading. Their results show that AfT is both statistically and economically significant in reducing the costs of trading, but the impact depends on the particular aid category. Indeed, highly targeted aid, such as aid spent on trade policy and regulations, and particularly on trade facilitation, is more effective than total AfT. Evidence on the effectiveness of AfT in reducing the time of trading is less robust, but there is still some evidence that aid directed to trade policy and regulations has a significant (though small) effect in terms of shrinking the time of trading.

Helble et al. (2009) empirically assess the relationship between different categories of AfT and trade performance of recipient countries. They find that a 1 per cent increase in assistance directed to trade facilitation could generate an increase in global trade of about US\$415 million. However, one aid category, that is, aid directed to trade policy and regulations, appears to have a particularly high impact on recipient countries' exports. Indeed, it is found that a 1 per cent increase in AfT policy and regulations could generate an increase in global trade of about US\$818 million.

Another interesting study assessing the relationship between different categories of AfT and recipient countries' exports is that by Calì and te Velde (2011). Its results

show that AfT has an overall positive and significant impact on exports. However, this effect is entirely driven by aid to economic infrastructure; aid to productive capacity has no significant impact on exports. Calì and te Velde (2011) also investigate the impact of different types of AfT on trading costs and time of trading. They find that AfT investments aimed at improving trade facilitation reduce import and export costs as well as time of trading. On the other hand, evidence on the impact of aid to trade policy and regulations on the costs of trading is more mixed.

Vijil and Wagner (2010) highlight the importance of Aid for Trade-related infrastructure (proxied by aid for economic infrastructure) in fostering recipient countries' exports. The results of their empirical assessment indicate that a 10 per cent increase in aid to infrastructure commitments leads to an average increase of the exports to GDP ratio for a developing country of 2.34 per cent. On the other hand, aid directed to trade policy and regulations turns out to have a limited impact on developing countries' exports.

Next to these studies looking at the impacts of different types of AfT, there are very few studies focusing on the effectiveness of specific instruments for delivering AfT. Among the studies reviewed, only Gourdon et al. (2011) in their firm-level study try to fill this gap, by examining the effectiveness of a single, well-defined export promotion instrument: an export promotion matching grant, as opposed to a mix of instruments. Their results suggest that recipients of the matching grant have experienced significantly better export growth (in terms of volumes, products and destinations) than non-recipients. This is particularly true in the case of first-time exporters, that is firms that started exporting after receiving the grant and services firms.

2.6.2 Recipient country's income level

The empirical evidence on whether the effectiveness of AfT changes depending on the level of income of recipient countries is still very limited, and deserves further investigation. Among the very few studies dealing with this issue, it is worth mentioning that by Ferro et al. (2011), which examines the impact of AfT in five service sectors by distinguishing between LICs, LMICs and UMICs. The results show that in certain sectors, such as transport and banking services, the effectiveness of aid in terms of export growth diminishes for higher-income country groups. Indeed, the impact of aid to transportation and banking services is found to be positive and significant for LICs and LMICs, but it becomes negative and significant in the case of UMICs. On the other hand, the effectiveness of aid to sectors such as energy and business services increases with the income level of the group of recipient countries.

These findings are to some extent in line with those reported in the study by Portugal-Perez and Wilson (2010), according to which the marginal effect of infrastructure improvement on exports is decreasing in income. However, although the findings of Ferro et al. (2011) on the effectiveness of aid to the ICT sector in different income groups of countries are mixed, Portugal-Perez and Wilson (2010) clearly show that the impact of ICT on exports is increasingly important for richer countries.

In this context, it is also important to mention the results of the empirical assessment by Busse et al. (2011), which distinguishes between LDCs and non-LDCs, since low income is one of the criteria used to identify LDCs. Busse et al. (2011) find that none of the types of AfT considered are effective in reducing the costs of trading in LDCs, whereas all the variables are highly significant in the non-LDC sub-sample, with the exception of the total AfT variable. As the authors suggest, this unexpected result might be due to absorption capacity constraints in LDCs, but also to the fact that in the sample the amounts of aid flows directed to LDCs are too low to show any impact on trading costs.

2.6.3 Recipient sector of aid

Some studies suggest that AfT may have a bigger impact on specific sectors. Indeed, sector analysis shows some interesting differences. For example, Brenton and von Uexkull (2009) (in line with Cali and te Velde 2011) find that export development programmes tend to have a higher impact in sectors that already have strong export performance. However, they suggest this may not necessarily be the result of AfT, since the good performance of these sectors would have made them a success anyway.

Portugal-Perez and Wilson (2010), instead, find evidence that trade facilitation (as measured by the physical infrastructure indicator) has a greater impact in the fuels sector and the ores and metal sector than in the textiles and manufactures sectors. Aid to ICT appears to be effective in the fuels sector but has a negative and significant impact in the ores and metals sector. On the other hand, Ferro et al. (2011) suggest that aid to the transport and energy sectors is the most effective in boosting exports. According to their baseline estimates, a 10 per cent increase in aid to transportation and energy is associated with a 2 per cent and 6.8 per cent increase in manufacturing exports, respectively, compared with a mere 0.3 per cent increase from aid to the ICT sector.

Finally, Ivanic et al. (2006) find that Aid for Trade policy can significantly lower costs of trading in the processed agriculture and primary agriculture sectors. Aid for infrastructure and for trade development seem instead to be particularly effective in the primary non-agriculture sector.

2.6.4 Geographical regions of recipient countries

Existing empirical evidence suggests that the same type of AfT may have varying effects depending on the geographical regions to which the aid flows are directed. Ivanic et al. (2006), for example, show that Asia sees the highest welfare gain from AfT facilitation, followed by SSA. Moreover, they find that, among all developing regions, SSA is the one that could benefit the most from AfT facilitation in terms of costs of trading reductions. Indeed, in the region, trade facilitation is estimated to reduce export costs by 1.9 per cent and import costs by 0.7 per cent, whereas in other regions, such as LAC, the reduction in export costs and import costs is estimated to be just 0.5 per cent and 0.2 per cent, respectively. This result is consistent with the

Table 2.1 Overview of empirical literature findings on Aid for Trade effectiveness

Aid for trade effectiveness by	
Type of aid flows	• Evidence on the effectiveness of different types of AfT flows is mixed, partly because results are not always comparable, as different definitions of specific categories of AfT are used. • However, there is some evidence that highly targeted aid flows (e.g. trade facilitation) are more effective. • A few studies find that Aid for Trade-related infrastructure is particularly effective in promoting recipient countries' exports. • Evidence on the effectiveness of Aid for Trade policy and regulations in improving trade-related performance is more mixed. • Evidence on the effectiveness of single export promotion instruments is still scarce.
Recipient's income level	• There is some evidence that certain types of AfT flows (e.g. aid to infrastructure such as aid flows to transportation) are more effective in LICs, whereas other aid flows, such as those directed to the business sector, are more effective in higher-income countries. • Much more evidence is needed in this area with respect to different types of AfT (especially aid to trade policy and regulations, aid to trade development and trade facilitation) and different recipient sectors of aid.
Recipient sector of aid	• The impact of AfT is found to vary among sectors. • Evidence is still mixed and the different sector classification used in the studies prevents comparability of results.
Geographical regions of recipient country	• There is evidence that the same type of AfT may have varying effects depending on the geographical regions of recipient countries. • It appears that SSA is one of the regions that could benefit the most from AfT.

Source: Author's elaboration from different sources

findings of Cali and te Velde (2011), according to which Aid for Trade facilitation has a larger cost-reducing impact in SSA than in the entire sample of developing countries.

Other relevant findings are those in Ferro et al. (2011) and Portugal-Perez and Wilson (2010). The former find that aid to the services sector has different impacts across developing regions. Aid to business appears to have a positive effect on exports in LAC and MENA, but a negative impact in SAS. On the other hand, aid to banking displays a negative relation with exports in LAC as well as in MENA, but has a positive impact on exports in SAS. These results suggest that regions with a high percentage of UMICs (e.g. LAC and MENA) benefit more from aid to business than regions with several LICs and LMICs (e.g. SAS). However, the latter gain the most from aid to banking. On the other hand, Portugal-Perez and Wilson (2010) find that aid to infrastructure produces much more significant trade gains in SSA than in other regions, especially SAS. Table 2.1 summarises the main findings of the empirical studies reviewed.

2.7 Conclusions

This review of empirical studies on the effectiveness of AfT shows that several econometric techniques with different degrees of sophistication have been used to assess the impact of AfT on trade and other economic performance in recipient countries, favouring analysis at the macro rather than the micro level. These methodologies include gravity model specifications, DID estimations, panel data estimations, OLS, 2SLS and GMM, among others. Each technique has its own advantages and disadvantages, so it is difficult to identify the best approach to employ; an approach should be chosen depending on the characteristics of the sample used.

Most of the studies reviewed assess the effectiveness of AfT at an aggregated level: very few focus on the impact of specific AfT interventions or instruments. Among the different categories of AfT, researchers have focused mainly on Aid for Trade policy and regulations and for trade-related infrastructure; Aid for Trade development and for productive capacity have received very limited attention. On the other hand, among the components of the different categories of AfT, only trade facilitation seems to have received some consideration, even though various definitions of this variable have been used.

In terms of country coverage, the existing research appears to be very heterogeneous. Some studies cover several developed and developing countries, whereas others focus on a small sample of economies or even on only one country. Differences across countries by income level and geographical region have been analysed to some extent. Very few studies have tried to assess differences in AfT effectiveness by productive sector (or sub-sector); those that have favour the agriculture and manufacturing sectors, and to a lesser extent the mining and services sectors.

Availability of data remains an important issue in conducting empirical studies on the effectiveness of AfT. The majority of studies rely on the OECD's detailed CRS database, which has significant gaps in the years before 1994. Moreover, it includes only aid flows allocated by countries that are members of the DAC – thus leaving out funds from key donors such as China – and takes into account only flows given on concessional financial terms. The CRS database is also likely to overestimate the actual volume of AfT for DAC members, since it does not disaggregate the trade component of projects that have trade and non-trade objectives. Hence, the development of improved databases on AfT is needed.

The empirical literature tends to confirm that AfT can be effective at both the macro and the micro level. However, its impacts may vary considerably depending on the type of AfT intervention, the income level and geographical region of the recipient country and the sector to which AfT flows are directed.

These findings have important policy implications. Indeed, the empirical evidence suggests that highly targeted AfT flows may be particularly effective in enhancing trade performance. More precisely, trade facilitation and Aid for Trade-related infrastructure are found to have significant positive impacts on recipient countries' exports. Moreover, among the different types of AfT flows, lower-income economies appear to benefit especially from Aid for Trade-related infrastructure. Finally, SSA is

one of the regions that could benefit the most from AfT, implying that greater efforts should be directed towards this region.

In summary, the review of the existing econometric research on the effectiveness of AfT shows four key issues that need to be addressed:

- evidence on the impact of specific AfT interventions or instruments is limited;
- differences in AfT effectiveness by productive sector have been taken into account to only a limited extent;
- evidence on the actual effects of AfT at the micro level is scanty; and
- databases on AfT need to be improved.

The literature survey also highlights that:

- AfT tends to be positive and economically relevant; and
- the impact of AfT is different depending on the type of intervention, the income level and geographical region of the recipient country and the sector to which AfT flows are directed.

In the light of the above, for future research it is worth analysing further the impact of different AfT instruments as well as investigating the sectors to which AfT flows should be directed to be more effective. Moreover, empirical analysis is required on how different country characteristics, such as institutional quality and different donor strategies, affect the effectiveness of AfT. More studies on the effectiveness of AfT at the micro level are also needed.

Annex 2.1 Summary of estimation methodologies and technical aspects of econometric studies

	AfT variable(s)	AfT data sources	Econometric technique(s)	Country coverage	Time horizon	Sector coverage
Busse et al. (2011)	1. Total AfT	OECD CRS database, aid disbursements	Panel data (fixed effects)	99 developing countries (including 33 LDCs)	2004–09	
	2. AfT policy and regulations			Countries grouped into LDCs and non-LDCs		
	3. AfT facilitation			Top 20 recipients and others		
Cali and te Velde (2010)	1. AfT facilitation	OECD CRS database, aid disbursements	Panel data (GMM)	130 developing countries regions	2005–09	Agriculture (including forestry and fishing); manufacturing; mining; tourism
	2. AfT policy and regulation					Agriculture; manufacturing
	3. Aid to economic infrastructure					
	4. Aid to productive capacity					
Brenton and von Uexkull (2009)	Product specific export development programmes	OECD/WTO Doha Development Agenda trade capacity-building database and data received from German Development Cooperation (GIZ) on technical assistance projects	DID, fixed-effects Poisson	48 developing countries	1975–2005	

(continued)

Annex 2.1 Summary of estimation methodologies and technical aspects of econometric studies (continued)

	AfT variable(s)	AfT data sources	Econometric technique(s)	Country coverage	Time horizon	Sector coverage
Ferro et al. (2011)	Aid targeting service sectors	OECD CRS database, aid disbursements	OLS	132 developing countries	2002–08	5 service sectors: transport; ICT; energy; banking/financial services; business services
Gourdon et al. (2011)	A single export promotion instrument (matching grant)	Official Registry of Firms in Tunisia and firm-level survey data	DiD	Countries grouped by income and geographical 1 developing country (Tunisia)	2004 and 2008	
Helble et al. (2009)	1. AfT policy and regulation 2. AfT development and economic infrastructure 3. <i>Hard</i> trade facilitation 4. <i>Soft</i> trade facilitation	OECD CRS database	Fixed-effects panel data (gravity model)	172 developed and developing countries	1990–2005	n.a.
Ivanic et al. (2006)	1. Aid to infrastructure	OECD CRS database	Gravity model, CGE	Nearly all individual countries aggregated into the 90 regions of Version 6 of the Global Trade Analysis Project model	1988–2004	Primary agriculture; primary non-agriculture; processed agriculture; manufactures; advanced manufactures; services
	2. AfT development 3. AfT policy 4. Trade facilitation			Countries grouped into 7 regional sub-samples: developed countries; EAP; ECA; LAC; MENA; SAS; and SSA		
Lederman et al. (2010)	EPAS	Survey data	OLS, 2SLS, Heckman correction	103 developing and developed countries	2000–04	n.a.

(continued)

Annex 2.1 Summary of estimation methodologies and technical aspects of econometric studies (continued)

	AfT variable(s)	AfT data sources	Econometric technique(s)	Country coverage	Time horizon	Sector coverage
Portugal-Perez and Wilson (2010)	4 trade facilitation indicators constructed using factor analysis: 1. Physical infrastructure 2. ICT 3. Border and transport efficiency 4. Business and regulatory environment	20 primary indicators collected from Doing Business, WDI, WEF, Transparency International	2-stage Heckman selection model (gravity model), Tobit and Poisson regressions	101 developed and developing countries Countries grouped into different developing regions	2004–07	Fuels; ores and metals; manufactures; textiles
Vijil and Wagner (2010)	1. AfT policy and regulation 2. Aid to economic infrastructure	OECD CRS database, aid commitments	OLS and 2SLS	n.a.	2002–08	n.a.
Volpe Martincus (2011)	Export promotion programmes	National customs agencies	DID	6 LAC developing countries	2002–07	

Source: Author's elaboration from different sources

Notes

- 1 This chapter has benefited from extensive comments and feedback provided by Sheila Page (ODI Senior Research Associate). It was funded by the Bill & Melinda Gates Foundation as part of 'Development Progress', a four-year research project which aims to better understand, measure and communicate what has worked in development and why. The findings and conclusions contained within are those of the author and do not necessarily reflect the positions or policies of the Bill & Melinda Gates Foundation.
- 2 The basic classical gravity model of trade is given by the benchmark log-linearised econometric specification:

$$\ln(EXP_{ijt}) = \alpha_0 + \alpha_1 \ln(GDP_{it}) + \alpha_2 \ln(GDP_{jt}) + \alpha_3 \ln(POP_{it}) \\ + \alpha_4 \ln(POP_{jt}) + \alpha_5 \ln(DIST_{it}) + \varepsilon_{ijt}$$

where i stands for the source exporting country, j for the target importing country and t for the time period. ε_{ijt} is a normally distributed idiosyncratic error term, with mean 0 and variance σ_{ε}^2 . The dependent variable EXP_{ijt} represents the export flows from country i to country j at time t . Among the explanatory variables, GDP_{it} and GDP_{jt} measure the gross domestic product (GDP) of countries i and j in period t , respectively. The population is given by POP_{it} and POP_{jt} for each of the two countries. The distance between the exporting and importing countries is given by $DIST_{ij}$, which represents trade costs or market frictions.

- 3 The simplest DID specification is as follows: $\gamma_{it} = \beta_0 + \beta_1 X_i + \beta_2 T_t + \beta_3 X_i \times T_t + \varepsilon_{it}$, where X_i is a dummy variable that takes the value of 1 if the individual/firm/country is in the treatment (in our case the treatment is AfT) group, and 0 if it is in the control group. T_t is a dummy that takes the value of 1 during the post-treatment period and 0 before the treatment period. The interaction term between X_i and T_t (β_3) corresponds to our DID outcome.
- 4 A normal CES utility function is $U_j = [\sum_i^R n_i x_{ij}^{(\sigma-1)/\sigma}]^{\sigma / (\sigma - 1)}$, $\sigma > 1$, where σ is the elasticity of substitution between products, n_i represents a set of varieties produced in country i and x_{ij} would be country j 's consumption of a variety from n_i .

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Chapter 3

Towards a Quantitative Assessment of Aid for Trade

Massimiliano Calì and Dirk Willem te Velde

3.1 Background and motivation

Aid for Trade (AfT) has moved up both the aid and trade agendas. Several studies have described the rationale for AfT, but it is now time to move beyond the descriptive stage and analyse the needs and design its implementation. A key motivation behind the research presented in this paper is that there is a lack of good quantitative evidence on (i) actual AfT flows in countries¹ and (ii) the possible effects of AfT.²

This study is designed to provide an understanding of whether and how AfT can help developing countries trade and improve their economic performance. It also illustrates the scope and limitations of a quantitative approach towards AfT, and should be read in conjunction with a study of whether AfT flows can actually be measured (Turner 2008).

The chapter discusses the effects of AfT. There are two ways of defining the scope of this question. The first is to focus on the AfT initiative adopted by the World Trade Organization (WTO) during the Doha negotiations. This now has legal status as a WTO agreement. Specifically, the AfT Task Force argued that developing countries 'expect Aid-for-Trade to go well beyond the scope of the IF' (WTO 2006). The Integrated Framework (IF) performs trade diagnostics rather than supporting productive capacities or infrastructure. The Task Force identified six categories of AfT and builds upon the definitions used in the WTO/OECD trade-related and capacity-building database (WTO 2006): trade policy and regulations; trade development; trade-related infrastructure; building productive capacity (including private sector development); trade-related adjustment (including support for adjustment associated with changes in international trade regimes); and other trade-related needs.

On this definition, AfT contributes to the provision of governance public goods, such as trade rules (to help countries implement and benefit from multilateral trade liberalisation) and regional public goods, such as cross-border infrastructure facilities (to facilitate intra-regional trade). Such effects could be measured by volume of funds and the emergence of new cross-border initiatives such as corridor approaches.

However, this focuses on a different way of examining the effects of AfT. This approach recognises that donor countries were already providing this form of aid long before the Aid for Trade (upper-case) label was introduced. Therefore, we should be able to address whether or not AfT has any impact using historical data on trade-related aid,

as collected by the OECD. (This is, of course, subject to the reliability of reporting by donors to the OECD.)

The chapter is organised as follows. Section 3.2 examines how AfT is expected to affect trade, growth and economic performance more generally. Section 3.3 suggests an empirical framework and describes the data used to test the theoretical hypotheses. Section 3.4 provides new empirical results. Section 3.5 sets out the policy implications and suggests directions for future research.

3.2 The effectiveness of Aid for Trade

3.2.1 Expected pathways

We first discuss why certain types of aid should produce particular effects on trade, so that we can propose hypotheses and assess the relevance of empirical patterns in the context of AfT. Table 3.1 identifies potential market and governance failures affecting the development of trade and suggests policy responses to address these failures. It identifies whether a proposed response could be assisted by an AfT package and what part of the package would be relevant to the task (on the basis of its current classification in the Organisation for Economic Co-operation and Development (OECD) Credit or Reporting System (CRS) aid statistics).

Table 3.1 suggests that, if employed effectively, AfT can improve trade policy co-ordination (*AfT category*: trade development); develop standards to improve access for exports (*AfT category*: trade facilitation); improve skill formation (*AfT category*: trade-related adjustment); improve infrastructure (*AfT category*: trade-related infrastructure); and overcome governance failures, such as weak institutions or weak administrative procedures (*AfT category*: trade policy and rules).

AfT also has a number of other more indirect effects. For example, the shift to giving trade priority in aid spending aims to put more emphasis on economic development and the supply side. The share of aid going to economic infrastructure decreased dramatically after a mid-1990s donor consensus that social sectors had to be supported (Figure 3.1).

The actual macroeconomic effects of aid depend on the functioning of a number of channels, e.g. whether the exchange rate appreciates as a result of inflationary expansion, so that exports decline, or whether aid actually improves trade competitiveness through better infrastructure. From an economic point of view, if more support goes to investment and productive uses, rather than to consumption or other projects with less growth potential, this will help to remove or reduce the Dutch disease effects of increased aid. This is confirmed by Adam and Bevan (2006). They use a computable general equilibrium model to show that aid-funded increases in public investment yield potentially large medium-term welfare gains, as public infrastructure investments offset short-run Dutch disease effects.

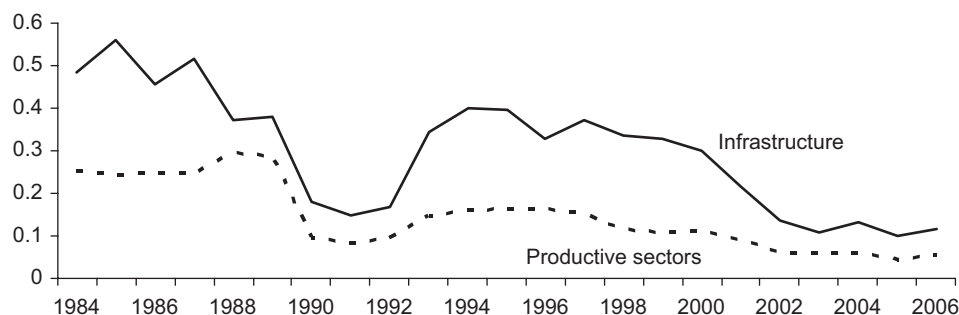
We do not have enough information to predict what channels may be relatively more important for trade-related outcomes. Our hypothesis is that both the direct and indirect effects of AfT are potentially important in stimulating competitiveness and exports.

Table 3.1 How Aid for Trade can address market and governance failures

Broad source/area of failure	Examples of failures	Responses: policies and activities	Role for Aft?
Market failures			
Co-ordination	Externalities ignored. Linkages not exploited.	Capacity building for trade policy to identify linkages and externalities. National trade strategy	Yes, training and institutional development
Developing, adapting and adopting technology	Complementarities not exploited Incomplete and imperfect information. Network externalities	Facilitate technology transfer and adoption. Support for quality control to meet export standards	Yes, trade facilitation. Assisting co-ordination with the private sector
Skills formation	Under-investment in training due to inability to appropriate externalities (in training workers) due to imperfect information	Better co-ordination and/or subsidies for training. Strengthen information flows	Mostly not included under Aft. Could be included in trade-related adjustment
Capital markets	Difficult access to credit	Credit schemes	Normally not included under Aft
Access to finance	High interest rates	Formal sector subsidy based on improved information about borrowers	
Infrastructure	Lack of good-quality infrastructure because lumpy investment gets postponed in uncertain times	Provide incentives for public–private partnerships. Provide grants in the case of low financial return/high economic return	Yes, aid to economic infrastructure and better co-ordination with development finance institutions/private sector
Governance failure			
Regulatory and administrative structure	Burdensome administrative requirements	Streamline administrative procedures and regulation	Yes, trade policy and regulations (especially trade facilitation)

Source: Adapted from te Velde (2008)

These effects are the product of a complex causality chain running from aid to country outcomes and mediated by domestic policy-makers, implementation agencies, policies and country conditions. Bourguignon and Sundberg (2007) define this chain as a ‘black-box’, as models usually do not include the actual way. ‘If a dollar of aid produces little discernible change, was the objective ill-defined, the service delivery

Figure 3.1 Share of total aid to economic infrastructure and productive sectors

Source: OECD CRS disbursements

inefficient, bureaucratic measures inadequate, or was money diverted?” (Bourguignon and Sundberg 2007: 317). This problem applies to our analysis as well, but it is less significant than for models which estimate a relationship between aid and growth, as here we identify the links between AfT and specific outcomes.

These outcomes can be linked directly to certain types of AfT, for example trade-related administrative support, or they can be linked less directly, for example the impact of aid for infrastructure on the values of exports and imports, which are also influenced by many other factors. Moreover, some outcomes can be clearly measurable (e.g. streamlined administrative procedures could be measured through the cost of processing an export), whereas others are less easily measurable (e.g. improved trade policy co-ordination). We will try to measure the impact of different types of AfT on measurable outcomes, direct and indirect.

3.3 Empirical literature on aid effectiveness

There is a large empirical literature on the macro relationships between aid, growth and investment, although not specifically on the effects of AfT. This literature tries to investigate the effects of aid on growth on the basis of a neoclassical growth model, where aid provides a boost in capital accumulation and thus to growth.³ The findings of this literature have been at best mixed, with no consensus on the direction of the effects, let alone on their size.

Consider first the effects of general aid. Burnside and Dollar (2000) argue that aid has no identifiable additional effect on growth once other factors have been accounted for, including economic policies. Aid raises growth only in countries with ‘good’ policies. Hansen and Tarp (2001) use different econometric specifications and find that aid is effective and that the results do not depend on policy. In a number of recent studies, Rajan and Subramanian (2005; 2008) use longer time spans and show that the impact of aid on growth is less positive. Rajan and Subramanian (2005) use an innovative strategy to examine the impact of aid across sectors within one country. In this way, they can better control for omitted variables bias or model specification. Their main

finding is that aid has systematic adverse effects on a country's competitiveness, which is reflected in a reduction of the share of labour-intensive and tradable industries in the manufacturing sector. They suggest that these are Dutch disease effects, related to the real exchange rate overvaluation caused by aid inflows. Using a large panel of countries and instrumentation strategy to correct for the bias in conventional ordinary least squares (OLS) estimation, Rajan and Subramanian (2008) do not find any positive relationship between aid and growth.

After analysing 97 different empirical studies on the impact of aid on growth, Doucouliagos and Paldam (2007) conclude that the impact of aid on growth is not significant. A number of factors may explain the inconclusiveness of these research efforts. Bourguignon and Sundberg (2007) argue that these mixed results are not surprising, given the heterogeneity of aid motives and the complex causality chain linking foreign aid to growth. Further, the impact of aid might depend on domestic economic policies, institutions and other conditions. Hansen and Tarp (2001) point to the lack of a satisfactory theoretical framework underpinning the empirical analysis. The simple neoclassical growth model of capital accumulation does not offer a framework to derive an exact empirical specification for a very complex relationship such as the one between aid and growth. Moreover the direction of causality (from aid to growth or vice versa) is to some extent still an unresolved issue.

There are number of studies that disaggregate aid by type or category. McPherson and Rakowski (2001) use a multi-equation system and find that the impact of aid on gross domestic product (GDP) per capita growth is positive but indirect through investment. Also emphasising that aid affects growth through investment, Gomanee et al. (2002) find on the basis of 25 sub-Saharan African countries in the period 1970–97 that every 1 percentage point in the ratio of aid to gross national product (GNP) contributes one-third of 1 percentage point to growth.

Clemens et al. (2004) split aid into different types and identify the types of aid that could plausibly stimulate growth in the short run. These include budget and balance of payments support, investments in infrastructure and aid for productive sectors. The study finds that this type of aid has a large positive effect on short-term growth: a US\$1 increase in aid raises the present value of output by US\$8, although this effect decreases at the margin. These results survive a number of checks for robustness, but they are based on a short time horizon (1997–2001).

A few studies have quantified the effects of infrastructure provision from trade and growth and all find a positive correlation. François and Manchin (2007) estimate a large panel of bilateral trade flows over the period 1988–2002 for a number of countries and focus on the effects of communications and transport infrastructure. They estimate that an increase of one standard deviation (from the mean) in the communications infrastructure raises the volume of trade by roughly 11 per cent, compared with a 7 per cent effect on transport infrastructure and a 2 per cent effect on trade for tariffs. For least developed countries (LDCs), transport is more important than communications. The effects of communications infrastructure on trade grow as a country reaches the middle-income range. Buys et al. (2006) find

that upgrading a primary road network connecting the major 83 urban areas in sub-Saharan Africa would expand overland trade within the region by around US\$250 billion over 15 years. Other studies have quantified the positive relation between infrastructure and growth, although they have been unable to properly address the problem of causality (e.g. Canning et al., 1994; Canning 1998). It seems natural to hypothesise that more aid to infrastructure should foster growth and exports.

By focusing our analysis on AfT, we can depart from the aid–growth conundrum by isolating the impacts of specific types of aid on specific outcomes. The rationale and objectives behind AfT are clearly narrower than those behind general aid, and this should allow a more precise identification strategy. We test for the effects of total trade-related aid and specific types of AfT on trade-related outcomes, including the costs of trading and the level of exports.

3.4 The effects of Aid for Trade: an empirical framework

We use two broad ways of assessing the impact of AfT: its effect on the costs of trading and on exports.

3.4.1 Aid for Trade and the costs of trading

First, we estimate whether particular types of AfT have affected trade costs as measured by investment climate indicators at the macro level, such as the time taken by customs to clear imports and exports, and the cost of exporting and importing goods across countries and over time (conditional on other variables). These variables measure separately the time and the costs (in US dollars) of handling and transporting a 20-foot container to (or from) the port of departure (or entry). In the case of costs, these include costs for documents, administrative fees for customs clearance and technical control, terminal handling charges and fees for in-country transport. The cost measure does not include tariffs or trade taxes. Only official costs are recorded. These cost and time variables capture the efficiency with which exports and imports are handled only *within* the country of interest. For instance, in the case of exports, procedures start after the goods are packed at the factory and include all official costs until the goods' departure from the point of exit. For imports, procedures start when goods are unloaded from a vessel at the port of entry, or when the vehicle carrying them has crossed the border, and go on until delivery at the factory or warehouse. Therefore, these measures are not affected by the degree of isolation of the country (e.g. its distance from its trading partners), as the costs of transporting the goods from (or to) the point of departure (or destination) are excluded. This analysis is important, as the costs faced and the time taken by firms to trade goods are significant determinants of a country's competitiveness. Djankov et al. (2006) find that each additional day that a product is delayed before shipping reduces trade by at least 1 per cent.

The equation we test at the macro level is:

$$\ln(IC)_{i,(2008)}^Z = \alpha + \beta_1 \ln(1 + Atpr)_{i,(2006)} + \beta_2 \ln(IC)_{i,(2007)} + \Gamma Z_i + \varepsilon_i \quad (3.1)$$

where IC is an investment climate indicator (country i , indicator z), $Atpr_{(2006)}$ is AfT policy and regulation (in thousands of US dollars) lagged two years, and Z is a vector of other determinants of IC . We use $\ln(1 + Atpr)$ to avoid missing and negative values.⁴

Specification (3.1) tests whether this type of AfT does indeed determine significant changes in the procedural costs of and the time taken to trade across borders. This is a direct test, as a substantial part of $Atpr$ is aimed at reducing the costs of trading across borders.⁵ In particular, AfT facilitation is one of the parts of $Atpr$ specifically targeting the reduction of these types of costs.

According to the data description by WTO/OECD (2008):

trade facilitation relates to a wide range of activities such as import and export procedures (e.g. customs or licensing procedures); transport formalities; and payments, insurance, and other financial requirements [...] Cutting red tape at the point where goods enter a country and providing easier access to this kind of information are two ways of ‘facilitating’ trade.

We will also test the effects of AfT facilitation on IC variables.⁶ We relate the IC variable in 2008 to the AfT regressor in 2006, as the former is measured at the beginning of the year to which it refers.

Other investment climate indicators which may also affect trade include variables such as being landlocked, income levels, size of the country and governance indicators from Kaufmann et al. (2007). Kaufmann indicators measure perceptions of the effectiveness of government. Income levels are important because higher levels are associated with better institutions and rules. The size and geographical status of countries clearly affect trade costs.

3.4.2 Aid for Trade and exports

Second, we will estimate the effects of AfT on exports directly, using an augmented export demand equation which includes AfT. We need to justify adding (aid to) infrastructure and productive capacities to an export demand equation. Better infrastructure and capabilities should improve productivity and hence prices, which would be reflected in the standard specification. However, as this normally measures relative prices by the real effective exchange rate based on the consumer price index, and the demand for exports depends on trade prices (production prices in the source country plus the costs of transporting the product to the other country), a reduced form equation includes aid to infrastructure and productive capacities because these types of aid affect the costs of trading via infrastructure and developing trade.

For example, better infrastructure, better marketing links or improved standards should make it easier to trade, but they tend to be excluded from traditional export and import demand equations:

$$\ln(E)_{it} = \alpha_i + \gamma_1 \ln(1 + Apc)_{it-1} + \gamma_2 (1 + Ai)_{it-1} + KEZ_{it} + \lambda_i + \varepsilon_{it} \quad (3.2)$$

where E is the volume of exports (country i , time t), Apc is aid for productive capacity and Ai is aid for economic infrastructure, α_i country effects, λ_t estimation period effects and Z a vector of controls, including relative prices and a measure of international demand.

Specification (3.1) has a number of potential problems that may bias the results, including omitted variable bias, owing to unobserved cross-country heterogeneity, and potential endogeneity of the AfT variable (e.g. if better-reforming countries tend to receive more aid). Specification (3.2) is less subject to omitted variable bias than (3.1), as it controls for time-invariant country characteristics (such as geography, location and history). However, this specification still suffers to some extent from omitted variable bias of cross-country regressions due to time-varying differences across countries.

To overcome these problems, we use a strategy based on inter-sectoral and intra-sectoral (over time) differences in exports. We divide aid to productive capacities into aid to the different sectors and then relate sectoral aid to sector-specific exports. This helps to identify whether sectors in the same country that receive more aid experience relatively faster growth in their exports (between-group component), as well as whether exports of a sector grow faster in years in which that sector receives relatively higher levels of aid (within-group component). The main advantage of this strategy is that it allows us to control for all time-varying within-country factors that may influence exports, such as effective demand, policies, size of the economy, economic fundamentals and country-level shocks. Because of this, we can also use value of exports as the dependent variable instead of real exports (as in specification (3.2)), which allows us to have more observations. We use four large sectors of the economy for which export data (from the World Development Indicators) are available: food production, manufacturing, mineral extraction and tourism. These account for all exports of goods and part of the exports of services of the countries in the panel. We match these sectors with their counterparts in the aid data: agriculture and fishing, industry, mining and tourism.

We estimate the following equation:

$$\ln X_{ijt} = \alpha_{it} + \delta_1 \ln Apc_{ijt-1} + \delta_2 \ln(Apc_{ijt-1})^2 + \phi \Delta \ln X_{ijt-1} + \lambda_{jt} + \varepsilon_{ijt} \quad (3.3)$$

where X is the value of exports (for country i , sector j and time t), Apc is aid to productive capacity, α_{ij} is country-year fixed effects, λ_{jt} is time-varying sector fixed effects and ΔX is the proportionate rate of growth of exports in country i and sector j in the previous period. The last variable serves to control for the endogeneity of aid, i.e. if aid for productive capacity may also be allocated on the basis of the growth of exports.

3.4.3 Data

We employ data from a variety of sources. Aid data are taken from the OECD CRS database on disbursements. This database has covered a number of AfT activities

since the mid-1970s; reporting to the CRS is improving and improvements are being made to the data. We use different types of AfT data from this database, including Aid for Trade policy and regulations, aid for productive capacity (both total and sectoral) and aid for economic infrastructure. These categories, as well as the basic structure of the database, are described in Box 3.1. We have also used the WTO/OECD (2008) database for trade facilitation data. This was a joint effort by the OECD and WTO, and covered a large number of trade-related technical

Box 3.1 Aid for Trade data in the OECD CRS database

The OECD Development Co-operation Directorate bases its classification of the destinations of aid on the specific area of the social or economic structure in the receiving country that the aid transfer is intended to foster. The categories therefore refer to the overarching goal (e.g. trade facilitation), rather than the service provided through the funds (e.g. funding of regional trade agreements (RTAs) or training). The system of purpose codes summarises this classification in five digits: the first three refer to the respective DAC5 sector, and the remaining two represent numbering from more general (10–50) to more specific (60–90).

- **Ainf** *Economic Infrastructure*, coded as number 200, includes transport and storage, communications, energy, banking and financial services, and business and other services, each with its own sub-components.
- **Apc** *Production sectors*, coded as 300, includes the four sectors treated separately: agriculture–forestry–fishing, industry–mining–construction, trade policy and regulations, and tourism.
- **Atpr** *Trade Policy and Regulations*, coded as 331, is composed of trade policy and administrative management, trade facilitation, regional trade agreements, multilateral trade negotiations, trade-related adjustment and trade education/training. The same holds true for tourism, which has only one final component: tourism policy and administrative management. The other destinations for sectoral aid for productive capacity all have multiple ramifications and are further focused. Under the category agriculture–forestry–fishing, *agriculture* (coded 311) has 18 final components, ranging from the general agricultural policy and administrative management (31110) to specific livestock/veterinary services (31195). The same applies for *fishing* (313), which incorporates five possible destinations for aid. The category industry–mining–construction has among its sub-sections *industry* (321) and *mineral resources and mining* (322), which we use for proxying aid to manufacturing and minerals sectors respectively in the analysis below.

Source: OECD CRS website; see also Turner (2008)

assistance projects between 2001 and 2006.⁷ As the OECD CRS is likely to become the standard for AfT data collection, we use data from WTO/OECD only for robustness checks.

Data on investment climate indicators have become available for a large number of countries through the World Bank reports *Doing Business*. These surveys cover the number of documents, and the time and costs required to change a certain regulation (e.g. in relation to registering property or dealing with licences). We focus on indicators for trade across borders provided in *Doing Business* (see Appendix 3.1). For total export data, we construct real exports series using IMF (2008) data on values and unit values, and we extract sectoral export data (in current US dollars) from World Bank (2008). We also use the real effective exchange rate from the IMF (2008) and the volume of world imports or GDP from World Bank (2008).

3.5 Empirical results

Table 3.2 presents the estimation results of the equation for costs of trading (exporting first) in 2008. We focus on this variable because it has an obvious relation to trade, but it is straightforward from a statistical point of view to examine some other indicators as well. The costs of trading variables are not particularly suitable for constructing time series, because of issues of data availability, so we focus on one year. We estimate equation (3.1) for a cross-section of around 120 developing countries.

There are a number of important findings. Aid to productive capacities ($Atpr$) has a mildly negative effect on the costs of exporting, but is not significant when it is used in a parsimonious specification with only the total size of the economy as a control (column 1).

The results are not in line with expectations, but they are not surprising given the way the cost index is constructed. The index includes the official costs for transport from the factory to the point of departure. These are likely to be much larger for a factory situated in a landlocked country. The small effect of $Atpr$ on that specification is probably because of omitted variable bias, as its coefficient becomes larger and highly significant (at the 1 per cent level) when other important variables relating to costs of exporting are added (column 2). These include a good governance indicator, which reduces costs of exporting, income per capita, which reduces costs of X , although it is not significant, and a dummy for being landlocked, which significantly increases the cost of exporting.

The coefficient of the size of the economy remains negative, but becomes insignificant in column 2. This suggests that the cost-reducing effect recorded in column 1 was probably due to that variable capturing a negative effect of income per capita (which is an indicator of better governance indicators). The cost reduction associated with an increase of 1 per cent in $Atpr$ is considerable at around 0.136 per cent of the costs of exporting. Put differently, an increase of US\$15,000 in $Atpr$ (from the mean of US\$1.48 million) is associated with a reduction of US\$1.80 (from the mean of US\$1,324) in the costs of packing goods and loading them into

Table 3.2 Explaining costs of exports (1n of US\$ per container in 2008)

Sample	(1) All	(2) All	(3) All	(4) <i>Tpr06</i> > 0	(5) All	(6) All	(7) Africa	(8) Africa	(9) All
Aid for trade policy and regulation									
Log (1 + <i>TPR</i>) ₂₀₀₆	-0.062 (1.01)	-0.136 (2.83) ^c	-0.089 (2.60) ^b	-0.109 (2.82) ^c	-0.080 (1.90) ^a	-0.085 (1.76) ^a	-0.072 (2.11) ^b	-0.040 (0.75)	-0.075 (2.33) ^b
Log (1 + avg <i>TPR</i>) ₂₀₀₅₋₀₆	-0.053 (2.53) ^b	-0.013 (0.63)	0.017 (1.52)	0.025 (1.75) ^a	0.016 (1.38)	0.018 (1.34)	0.005 (0.25)	0.002 (0.12)	0.015 (1.32)
Log GDP ₂₀₀₆		-0.173 (2.29) ^b	-0.062 (1.18)	-0.070 (1.09)	-0.063 (1.21)	-0.063 (1.27)	0.014 (0.42)	0.004 (0.11)	-0.067 (1.26)
Governance ₂₀₀₆		-0.040 (0.94)	-0.004 (0.14)	-0.005 (0.17)	-0.002 (0.07)	-0.005 (0.22)	-0.042 (1.57)	-0.033 (1.05)	0.002 (0.09)
Log GNI per capita ₂₀₀₄		0.489 (5.19) ^c	0.090 (1.88) ^a	0.116 (1.83) ^a	0.090 (1.87) ^a	0.100 (1.70)	0.109 (1.01)	0.112 (1.02)	0.097 (1.93) ^a
Landlocked			0.837 (13.90) ^c	0.816 (11.11) ^c	0.839 (13.59) ^c	0.830 (11.79) ^c	0.878 (8.62) ^c	0.881 (8.45) ^c	0.841 (14.07) ^c
Log (X cost) ₂₀₀₇					-0.120 (1.04)	-0.110 (0.81)	-0.201 (1.30)		
Egypt									
Asia						-0.028 (0.71)			
America						0.024 (0.40)			
Europe						-0.050 (0.50)			
Constant	7.208	7.255	1.143	1.295	1.114	1.202	1.152	1.057	1.072
Observations	129	120	119	97	119	119	49	49	119
R-squared	0.07	0.42	0.86	0.85	0.86	0.86	0.90	0.90	0.86

Robust *t*-statistics in parentheses; ^asignificant at 10 %; ^bsignificant at 5 %; ^csignificant at 1 %; dependent variable is 1n (1 + cost of exporting)₂₀₀₈

a 20-foot container, transporting them to the port of departure and loading them onto the vessel or truck.

The results for column 2 may be biased by reverse causality if, for example, more efficient procedures for handling exports lead to countries receiving more *Atpr*.⁸ To deal with this issue, we include in the regression the costs of exporting index lagged one year (for 2007) (see column 3). The coefficient of *Atpr* remains highly significant to this addition and it is the only variable which does not experience a reduction in its level of significance. These results are also robust to the restriction of the sample to countries for which a positive value of *Atpr* is reported (column 4). This robustness check is important to verify that results are not driven by potential misreporting. That would be the case if, for instance, countries which appear not to have received any *Atpr* are in fact just non-reporting countries. The cost-reducing effect of *Atpr* holds also when a dummy for Egypt (by far the largest *Atpr* recipient in our sample) is included, and dummies for the main continents (columns 5 and 6).⁹ The effect of *Atpr* in Africa is slightly lower than for the whole sample (column 7), and it appears to be mainly driven by Egypt (column 8). If Egypt is included as an additional variable, *Atpr* does not have a significant effect. This calls for a closer evaluation of the effects of this type of aid on African countries. Finally, the results are robust to the use of the average value of *Atpr* between 2005 and 2006, to excluding the possibility that cross-country year-to-year fluctuations of aid are not driving the findings (column 9). The high values of R-squared for columns 3–9 suggest that these regressions are well specified, explaining up to 86 per cent of the cross-country variability in the changes of the costs of exporting.

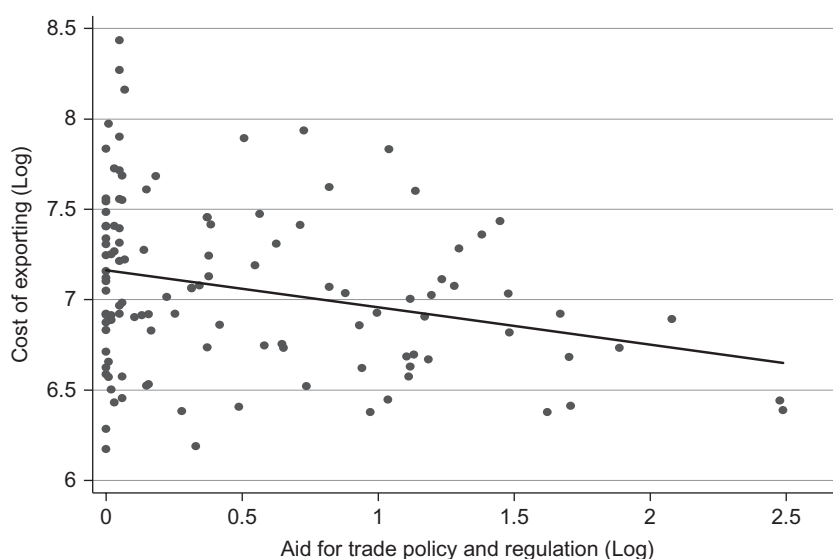
Figure 3.2 suggests that the negative relationship found in the regressions is not due to the presence of outliers or influential observations (Egypt is excluded from the picture).

The relationship shown in the graph is conditional on the control variables found in Table 3.2 (column 6).

3.5.1 Costs of importing, and time of exporting and importing

We carried out additional tests to check if our findings are robust to the use of other dependent variables as well as to other main regressors. Table 3.3 presents the results. The results of Table 3.2 hold when using costs of importing (rather than exporting) as the dependent variable (columns 1 and 2), and the coefficient of *Atpr* is very similar to (only slightly smaller than) that of Table 3.2.

Higher *Atpr* is associated with decreases in the time taken to export goods (column 3). The results in column 4, where a control for the number of documents is added, suggest that this result is not driven by a lower number of documents to be processed. These results for time (to export) do not apply to the same extent to dynamic specifications. Adding the time taken for exporting in 2007 (column 5) makes the coefficient of *Atpr* insignificant and reduces its value substantially (although it is still negative). This suggests that *Atpr* does not significantly affect changes in time to export, which is rather explained by other control variables, such as governance, the size of the economy and being landlocked. This case is confirmed in the case of Africa (column 6).

Figure 3.2 Conditional relation between costs of exporting and *Atpr*

The negative effect of AfT on the costs of exporting is confirmed by the use of Aid for Trade facilitation (a sub-category of *Atf*) in place of *Atpr*. Unlike the latter, this variable has a non-linear U-shaped relationship with the costs of exporting (as suggested by the difference in the coefficient's significance between column 7 and 8). This implies that *Atf* reduces the cost at a diminishing rate up to a trough, after which it even increases it. This is consistent with the idea of diminishing returns to aid already found by other studies (e.g. Hansen and Tarp 2001; Clemens et al. 2004). This relationship is robust to restricting the sample to those countries which report positive levels of *Atpr* (column 9), but not when using the time of exports as the dependent variable (column 10). In the latter case the relation appears negative and linear, although not significant.¹⁰

3.5.2 Aid for Trade and exports

Macro analysis

We use a standard export demand equation as in equation (3.2), where the volume of exports depends on relative prices and the demand for exports. We proxy these two variables through the real effective exchange rate (REER) and world GDP, respectively. We employ two aid measures: aid to economic infrastructure and aid to productive capacities.

Table 3.4 presents the results of the analysis. Aid for productive capacity (*Apc*) has an insignificant effect on real exports (column 1), while world demand is highly and positively related to real exports and REER has the expected negative sign but is

Table 3.3 The effects of Aid for Trade on other trade cost variables

Dependent variable	(1) Log (M cost) ₂₀₀₈	(2) Log (M cost) ₂₀₀₈	(3) Log (X time) ₂₀₀₈	(4) Log (X time) ₂₀₀₈	(5) Log (X time) ₂₀₀₈	(6) Log (X time) ₂₀₀₈	(7) Log (X cost) ₂₀₀₈	(8) Log (X cost) ₂₀₀₈	(9) Log (X cost) ₂₀₀₈	(10) Log (X time) ₂₀₀₈
Sample	All	All	All	All	All	Africa	All	All	<i>Tpr06 > 0</i>	All
AfT policy and regulations										
Log (1+ <i>Atpr</i>) ₂₀₀₆	-0.074 (2.67) ^c	-0.078 (2.54) ^b	-0.088 (2.13) ^b	-0.082 (2.02) ^b	-0.019 (0.79)	-0.014 (0.53)				
Aid for trade facilitation (narrow)										
Log (1+ <i>Atf</i>) ₂₀₀₆							-0.009 (0.87)	-0.047 (1.68) ^a	-0.076 (1.96) ^a	-0.010 (1.42)
Log (1+ <i>Atf</i>) ₂₀₀₆ sq.								0.004 (1.60)	0.006 (1.99) ^b	
Log GDP ₂₀₀₆	0.011 (1.10)	0.012 (1.12)	0.015 (0.93)	0.011 (0.71)	-0.016 (1.87) ^a	-0.007 (0.63)	0.008 (0.74)	0.010 (0.92)	0.021 (1.35)	-0.013 (1.73) ^a
Governance ₂₀₀₆	-0.045 (1.27)	-0.044 (1.30)	-0.160 (2.70) ^c	-0.131 (2.20) ^b	-0.063 (2.22) ^b	-0.045 (1.22)	-0.075 (1.26)	-0.076 (1.27)	-0.084 (1.20)	-0.065 (2.00) ^b
Log GNI per capita ₂₀₀₄	-0.003 (0.20)	-0.005 (0.36)	-0.092 (2.53) ^b	-0.089 (2.46) ^b	0.037 (1.90)	0.007 (0.63)	0.009 (0.36)	0.007 (0.26)	0.007 (0.22)	0.032 (1.53)
Landlocked	0.062 (2.38) ^b	0.070 (2.38) ^b	0.484 (6.20) ^c	0.448 (5.64) ^c	0.108 (2.98) ^c	0.069 (1.49)	0.117 (1.76) ^a	0.126 (1.83)	0.138 (1.62)	0.115 (3.10) ^c
Log (M Cost) ₂₀₀₇	0.911 (29.63) ^c	0.904 (26.54) ^c								

(continued)

Table 3.3 The effects of Aid for Trade on other trade cost variables (continued)

Dependent variable	(1) Log (M cost) ₂₀₀₈	(2) Log (M cost) ₂₀₀₈	(3) Log (X time) ₂₀₀₈	(4) Log (X time) ₂₀₀₈	(5) Log (X time) ₂₀₀₈	(6) Log (X time) ₂₀₀₈	(7) Log (X cost) ₂₀₀₈	(8) Log (X cost) ₂₀₀₈	(9) Log (X cost) ₂₀₀₈	(10) Log (X time) ₂₀₀₈
Sample	All	All	All	All	All	Africa	All	All	<i>Tpr06 > 0</i>	All
Log (X time) ₂₀₀₇					0.851 (14.30) ^c	0.881 (13.27) ^c				0.851 (13.96) ^c
Log (X Cost) ₂₀₀₇							0.836 (11.94) ^c	0.833 (11.76) ^c	0.815 (9.26) ^c	
Log (X Docs) ₂₀₀₇				0.271 (2.14) ^b	0.064 (1.19)	0.130 (1.52)				0.061 (1.13)
Asia		-0.011 (0.38)	0.056 (0.84)	0.048 (0.75)	0.003 (0.13)		-0.019 (0.52)	-0.016 (0.44)	-0.015 (0.34)	0.017 (0.61)
America		0.012 (0.25)	-0.087 (0.99)	-0.073 (0.87)	-0.023 (0.55)		0.021 (0.34)	0.031 (0.53)	0.012 (0.18)	-0.012 (0.29)
Europe		-0.041 (0.56)	-0.460 (2.39) ^b	-0.428 (2.16) ^b	-0.089 (1.26)		-0.000 (0.00)	-0.036 (0.32)	0.069 (0.30)	-0.080 (1.05)
Egypt						-0.292 (3.05) ^c			-0.358 (8.18) ^c	
Constant	0.637	0.698	3.791	3.255	0.083	0.053	1.061	1.172	1.356	0.139
Observations	119	119	120	120	119	49	118	118	97	118
R-squared	0.93	0.94	0.61	0.63	0.93	0.96	0.85	0.85	0.85	0.93

Robust *t*-statistics in parentheses

^aSignificant at 10 %

^bSignificant at 5 %

^cSignificant at 1 %

Table 3.4 Real exports and Aid for Trade (1984–2006)

Sample	(1) REER available	(2) REER available	(3) All	(4) REER available	(5) All	(6) All	(7) All	(8) Ai and $Apc > 0$	(9) All	(10) Africa
Aid for productive capacities										
Log $(1+Apc)_{t-1}$	-0.025 (1.31)	-0.038 (1.77) ^a	-0.007 (0.54)				-0.038 (2.74) ^c	-0.049 (4.07) ^c	0.354 (2.13) ^b	-0.041 (1.39)
Aid for infrastructure										
Log $(1+Ainfra)_{t-1}$				0.033 (1.35)	0.059 (4.00) ^c	-0.131 (3.75) ^c	-0.120 (3.34) ^c	-0.169 (3.99) ^c	-0.129 (3.96) ^c	-0.121 (1.21)
Log $(1+Ainfra)_{t-1}$ sq.						0.035 (6.40) ^c	0.035 (6.55) ^c	0.026 (4.24) ^c	-0.026 (0.81)	0.044 (1.86) ^a
Log REER	-0.017 (0.26)	-0.024 (0.31)		-0.012 (0.16)						
Log World GDP	1.242	(16.44) ^c								
Log $(1+Apc)_{t-1} \times$ world GDP									-0.070 (2.29) ^b	
Log $(1+Ainfra)_{t-1} \times$ world GDP									0.010 (1.87) ^a	
Constant	-2.670	4.922	4.261	4.696	4.144	4.225	4.190	5.247	2.864	3.514
Year effects	NO	YES	YES	YES	YES	YES	YES	YES	YES	YES
Country effects	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	466	497	1468	497	1468	1468	1468	457	1009	350
Number of countries	44	44	82	44	82	82	82	43	81	26
R-squared	0.48	0.49	0.53	0.49	0.54	0.55	0.55	0.71	0.59	0.47

Robust *t*-statistics in parentheses

^asignificant at 10 %

^bsignificant at 5 %

^csignificant at 1 %

not significant (column 1). When we rerun the same regression using year effects, the coefficient for aid for productive capacity becomes more negative and mildly significant, while the coefficient for REER is insignificant (column 2).

This negative result for *Apc* is driven by the restricted sample we are using (44 developing countries), which is constrained by the availability of REER data. Given the insignificance of the REER coefficient (which is also orthogonal to the aid variable), we drop it, and the *Apc* coefficient then becomes insignificant (column 3).

The effect of restricting the sample to countries for which REER data are available is even more distorting when we use aid to economic infrastructure (*Ainf*). With this restricted sample, this variable exerts an insignificant effect on exports (column 4); this positive effect becomes much larger (and the coefficient highly significant) when we use the full sample (column 5).

The impact of *Ainf* on exports appears to be highly non-linear and U-shaped (column 6). This type of relationship is confirmed when both aid variables are included (column 7). In this case, *Apc* appears to exert a negative and significant impact on real exports, whereas *Ainf* has a negative and then a highly positive effect on exports. The latter effect may be explained through the lumpiness of the investment in economic infrastructure. If this investment is insufficient, the infrastructure would not reduce export prices and thus stimulate exports.

It is more difficult to explain the negative coefficient of *Apc*. It is possible that this effect is driven by omitted variable bias due to unobserved time-varying heterogeneity across countries (e.g. specific country shocks) or by problems with the identification strategy; in other words, *Apc* has mainly sectoral effects and considering its impact on the whole of exports may be misleading. Of course it could also be the case that this type of aid is not actually spent effectively and actually harms exports via Dutch disease-type effects by subsidising inefficient production within the country.

The positive effects of aid to infrastructure are clearer for non-African countries than for African countries. These results are robust to the exclusion of country-year pairs for which a value of zero for both types of aid is reported (column 8). These effects appear to be magnified when world demand is higher (negative and significant effect for the interaction between *Apc* and world demand and positive and significant effect for the interaction between *Apc* and world demand (column 9)). Finally, the results for Africa are qualitatively in line with those of the whole sample but less robust (column 10). The most important findings are that different types of aid can have different effects and that these vary across regions.

Sectoral analysis

The surprising impact of *Apc* on exports suggests problems in the type of specification used to estimate the equations in Table 3.4. In order to deal with these issues, we adopt the specifications based on equation (3.3), analysing the impact of sectoral aid on sectoral exports. We study how the inter-sectoral, as well as intra-sectoral (over time), variation in aid and exports is related, using data from four sectors: food production, manufacturing, mineral extraction and tourism.

The results are clear and show a robust, positive and non-linear effect of Apc on exports. In line with the results shown in Table 3.3, as well as with other findings on the impact of aid on growth (e.g. Hansen and Tarp 2001; Clemens et al. 2004), this relationship has the shape of an inverted U. Aid has a positive impact on exports at a diminishing rate.

These results are robust to a variety of specifications, control variables and sampling strategies. Tables 3.5 and 3.6 show that they are robust to the inclusion of country and sector–year fixed effects (columns 1–3), country–year fixed effects only (column 4) and both country–year and sector–year fixed effects (columns 5–13). They are also robust to using different types of samples: including only observations with positive values of Apc ; including all observations (columns 7 and 8); and including only years after 1990 (columns 6 and 7). The power of the results also holds when including a lagged change in export variables (which has a highly negative association with the dependent variable). This controls for a potential source of endogeneity in aid allocation, as discussed above. Moreover, Apc also has a positive (although only at 10 per cent) impact on the rate of export growth (column 11, where a lagged export variable is included). The effect of Apc is around 50 per cent larger when country–year fixed effects are included, instead of only country effects (see columns 1 and 5), confirming that time-varying country-specific effects (e.g. policies, shocks and state of the economy) play an important conditioning role in determining the impact of aid on exports.

There are a number of other interesting findings from the regressions reported in Tables 3.5 and 3.6. First, aid to economic infrastructure appears to exert a positive and significant effect on exports (columns 2–3). Such an effect is linear, unlike that found in regression (2) and reported in Table 3.4.¹¹ Moreover, $Ainf$ appears to interact with Apc in affecting exports in a non-linear way (columns 10 and 12). Apc has a smaller positive impact for higher levels of $Ainf$, although the effect of this interaction changes as Apc increases, becoming positive for high levels of Apc . This suggests that positive complementarities between these two types of aid tend to emerge for relatively large amounts of Apc . Such complementarities appear to be positive in the case of landlocked economies (column 12).

The effects of Apc are relatively more important in supporting exports in mining and manufacturing than in tourism and agriculture (column 13). This suggests that the more capital-intensive sectors (such as mining and manufacturing) are also the ones where the lack of domestic resources has most penalised developing countries. Aid can thus play a role in helping to move the comparative advantage of (certain) developing countries away from non-capital-intensive sectors.

3.6 Policy implications and future research

This chapter has a number of key findings. We have argued that AfT should affect trade directly or indirectly by improving the investment climate in which trade takes place. We found that AfT can have a positive effect on investment climate indicators. We found that AfT that falls into the category of trade policy and regulations has helped to reduce the costs of trading, controlling for a number of other factors such as

Table 3.5 Sectoral exports and sectoral aid for productive capacity (1985–2006)

(1) Sample $Apc > 0$	(2) $Apc > 0$	(3) $Apc > 0$	(4) $Apc > 0$	(5) $Apc > 0$	(6) $Apc > 0$ and post-1990	(7) post-1990
Aid for productive capacities						
$\text{Log}(1 + Apc)_{t-1}$	0.446 (7.93) ^c	0.438 (7.75) ^c	0.624 (8.23) ^c	0.658 (8.21) ^c	0.710 (8.62) ^c	0.629 (8.72) ^c
$\text{Log}(1 + Apc)_{t-1} \text{ sq.}$	-0.049 (4.14) ^c	-0.048 (4.09) ^c	-0.071 (4.38) ^c	-0.073 (4.28) ^c	-0.078 (4.58) ^c	-0.090 (5.67) ^c
Aid for infrastructure $0.055 \text{ } 0.035 \text{ } \text{Log}(1 + \text{Ainf})_{t-1} \text{ (2.74)}^c \text{ (1.75)}^a$						
Manufacturing			0.646 (11.11) ^c			
Minerals			-1.120 (9.68) ^c			
Tourism			0.561 (5.73) ^c			
$\Delta \text{Export}_{t-1}$			-0.030 (6.02) ^c			
Country effects	YES	YES	YES	YES	YES	YES
Country-year effects	NO	NO	NO	YES	YES	YES
Sector-year effects	YES	YES	YES	YES	YES	YES
Constant	16.701	16.659	19.129	18.549	18.494	18.721
Observations	3647	3595	3647	3647	3340	6176
R-squared	0.79	0.79	0.84	0.84	0.83	0.79

Robust *t*-statistics in parentheses

^asignificant at 10 %

^bsignificant at 5 %

^csignificant at 1 %; dependent variable is log of export value (in current US\$)

Table 3.6 Sectoral exports and aid for productive capacity, developing countries (1985–2006)

Sample	(8) All	(9) $Apc > 0$	(10) $Apc > 0$	(11) $Apc > 0$	(12) $Apc > 0$	(13) $Apc > 0$
Aid for productive capacities						
$\text{Log}(1 + Apc)_{t-1}$	0.492 (7.16) ^c	0.622 (8.55) ^c	0.976 (5.77) ^c	0.033 (1.89) ^a	0.614 (3.74) ^c	0.480 (2.78) ^c
$\text{Log}(1 + Apc)_{t-1}$ sq.	−0.068 (4.47) ^c	−0.072 (4.54) ^c	−0.156 (3.39) ^c		−0.167 (3.87) ^c	−0.060 (1.34)
$\Delta \text{Export}_{t-1}$		−0.038 (6.10) ^c			−0.038 (5.93) ^c	
$(Apc \times Ainf)_{t-1}$			−0.081 (2.31) ^b	−0.006 (0.99)	−0.076 (2.32) ^b	−0.034 (1.00)
$(Apc \text{ sq.} \times Ainf)_{t-1}$			0.020 (2.31) ^b	0.000 (0.53)	0.023 (2.88) ^c	−0.004 (0.51)
$\text{Log}(\text{export})_{t-1}$				0.948 (62.50) ^c		
$Apc \times Ainf \times$ landlocked					0.069 (3.65) ^c	
$Apc \times \text{America}$					0.381 (4.02) ^c	
$Apc \times \text{Asia and}$ Oceania					0.201 (2.07) ^b	
$Apc \times \text{Africa}$					0.280 (2.84) ^c	
$Apc \times \text{Mineral}$						0.436 (4.13) ^c
$Apc \times$ Manufacturing						0.380 (8.18) ^c
$Apc \times \text{Tourism}$						−0.060 (0.57)
Country–year effects	YES	YES	YES	YES	YES	YES
Sector–year effects	YES	YES	YES	YES	YES	YES
Constant	18.220	18.807	18.931	1.095	18.820	19.176
Observations	9963	3216	3595	3375	3167	3595
R-squared	0.77	0.85	0.84	0.98	0.85	0.84

Robust *t*-statistics in parentheses^asignificant at 10 %^bsignificant at 5 %^csignificant at 1 %; dependent variable is log of export value (in current US\$)

governance generally, being landlocked and income status. This is a key policy finding because it shows that AfT is effective where it aims to be effective (subject, of course, to the quality of reporting by donors to the OECD CRS database).

The results are clear and show that *Apc* has a robust, positive and non-linear effect on exports. In line with the results shown in Table 3.3, as well as with other findings on the impact of aid on growth (e.g. Hansen and Tarp 2001; Clemens et al. 2004), this relationship has the shape of an inverted U. Aid has a positive impact on exports at a diminishing rate. The second finding is that it is more difficult to establish a direct relationship between AfT, especially aid to productive capacity, and total exports. We have undertaken a number of regressions which tend to suggest that different types of aid affect exports differently, hence the difficulty in finding an aggregate effect in the literature. However, on closer inspection, it seems that aid to productive capacity must be modelled by sector, whereas aid to infrastructure has a positive or negative effect depending on empirical specifications.

To overcome this problem, we employ a new strategy based on inter-sectoral and intra-sectoral (over time) differences in exports. We divide aid to productive capacities into aid to the different sectors and then relate sectoral aid to sectoral exports. The identification comes from analysing if sectors that receive more aid than other sectors in the same country experience relatively faster growth in their exports (between-group component), as well as if exports of a sector grew faster in years in which that sector received a relatively high level of aid (within-group component). The main advantage of this strategy is that it allows us to control for all time-varying country factors which may influence exports, such as effective demand, policies, size of the economy, economic fundamentals and country-level shocks. The results based on this new identification strategy are clear and show there is a robust, positive and non-linear effect of *Apc* on exports.

The chapter examines other aid categories and new dependent variables. There are a number of policy implications:

- There are a number of pathways through which AfT affects trade.
- AfT has significant and measurable effects in reducing the cost of trading, which is an important investment climate indicator relevant to exporting.
- Although the effects of AfT on exports are more ambivalent depending on the specification used, when properly specified, AfT does foster exports in productive sectors, up to a point.
- Aid for infrastructure has significant positive effects at both macro and sectoral levels.
- Aid for Africa (if Egypt is excluded) has smaller, and sometimes insignificant, results.

The chapter extends the literature on aid and growth by showing that refining the aid category into sub-groups related to AfT and examining effects at a more disaggregated level yields significant results. It started the impact assessment of trade-related aid

using a number of outcome variables, as well as different measures of aid. Many extensions of the analysis are possible based on available data, which may bring about further insights into the effects of different types and modalities of aid on different countries, regions and variables. We propose some of these extensions below.

1. One possible extension could be to run a similar analysis to that in Table 3.2, but with panel data to control for country-specific time-invariant effects. This would make estimation of the cost-effectiveness of this type of aid more precise.
2. It would also be possible to examine the effects of aid on specific regions and countries, performing the analysis in equation 3.3 on a sub-set of countries, such as small islands, landlocked economies, Africa, African, Caribbean and Pacific countries or less developed countries, and also on countries which differ in terms of economic specialisation. The methodology described in Section 3. 2 is robust enough to also extract consistent policy implications for fairly small sub-sets of countries. This is important, given the apparently varying effects.
3. Provided that the data in the OECD CRS database do not suffer from classification error at fairly disaggregated levels, we could slice the data further by purpose code and examine the effects of different types of specific trade-related aid on the investment climate and exports.
4. We could examine the impact of AfT on other types of dependent variables, such as the real exchange rate, to test if and to what extent this aid can prevent Dutch disease-type effects.
5. There is a need for more analysis and data on the ‘trading climate’ so that the type of analysis set out in this chapter does not need to rely on data collected for investment analysis.

Appendix 3.1 Defining ‘Trading Across Borders’

Source: www.doingbusiness.org/MethodologySurveys/TradingAcrossBorders.aspx (accessed January 2012).

Doing Business compiles procedural requirements for exporting and importing a standardised cargo of goods by ocean transport. Every official procedure for exporting and importing the goods is recorded – from the contractual agreement between the two parties to the delivery of goods – along with the time and cost necessary for completion. All documents required for clearance of the goods across the border are also recorded. For exporting goods, procedures range from packing the goods at the factory to their departure from the port of exit. For importing goods, procedures range from the vessel’s arrival at the port of entry to the cargo’s delivery at the factory warehouse. Payment is made by letter of credit.

Local freight forwarders, shipping lines, customs brokers and port officials provide information on required documents and cost as well as the time to complete each procedure. To make the data comparable across countries, several assumptions about the business and the traded goods are used. Since 2007, assumptions have been refined

to adjust for particularities of landlocked countries and reduce variations related to documentation involving private parties. In the case of landlocked countries, any port-related data are based on information provided by the relevant sea port country. Inland transport costs are based on number of kilometres. Any documentation between the shipper and trader is excluded.

Assumptions about the business

- A business with 100 or more employees
- Is located in the country's most populous city
- Is a private, limited liability company; it does not operate within an export processing zone or an industrial estate with special export or import privileges
- Is domestically owned with no foreign ownership
- Exports more than 10 per cent of its sales.

Assumptions about the traded goods

The traded product travels in a dry-cargo, 20-foot, full container load. The product:

- Is not hazardous nor does it include military items
- Does not require refrigeration or any other special environment
- Does not require any special phytosanitary or environmental safety standards other than accepted international standards.

Measuring documents required to export and import

All documents required to export and import the goods are recorded. It is assumed that the contract has already been agreed upon and signed by both parties. Documents include bank documents, customs declaration and clearance documents, port filing documents, import licenses and other official documents exchanged between the concerned parties. Documents filed simultaneously are considered different documents but with the same time frame for completion.

Measuring time required to import and export

Time is recorded in calendar days. The time calculation for a procedure starts from the moment it is initiated and runs until it is completed. If a procedure can be accelerated for an additional cost, the fastest legal procedure is chosen. It is assumed that neither the exporter nor the importer wastes time and that each commits to completing each remaining procedure without delay. Procedures that can be completed in parallel are measured as simultaneous. The waiting time between procedures – for example, during unloading of the cargo – is included in the measure.

Measuring costs required to import and export

Cost measures the fees levied on a 20-foot container in US\$. All the fees associated with completing the procedures to export or import the goods are included. These

include costs for documents, administrative fees for customs clearance and technical control, terminal handling charges and inland transport. The cost measure does not include tariffs or trade taxes. Only official costs are recorded.

Notes

- 1 For instance, we found large disparities between the AfT data recorded by the Organisation for Economic Co-operation and Development (OECD) or the World Trade Organization (WTO) and the AfT data as recorded by ministries in each country (Cali 2007). The analysis also highlights the need for a better definition and a harmonisation of the categories used to record AfT, along with clear criteria for how to calculate the trade component in multipurpose projects. See also Turner (2008).
- 2 te Velde et al. (2006) argue in relation to the evaluation of European Commission (EC) trade-related assistance activities: 'there is generally little quantitative evidence provided – descriptive or analytical – which is a significant gap. The EC's own assessment was based on interviews and analysis of documents, with no quantitative estimation of the impact of these activities on trade and economic development.'
- 3 See Burnside and Dollar (2000) and Rajan and Subramanian (2008) for illustrations.
- 4 The main results are robust to using $\ln(AfT)$.
- 5 For instance, types of projects included in this category of aid include simplification and harmonisation of international import and export procedures (e.g. customs valuation, licensing procedures, transport formalities, payments, insurance) and support to customs departments.
- 6 We prefer to base the analysis on Aid for Trade policy and regulation data, rather than on Aid for Trade facilitation data for two reasons: first, the former encompasses a broader range of activities which may still be important in influencing the costs of trading across borders; second, the former data come from the OECD CRS database, which is likely to soon become the standard for AfT data (see below).
- 7 WTO/OECD reports on the WTO/OECD database and Cali et al. (2006) have discussed this database in detail to describe the pattern of past AfT spending by donors, recipients and category.
- 8 Such could be the case, for instance, if aid were allocated on the basis of the expected efficiency of its use (so that it would target relatively more efficient bureaucracies).
- 9 Oceania is included in Asia.
- 10 We test for nonlinearities, but the robust t -statistics for the coefficients of the linear and squared terms of AfT were 0.08 and 0.38 respectively (not reported here).
- 11 When we tried to include a squared term for $Ainf$, it made both terms jointly non-significant, according to an F-test.

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Chapter 4

Aid for Trade and the Integration of Small and Vulnerable Economies into the Global Economy

Massimiliano Calì, Mohammad A. Razzaque and Dirk Willem te Velde

4.1 Background

This chapter extends the assessment of Aid for Trade (AfT) to a special group of countries, known as the small and vulnerable economies (SVEs). SVEs are a group of developing countries facing some unique challenges related to their integration into the global economy.¹ This group mainly includes Caribbean and Pacific small and island states, whose exports tend to be concentrated in a few sectors and are extremely vulnerable to the volatile international markets.

Because of their small populations, the domestic market is small in these countries. As a result, most of the firms are small and medium-sized enterprises with limited opportunities for reaping the benefits of economies of scale and investing in research and development.² Also, most SVEs have a poor investment climate and weak institutions, are remote and lack skilled labour or adequate human capital; these problems limit access to external capital and constrain industrial development. Small states are also characterised by lack of competition in product markets. This leads to a misallocation of resources, inefficiencies in production and lack of incentives for innovation. Moreover, the small size of the domestic market often implies that production cannot enjoy economies of scale in most sectors. All these factors contribute to high unit production costs for firms in these countries. The high production costs are compounded by high transport costs due to the remoteness and insularity of many small states. This implies that SVEs need to charge higher prices to stay in business or else accept lower returns on some part of their costs than larger economies.

The vulnerability of small states to fluctuations in input and output prices is aggravated by their undiversified economic bases, which themselves are in many cases an outcome of their limited size and the scarcity of human capital. For most economies in the Pacific and Caribbean regions, the combined share of the first and second commodity/service is over 50 per cent in the total exports of goods and services. Many other small states in different regions exhibit a similar pattern, which indicates the higher vulnerability of these states to internal and external shocks.

In addition, in the context of wider integration, Mattoo and Subramanian (2004) argue that small states face systematic problems within the multilateral trading system despite acquiring significant influence in the system since the Uruguay Round. This is because of their limited bargaining power in trade negotiations and misalignment of their interests with those of the broader trade liberalisation agenda. Importantly, the cost of doing business in small states seems to be generally higher than in other

countries. In a Commonwealth Secretariat study, Winters and Martins (2005) find that business costs, particularly transport and labour, are significantly higher in small states.³ On average, micro (and very small) states face cost penalties ranging from 22 to 222 per cent relative to the median country. The authors argue that small consignment size, poor infrastructure, lack of competition and weak institutions inflate the costs of trade, and create such strong economic disadvantages for these countries.

In this context, well-designed trade-related assistance may help SVEs face the challenges posed by their characteristics. This is particularly the case during a time when the prospects for small states have deteriorated further because of (future) preference erosion and the emergence of new and large competitors (Briguglio et al. 2006). Many small economies are critically dependent on trade preferences that they have enjoyed for quite some time but are now being eroded because of the changing trade regimes in developed countries. There is evidence that some of these countries are likely to face severe consequences arising from further multilateral trade liberalisation. Given all this, a review of the small states agenda proposed in the Commonwealth Secretariat/World Bank Joint Task Force Report (2000) suggests the need for small states to reposition themselves in the global economy and move further into knowledge-based and service industries. Qureshi and te Velde (2008) suggest how this can be done, and AfT can play a role. The report also calls for a renewed effort of the donor community in helping small states address the challenges of an adjustment of the economy. It is worth pointing out that the scope of the World Trade Organization's (WTO's) AfT agenda comprises helping countries adjust to trade shocks and, given this, mitigating the loss in trade preferences through most favoured nation (MFN) tariff reductions by developed countries constitutes an interest of small states.

This chapter takes the issue of AfT in small states seriously. It sheds light on the extent to which SVEs have been able to access AfT funds and on whether or not and to what extent this assistance has helped SVEs improve their trade performance. It is organised as follows: Section 4.2 examines the rationale for AfT to SVEs by looking at the evolution of their significance in global trade, and the expected costs of adjustment from trade integration; Section 4.3 describes the programmes and institutions offering AfT and in particular to countries such as SVEs; Section 4.4 takes stock of the volumes and types of trade-related assistance that SVEs have received so far and compares them with other developing countries; Section 4.5 analyses how AfT could help developing countries integrate in the global economy through an export demand model with particular reference to SVEs and, furthermore, reviews some suggestive evidence on the effectiveness of AfT on trade-related performance; Section 4.6 provides empirical results associated with the impact of AfT on export performance in SVEs and other developing countries; and Section 4.7 concludes by drawing some policy implications for SVEs.

4.2 The rationale behind Aid for Trade in SVEs

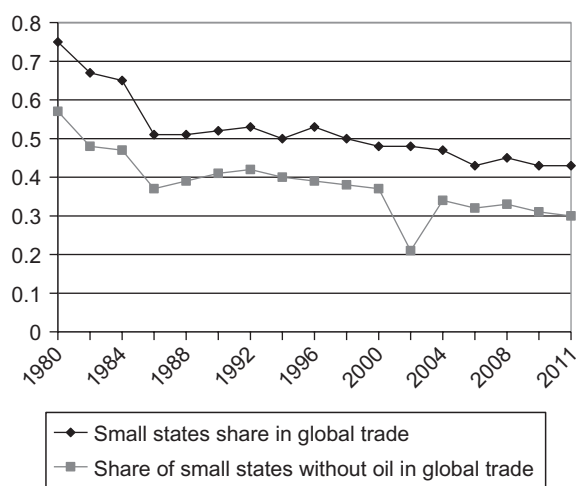
Until the recent economic slowdown, the global process of economic integration amongst countries intensified, underpinned by an unprecedented rise in volume of trade and capital flows and a reduction in barriers to worldwide trade and investment

activities. This drive to globalisation received substantial impetus from the birth of the WTO, providing specific trade rules and procedures, and promising further liberalisation in the world trade regime. Despite these developments there remain serious concerns that small states have failed to derive significant benefits from the process of trade liberalisation and globalisation.

The introductory section above has highlighted a number of overriding problems constraining the economic development of small states. Most of these problems would potentially constrain these countries' international competitiveness, preventing their effective participation in global trade. The trade data seem to confirm this fear, suggesting that over the years small states have become marginalised in global trade. During the period between 1980 and 2011, combined global share of total goods and services of the set of 43 small states in our list had fallen from 0.75 per cent to 0.62 per cent.⁴ When the five oil-exporting small states are excluded, the comparable share falls from 0.57 per cent to 0.3 per cent. The trends indicate sustained declining significance of small states. Even when considering only services trade, which is more important than merchandise trade for a number of small states, their declining significance cannot be overlooked. Small states' share in such trade has fallen from as high as 0.95 per cent in 1985 (when the first data on commercial services exports started to become available) to 0.7 per cent in 2011. When the set of Small Island Developing States (SIDS) is considered, the share falls from 0.58 per cent in 1980 to 0.21 per cent in 2012. Since the mid-1990s, both global merchandise and commercial services exports have grown on average at 10 per cent per annum, while merchandise exports from non-oil-exporting small states have registered a modest annual growth of only 6 per cent. The growth of commercial services exports from small states was also lower, at 8 per cent per annum. These figures are significantly lower than the average growth of merchandise and commercial services exports from least developed countries (LDCs), which are estimated to be about 18 and 10 per cent respectively over the same period of time (Cali et al. 2011).

Seventy per cent of the small states in our sample (i.e. 27 of the 39 countries referred to above) have a lower share in 2008 than in 1995. In the case of services, the corresponding share is 72 per cent (28 countries) (Cali et al. 2011). On the whole, small states' marginalisation in world trade remains unabated. Figure 4.1 shows that small states without the oil-exporting countries' share in global merchandise and commercial services have been subject to secular decline as it fell from 0.5 per cent in 1980 to 0.30 per cent in 2011.

Because of their inherent economic characteristics associated mainly with the small size of the domestic market, SVEs are more dependent on international trade for their growth and economic development. Indeed, the trade orientation in these countries is generally much higher than that of other developing countries. The mean ratio of exports to gross domestic product (GDP) in small states is about 55 per cent compared with less than 30 per cent for the world economies. Consequently, marginalisation of these economies in world trade could seriously jeopardise their growth and development. Along with the problem of smallness, which results in non-exploitation of increasing returns to scale in production and diversification opportunities into a

Figure 4.1 Exports and imports of goods and services, annual 1980–2011

Source: Authors' own estimates using UNCTAD data

wide range of activities, these countries also suffer from lack of productive capacity, trade-related infrastructures and adequate and effective trade policy and regulations. All this has contributed to dwindling comparative advantage, as reflected in their declining trade share. AfT has been specifically designed to address many of these issues and is thus extremely relevant to an international support regime that aims to foster beneficial participation of vulnerable countries in global trade.

Another 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. Amongst these, adjustment support for loss of trade preferences has become one of the most critical issues for many small and vulnerable economies. Calì et al. (2006) provide a review and summary of such estimates for a large sample of developing countries from which it is possible to compute the estimated losses for SVEs.

There are many estimates of these costs available, with those by the International Monetary Fund (IMF) and WTO probably the most consistent across countries and products. Gillson et al. (2004) has more detailed ones for sugar and bananas. We use various studies to provide the preference erosion figures reported in Table 4.1. The lower bound is obtained by adding two sets of estimates from WTO studies: Low et al. (2005) estimation of costs for non-agricultural products due to preference erosion and Low et al. (2006) estimation of costs for agricultural products due to preference erosion. The upper bound is computed by including additional estimates that use the highest figures for each country among the available lower bound estimates in Gillson et al. (2004), IMF (2003) and Alexandraki and Lankes (2004).

Table 4.1 Estimated costs by country of agricultural liberalisation and preference erosion (all figures in US\$ millions)

	Pref. Erosion NAMA – WTO est.	Pref. Erosion Agric. – WTO est.	Total Pref. Erosion – lower bound	Banana and sugar Pref. Erosion – high lib.	Pref. Erosion (IMF estimates)	Total Pref. Erosion – upper bound
	Low et al. (2005)	Low et al. (2006)	Low et al. (2005); Low et al. (2006)	Gillson et al. (2004)	IMF (2003) and Alexandraki and Lankes (2004)	All sources
SVEs						
Barbados	0.1	1.2	1.3	18.4		18.4
Belize	0.7	9.5	10.2	32.7	18	32.7
Botswana	0.8	5.8	6.6			6.6
Dominica		1	1	14.6	2	14.6
Fiji		6.7	6.7	55.5	41	55.5
Guyana		6.6	6.6	69.3	41	69.3
Jamaica	6.4	8.5	14.9	80.5	46	80.5
Mauritius	31	23.4	54.4	205.6	201	205.6
Papua New Guinea		4.9	4.9			4.9
St Kitts and Nevis		0.5	0.5		3	3
St Lucia	0.3	3.1	3.4	30.5	4	30.5
St Vincent and the Grenadines		1.9	1.9	22	5	22
Swaziland	11.9	5.6	17.5	41.1	21	41.1
Trinidad and Tobago		1.8	1.8	16.7		16.7
Cape Verde			0		0.9	0.9
Comoros			0		0.3	0.3
Eq. Guinea			0		1.3	1.3
Gambia, The			0		0.3	0.3

(continued)

Table 4.1 Estimated costs by country of agricultural liberalisation and preference erosion (all figures in US\$ millions) (continued)

	Pref. Erosion NAMA – WTO est.	Pref. Erosion Agric. – WTO est.	Total Pref. Erosion – lower bound	Banana and sugar Pref. Erosion – high lib.	Pref. Erosion (IMF estimates)	Total Pref. Erosion – upper bound
	Low et al. (2005)	Low et al. (2006)	Low et al. (2005); Low et al. (2006)	Gillson et al. (2004)	IMF (2003) and Alexandraki and Lankes (2004)	All sources
Guinea	0.2		0.2		1.6	1.6
Lesotho	30.1		30.1			30.1
Maldives			0		2.8	2.8
São Tomé and Príncipe			0		1.1	1.1
Seychelles			0		10	10
Solomon Islands	0.1		0.1		2.5	2.5
Vanuatu			0		1.9	1.9
Total SVEs	81.6	80.5	162.1	586.9	404.7	654.2
Others						
Albania	1.2		1.2		10	10
Bolivia		0.7	0.7			0.7
Cameroon	1	29.8	30.8			30.8
Cuba			0			0
Dom. Rep.	139.2	21	160.2		100	160.2
El Salvador	110.5	2.5	113			113
Ghana		0.6	0.6			0.6
Guatemala	141.7	1.9	143.6			143.6
Honduras	167		167			167
Jordan			0			0
Kenya	14	5.8	19.8	1.3		19.8
Namibia	10.7	6.5	17.2			17.2
Nicaragua	31	1.2	32.2			32.2

(continued)

Table 4.1 Estimated costs by country of agricultural liberalisation and preference erosion (all figures in US\$ millions) (continued)

Sri Lanka		0.1	0.1	22.7		0.1
Zimbabwe	1.9	3	4.9			22.7
Angola	0.3	0	0.3		21.1	21.1
Bangladesh	61.6	0.1	61.7		222.4	222.4
Benin			0		0.3	0.3
Burkina Faso		1.6	1.6		0.3	1.6
Burundi			0		1	1
C. d'Ivoire	25.3	22.1	47.4	3.7	69	69
Cambodia	18.8		18.8		53.6	53.6
Cen. Afr. Rep.			0		0.7	0.7
Chad			0		0.1	0.1
DRC		0.1	0.1	0.7	0.8	0.8
Egypt		1.4	1.4			1.4
Ethiopia			0		15.4	15.4
Guinea B.			0		0.2	0.2
Haiti	21.7		21.7		3.9	21.7
Liberia			0		3.4	3.4
Madagascar	19.1		19.1	5.6	8.6	19.1
Malawi	2	0.8	2.8	13.9	48.6	48.6
Mali			0		0.1	0.1
Mauritania	1.7		1.7		40.4	40.4
Morocco			0		152	152
Mozambique	5.5		5.5		5.7	5.7
Myanmar	8.3		8.3		2.2	8.3
Nepal			0		17.8	17.8
Nigeria	1.3	0.1	1.4			1.4
Pakistan		2.7	2.7			2.7
Peru		8.4	8.4			8.4
Senegal	3.6	0.5	4.1		23.6	23.6
Serbia and M			0		45	45
Sierra Leone	0.2		0.2		2.5	2.5

(continued)

Table 4.1 Estimated costs by country of agricultural liberalisation and preference erosion (all figures in US\$ millions) (continued)

	Pref. Erosion NAMA – WTO est.	Pref. Erosion Agric. – WTO est.	Total Pref. Erosion – lower bound	Banana and sugar Pref. Erosion – high lib.	Pref. Erosion (IMF estimates)	Total Pref. Erosion – upper bound
	Low et al. (2005)	Low et al. (2006)	Low et al. (2005); Low et al. (2006)	Gillson et al. (2004)	IMF (2003) and Alexandraki and Lankes (2004)	All sources
Sudan			0		6.9	6.9
Tanzania	1.2	1.4	2.6	5	28.9	28.9
Togo	0.2	0.1	0.3		1.3	1.3
Tunisia			0		146	146
Uganda	0.7	0.5	1.2		9.1	9.1
Venezuela	3.7	0.5	4.2		4.2	4.2
Zambia	0		0	5.5	5.5	5.5
Non-SVEs	793.4	113.4	906.8	58.4	1040.9	1708.1
SVEs (WTO)	669.4	153.6	823	610.9	492	1319.3
Non-SVEs (WTO)	205.6	40.3	245.9	34.4	953.6	1043
Total Pref. Erosion lower bound		1,069				
Total Pref. Erosion upper bound		2,362				

Cumulative value of countries' estimates from Low et al. (2005) and Low et al. (2006)
 Obtained by using the highest estimates for each country among the lower bound
 estimate, Gillson et al. (2004), IMF (2003) and Alexandraki and Lankes (2004)

Source: Adapted from Cali et al. (2006)

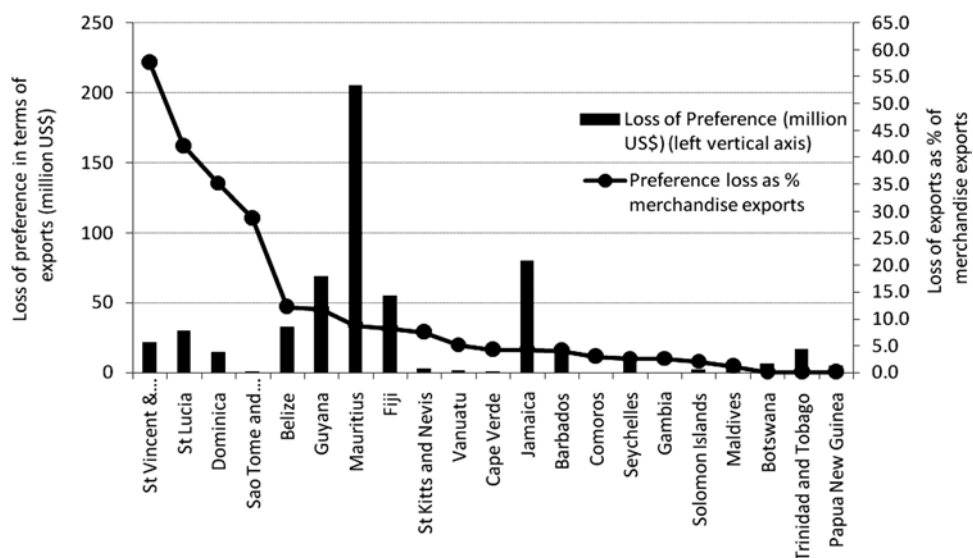
Different assumptions (regarding the liberalisation process and the methods of calculation) produce different losses and gains for countries. Our central estimates are mainly based on WTO studies, as they employ the most up-to-date methodology in terms of the assumptions about what an eventual multilateral trade liberalisation may involve. An important part of this methodology is related to the adjustment of preference margins for competition and for utilisation rates (where available). The first type of adjustment accounts for the competition effects resulting from other exporters' benefiting from the same preferential scheme or other forms of preferences. The resultant estimates will be lower than those that do not take such effects into account. If there is significant liberalisation, leading to entry into the market by countries that are currently completely excluded, this will underestimate preference erosion. The latter type of adjustment considers the actual rate of utilisation of preferences by exporters from developing countries. This adjustment is computed only for the exports of non-agricultural products to the US market.

The estimates provided by IMF are not directly comparable with the WTO estimates, as they use different methodologies. Therefore, some caution is required in comparing these. Note also that all estimates are based on partial information and static calculation; hence, they are potentially subject to various types of biases. One such bias is because the extent of gains or preferential margins that actually accrue to the exporters is not known. The share is likely to be less than the 100 per cent assumed by the studies (except for sugar, where the quota scheme ensures that countries receive the rents). Other issues are due to the lack of consideration of elasticities of substitution and of dynamic interaction.

The calculations relying only on WTO studies give total estimates for SVEs, including textiles and clothing and sugar, of about US\$162 million out of a total of US\$1,070 million. These are lower bound estimates on current maximum expectations for the Doha Round; taking an upper bound estimate would give a loss of US\$654 million for SVEs out of a total loss of US\$2,362 million a year for all developing countries in the sample. According to these estimates the expected costs from preference erosion for SVEs range between 15 per cent (lower bound scenario) and 28 per cent (upper bound scenario) of total costs for developing countries. Considering that the share of population of SVEs in total population in the sample of countries in Table 4.1 is only 2.3 per cent, SVEs are effectively expected to bear a much higher than proportionate share of the costs from preference erosion.

Amongst the SVEs in our sample, Mauritius, Jamaica, Guyana, Fiji, Belize and St Lucia are likely to suffer most in terms of absolute loss of exports due to preference erosion. When measured as proportion to respective countries' total merchandise exports, export losses turn out to be massive for St Vincent and the Grenadines (58 per cent), St Lucia (42 per cent), Dominica (35 per cent) and São Tomé and Príncipe (29 per cent), as shown in Figure 4.2.

We also estimate the same costs for the group of SVEs as defined in the WTO. This is a larger group and it is expected to face most of the estimated costs of preference erosion: between 77 per cent (lower bound scenario) and 56 per cent (upper bound) of total costs for the countries in the sample. Again, these shares are well above the share of the WTO SVEs group in total population (around 14 per cent). This

Figure 4.2 Loss of preference of some SVEs

is unsurprising given that the majority of SVEs are preference-receiving countries, and the preferences often allow them to obtain (much) larger market shares in the preference-conceding countries than in a liberalised regime.

4.3 SVEs accessing Aid for Trade

4.3.1 Main programmes of relevance for SVEs

Calì et al. (2011) came up with a list of a variety of AfT programmes relevant for addressing the needs of SVEs, the majority of which are of small size (below US\$200,000). This reflects the absence of infrastructure projects from the list, which are usually large as they may entail large capital investments. Conversely, the rest of trade-related assistance is inherently targeted to specific recipients (e.g. trade ministry, border-post authority, chamber of commerce) and does not usually include large fixed investments. On the other hand, projects of small size are more typical of the assistance to small economies, such as SVEs.

The larger projects on the list are those geared towards trade development, through strengthening both sectoral and general competitiveness, and towards assisting in the adjustment process following the preference erosion in key agricultural sectors, such as sugar, banana and rum. The latter programmes are funded by the European Commission and aim to strengthen the sectors that are going to be exposed to competition as well as to help diversify the economy away from those sectors. We review the strengths and weaknesses of some of those programmes below.

The **EU special fund for rum** was intended to help a sector damaged by trade reform in the EU. It was unusual in its direct assistance to the private sector. It attracted a high degree of regional ownership (private sector) and, because of this, showed some

success. It was, however, transitional and ended after the scheme's foreseen time of existence.

The **EU special framework for assistance for bananas** is an example of an assistance programme designed to meet the costs of countries that are damaged by trade reforms which could assist other developing countries. The programme faces the potential difficulties of choosing the most appropriate means of adjustment for sectors that start to be exposed to competition (see below a review of its effectiveness).

The **EU Action Plan for Sugar**, which from the beginning allowed for adjustment through increasing productivity, finding related production or a total change in production, thus attempted to avoid the problems of the banana scheme. Like the rum and banana schemes, it is an example of aid to provide adjustment assistance for countries which suffer losses because of trade reforms. It is an interesting precedent because it solves the problem that compensating African, Caribbean and Pacific (ACP) farmers for changes in European sugar policy is not strictly speaking aid by giving it a separate budget line: it uses grants and it bases eligibility on adjustment need, not on need for infrastructure.

The **Trade Integration Mechanism (TIM)** run by the IMF was established explicitly to deal with preference erosion, as implementation of the commitments made by the IMF and the World Bank before and at Cancún. As SVEs are among the largest losers of preferences (in relative terms), such a scheme may be particularly relevant to them. It is the clearest recognition by an international agency outside the WTO that there is a legitimate aid problem as a consequence of WTO obligations. It offers loans, rather than grants. Mitchell and Hoppe (2006) mention the IMF compensatory financing facility as another potential source of funds, but this also is based on loans (as part of the IMF), not grants.

Finally, as we mentioned above, the **Commonwealth Fund for Technical Co-operation (CFTC)** targets specifically SVEs, although it covers other areas than just AfT.

4.3.2 Eligibility criteria and implementation

Some programmes are aimed specifically at certain countries, for example the Enhanced Integrated Framework (EIF) for LDCs and the Joint Integrated Technical Assistance Programme (JITAP) for Africa. Others have certain specific requirements, such as the Millennium Challenge Corporation, which requires countries to demonstrate a commitment to policies that promote political and economic freedom, investments in education and health, the sustainable use of natural resources, control of corruption, and respect for civil liberties and the rule of law, as measured by 17 different policy indicators.

Virtually all donors require *ownership* as the main requisite to provide trade-related assistance to any countries. Trade needs to be prioritised in governments' planning documents, such as national and regional indicative programmes (NIPs and RIPs), in order for countries to receive AfT. An example of that is the criteria set out by the European Commission (EC) in its AfT strategy. The European Union (EU) and its member states claim that trade-related support can be made available only if it is taken up in the 'Country or Regional Strategy Papers' (CSPs/RSPs) as a priority. According

to the EC (2008) this would demonstrate that the country concerned considers trade-related assistance to be essential to its own national development agenda. The EC goes as far as stating that ‘the particular challenge in fulfilling the commitments undertaken in the EU’s AfT strategy is about how to create solid demand in Aid for Trade’ (EC 2008: 5). This donor-induced concept of ownership does not sit easily with the original spirit of the Paris declaration of genuine ownership.

Aside from ownership, programmes differ in terms of eligibility criteria and geographic implementation. Some information provided by Cali et al. (2011), for example, shows that funds emerged out of specific concerns, for example the Sugar Action Plan to provide payments to ACP Sugar Protocol countries that need to adjust after sugar sector reform, and the TIM to provide temporary cushions to deal with preference erosion. Others were more general, for example schemes focusing on growth and poverty reduction. There had been quite a few funds that address diagnostics of what trade measures are required (the Integrated Framework – IF – part of EC Trade Related Assistance, JITAP, etc.) but far fewer programmes address supply-side constraints directly or implementation costs of trade agreements.

This review suggests that only a handful of trade-related programmes are not available to some SVEs, such as the EIF (not available to non-LDC SVEs), JITAP and the Emerging Africa Infrastructure Fund (EAIF) (not available to non-African SVEs). On the other hand, some of the funds are particularly accessible to SVEs, as they target some of the trade-related needs specific to (some of) the SVEs, such as the EC Sugar Action Plan and Special Framework for Assistance (SFA) for bananas, the TIM and the Inter-American Development Bank (IADB) trade-related activities (directed in particular at smaller Latin American and Caribbean countries). Thus, despite the absence of a specific fund addressing all the special needs of SVEs, there seems to be plenty of scope to access AfT for SVEs that are able to articulate their trade-related needs consistently. The next section examines to what extent this potential for assistance has turned into *actual* AfT for SVEs in the past and what form this assistance has taken.

4.4 Aid for Trade flows to SVEs

AfT has been on the increase for the last few years. Table 4.2 shows the main recipients (in millions of US dollars) of AfT disbursements between 2006 and 2011. We can identify two major types of AfT beneficiaries: large countries and countries in post-conflict situations. Most of the major ten recipients are large low-income countries, including China, India, Indonesia, Vietnam, Ethiopia and Egypt. Also, large amounts of AfT (especially in the form of economic infrastructure) have been given in recent years to Iraq and Afghanistan, which were not major recipients of aid before being occupied by US-led forces. The first sub-Saharan recipient, Ethiopia, is in the eighth position, confirming a different (less trade-related) model of development assistance for sub-Saharan Africa than for Asia (see Cali 2007). SVEs receive small absolute amounts of AfT, and the largest recipient of AfT is Papua New Guinea, which is only the fifty-second among all countries. Others SVEs are further down in the ranking (below sixty-fourth position). This clearly points to the relevance of size in AfT (as well as general aid) allocation.

Table 4.2 Main recipients of Aid for Trade (disbursement in current US\$ million)

	Total 2006–11	2006	2007	2008	2009	2010	2011	Rank
India	11,091	1,159	1,268	1,905	2,064	2,463	2,232	1
Vietnam	9,174	1,026	1,376	1,358	1,502	1,843	2,069	2
Afghanistan	8,197	854	958	1,230	1,748	1,818	1,590	3
Iraq	6,903	3,042	1,710	788	373	487	503	4
Indonesia	5,837	921	844	1,092	905	1,214	860	5
China	4,456	859	945	943	660	543	505	6
Egypt	4,051	521	462	810	692	942	624	7
Ethiopia	3,959	533	522	573	1,086	594	650	8
Morocco	3,815	385	532	499	651	785	964	9
Turkey	3,349	353	319	674	826	774	403	10
SVEs								
Papua New Guinea	762	70	146	147	107	141	151	52
Cape Verde	529	50	48	101	77	166	87	65
Jamaica	305	26	43	76	71	56	32	81
Guyana	264	6	11	37	64	55	91	90
Vanuatu	185	6	17	50	56	38	18	98
Gabon	182	19	37	21	19	59	27	100
Gambia	180	15	17	17	35	36	59	101
Suriname	179	5	29	41	50	25	28	102
Solomon Islands	167	25	23	14	26	29	50	104
Islands								
Lesotho	133	16	19	22	13	26	38	108
Samoa	126	11	11	11	22	35	36	111
Botswana	104	12	15	11	24	27	16	114
Mauritius	93	2	14	4	24	18	30	116
Swaziland	91	19	11	12	13	10	27	117
Dominica	88	7	11	12	24	20	15	119
Kiribati	61	13	16	8	7	4	13	127
Fiji	57	12	9	8	6	10	11	129
São Tomé and Príncipe	49	6	6	9	3	6	19	131
TOTAL	172,111	21,972	24,063	27,768	30,758	34,361	33,189	
2006–2011								
TOTAL SVEs	3,555	320	483	601	641	761	748	

Source: Derived from data obtained from the OECD CRS database

In order to account for the importance of size in AfT allocation, we compute the values of AfT per capita received by beneficiaries. Table 4.3 presents the results. In fact this computation drastically changes the relative rankings of the major recipients, with small countries receiving proportionately more AfT. The main recipients in terms of per capita income are mainly small and very small islands in the Pacific and the Caribbean. Given this trend it is not surprising that SVEs receive relatively higher levels of AfT per capita. In fact 4 of the major 10 recipients and 12 of the major 20 are SVEs.

Table 4.3 Main recipients of Aid for Trade (disbursement in current US\$ per capita)

	2006	2007	2008	2009	2010	2011 ^p	2006–2011	Rank
St Helena	2,225.68	1,823.15	6,529.84	4,050.51	2,428.36	18,495.68	5,925.53	1
Montserrat	1,388.88	342.17	580.92	1,696.35	1,836.39	1,819.38	1,322.34	2
Nauru	1,085.56	1,083.32	1,473.48	881.32	97.51	97.01	786.37	3
Tuvalu	1,027.54	409.75	510.93	712.85	203.52	406.22	545.14	4
Palau	449.75	347.95	741.55	245.75	439.62	48.52	378.86	5
Wallis and Futuna	—	214.50	144.45	219.01	516.00	743.49	367.49	6
Anguilla	356.94	—	203.57	66.42	586.01	—	303.24	7
Dominica	101.89	160.73	176.06	353.35	295.17	221.65	218.14	8
Cape Verde	104.54	99.37	207.23	156.62	334.68	173.80	179.37	9
Mayotte	5.55	215.14	125.13	187.00	264.56	—	159.48	10
Tonga	59.06	136.91	48.58	115.92	355.57	162.67	146.45	11
Vanuatu	27.68	76.45	219.26	239.53	158.56	73.28	132.46	12
Samoa	60.85	60.68	60.50	120.61	191.17	195.79	114.93	13
Kiribati	138.99	168.34	82.87	71.41	40.18	128.59	105.61	14
St Vincent and G	27.54	91.69	174.03	118.97	36.59	82.29	88.51	15
St Lucia	23.95	41.47	76.19	115.97	137.71	62.48	76.30	16
Seychelles	83.05	23.54	35.06	121.79	57.79	80.57	66.96	17
Iraq	105.10	59.05	26.42	12.14	153.75	15.40	61.97	18
Suriname	9.90	56.85	79.60	96.18	47.65	52.89	57.19	19
Solomon Is.	51.76	46.33	27.44	49.61	48.31	91.20	52.44	20
St Kitts and Nevis	120.46	19.82	0	57.97	57.24	37.70	48.87	21
Antigua B.	35.31	0	11.51	22.78	78.91	122.25	45.13	22
S. Tome and P.	3.87	38.13	56.30	18.46	36.28	112.75	44.29	23
Grenada	9.71	9.67	19.28	28.82	95.71	95.34	43.09	24
Gabon	10.74	11.94	11.72	23.69	23.91	38.45	20.08	25

Source: Derived from data obtained from the OECD CRS database

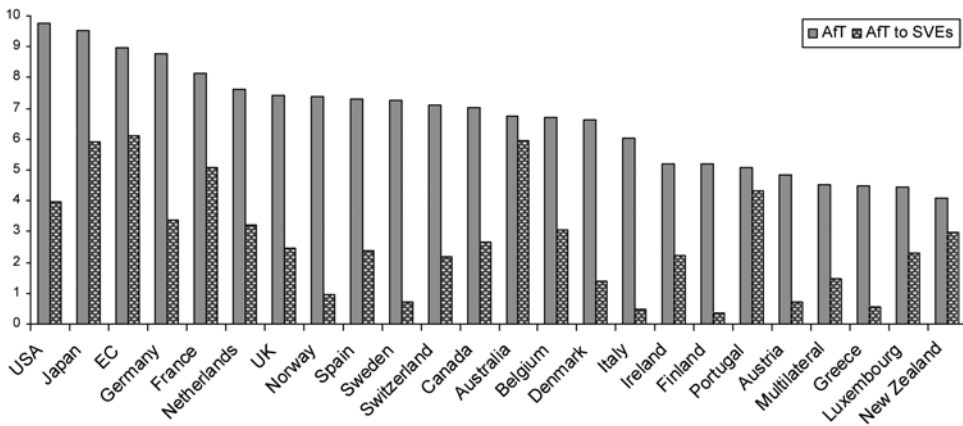
4.4.1 Current and past flows by donor

Cali et al. (2011) show the value of AfT disbursements by donors (in log scale) and the value going specifically to SVEs, with the USA being the largest donor between 2002 and 2007, mainly on account of the assistance provided in Iraq and Afghanistan for reconstruction (Figure 4.3). Taking away the US assistance, Japan became the largest provider of AfT, with the EC coming third, with member states Germany, France, the Netherlands, the UK, Spain and Sweden being important donors. The low share of multilateral donors is because they mainly manage funds provided by bilateral donors, while only a small part of their activities is funded directly by them. For Cali et al. (2011) the picture changed significantly when considering the trade-related assistance provided to SVEs, with the EC being the largest provider of AfT to SVEs in the 2002–07 period, followed by Australia and Japan. The USA, on the other hand, remained a fairly unimportant AfT donor for SVEs, preceded also by France and Portugal. As shown below, some countries prioritise assistance to certain SVEs, such as Australia, which funds activities in a number of SVEs in the Pacific region, and the members of the EC, which assist small states in the Caribbean and the Pacific through programmes aimed at diversifying their economies.

In order to understand the relative importance that donors attach to AfT, Cali et al. (2011) estimated the extent to which countries are specialised in this type of assistance by constructing a simple *index of specialisation* for all major aid donors (see Cali 2007). The index is the ratio of the share of a country in total AfT and the share of the country in total official development assistance (ODA):

$$S_i = \frac{AfT_i / \sum_{j=1}^n AfT}{A_i / (\sum_{j=1}^n A_j)} \quad (4.1)$$

Figure 4.3 Aid for Trade disbursements by donors (log of US\$ million)



Source: Cali et al. (2011)

where AfT_i and A_i are AfT (in US dollars) and total ODA for country i respectively, and n is the total number of donors.⁵ A value of the index greater than 1 indicates that the donor is spending proportionally more on AfT. Calì et al. (2011) report that Japan and the EC are the donors with the highest specialisation in AfT over the entire period 2002–07, although the intensity of this specialisation has been somewhat declining. The value for the EC is mainly driven by expenditure on trade policy and regulation and trade development, while Japan's value is the result of the focus on infrastructure in its development assistance strategy. Among the major donors, the United States has an index greater than 1 only since 2004, because of the shock in its aid pattern related to the reconstruction in Iraq and Afghanistan. All other main bilateral donors – except for Germany and Norway – have been spending little on trade-related assistance relative to general ODA, with Italy, France and the UK at the bottom of the list. The multilateral donors tend to have a specialisation in AfT quite consistently throughout the period.

4.4.2 AfT to SVEs

Calì et al. (2011) show the extent to which donors focus on SVEs in their AfT spending. Portugal, Australia and New Zealand devote a large share of their AfT to SVEs (around 40 per cent in 2007). In the case of the Oceanic countries, this is driven by the special attention granted to their neighbours in the Pacific, which are mainly small island developing countries, such as Papua New Guinea, Fiji, Samoa and Tonga. In the case of Portugal, the result is mainly due to its assistance to the former colony of Cape Verde. Among the major donors, the EC is the one providing the largest share of its AfT to SVEs (over 6 per cent of the total in 2007 and 5.7 per cent on average throughout the period).

The relative focus of donors on SVEs tells only part of the story about the largest providers of AfT to SVEs. Indeed Calì et al. (2011) show that the EC has been consistently the largest donor over 2002–07, with more than US\$150 million disbursed in 2007, almost double the amount of 2006. Australia and Japan are the other main AfT donors to SVEs, with the former more than doubling its assistance in 2007.

The above analysis has provided some rationale for external assistance to SVEs in the form of AfT. Thus it is worth asking whether SVEs are receiving relatively more or less aid as AfT. According to the specialisation index computed by Calì et al. (2011), SVEs have received roughly the same proportion of AfT as that of ODA over the 2002–07 period. These swings suggest that there may not be a long-term strategy in terms of AfT allocation across countries, and to SVEs in particular. This is also a result of shocks that may have a large impact on aid (including AfT) allocation decisions, such as wars, natural calamities and changes in market access.

4.4.3 Types of Aid for Trade provided to SVEs

In order to identify what type of AfT is directed to SVEs, we divide it into three main categories (as from the OECD/DAC database): aid for economic infrastructure, for productive sectors and for trade policy and regulation (TPR). The majority of the AfT funds accrues to economic infrastructure, as is the case for other developing countries as well. In terms of per capita aid, the ratio between SVEs and non-SVEs for the economic infrastructure category is similar to that of total ODA, while the same ratio

is higher for aid to productive sectors, suggesting that AfT is relatively more targeted to this type of assistance. The opposite is true for TPR, for which the ratio (although usually higher than 1) is much lower than for the other categories. A relatively important category of AfT for SVEs, that of trade-related adjustment, appears with no records at the time when this study is being prepared, perhaps suggesting that donors have not yet started to provide it.

In sum, the analysis suggests that small countries, and thus SVEs, receive higher per capita amounts of AfT, just like general aid. However, AfT to SVEs declined somewhat in the years up to 2006, and it seems to have bounced back in 2007. The previous sections have provided some arguments that, in the context of increasing integration of the world economy, small states may be in particular need of AfT. This assistance is provided mainly by a few large donors, including the EC, Australia, Japan and, to a smaller extent, France, Portugal, the USA and New Zealand.

4.5 How Aid for Trade could help SVEs integrate into the global economy

How can AfT address the typical constraints of SVEs? There are a number of theoretical models that could account for the role that AfT may have in promoting export competitiveness of SVEs. One such model is developed by Limao and Venables (2002). They combine a traditional Heckscher–Ohlin model of trade with a spatial economics model in the spirit of von Thünen to show that regions located far away from the economic centre tend to develop import-substituting activities and small exports as a result of the transport cost disadvantage. A generalised reduction in the cost of trading (due, for instance, to globalisation) leads the regions far from the centre to gain a more than proportionate increase in export activities. If AfT were able to reduce the transport costs (i.e. the geographic remoteness in the model), the country's income would benefit. The Limao and Venables model is more concerned with incomes rather than export activities *per se*. This focus would make identifying the effects of AfT difficult. In fact, a review of a vast number of empirical studies on the impact of aid on income growth (Doucouliagos and Paldam 2007) concludes that this literature is fairly inconclusive. A number of factors may explain the inconclusiveness of these research efforts. Bourguignon and Sundberg (2007) argue that these mixed results are not surprising, given the heterogeneity of aid motives and the complex causality chain linking foreign aid to growth. Further, the impact of aid might depend on domestic economic policies, institutions and other conditions. The channels linking aid to economic growth are very complex and it is difficult for any reduced form equations to capture all these links. In particular, AfT is related specifically to trade-related performance; thus a more appropriate way to identify the impact of AfT is to measure it on trade-related variables.

4.5.1 A simple model

We present a simple exports demand model borrowed from Fontagné et al. (2002) to show some channels through which AfT may help countries (and SVEs in particular) increase their level of exports. In the model, each country produces only one good, differentiated from the others by the place of origin; the supply of each good is fixed;

and consumers have identical and homothetic preferences represented by a constant elasticity of substitution (CES) utility function. The collective utility function of individuals in country j is denoted by:

$$U_j = \left(\sum_{i=1}^N \alpha_i^{1/\sigma} c_{ij}^{(\sigma-1)/\sigma} \right)^{\frac{\sigma}{\sigma-1}} \quad (4.2)$$

where σ is the elasticity of substitution between all goods, α is the share of the good from i in total expenditure in j and c_{ij} the value of consumption of the good produced in country i by individuals in country j , with $i, j \in [1, N]$.

The utility function is subject to the budget constraint stating that the value of goods consumed by individuals in country j needs to equal the national income of j .

$$y_j = \sum_{i=1}^N c_{ij} p_{ij} \quad (4.3)$$

where p_{ij} is the price in j of the good produced in i . Defining p_i as the exporter's supply price, then $p_{ij} = p_i \tau_{ij}$ where $\tau_{ij} \geq 1$ and includes all types of trade costs, for example transport, tariffs, administrative costs of trade, information costs. These costs are modelled as the standard iceberg type.⁶

Maximising equation (4.2) subject to the budget constraint (4.3) and after some manipulation we obtain the total (real) consumption (i.e. import) of good i by country j :

$$C_{ij} = \frac{\alpha_i Y_j}{\tau_{ij} p_i} \left(\frac{\tau_{ij} p_i}{\Pi_j} \right)^{1-\sigma} \quad (4.4)$$

where

$$\Pi_j = \left(\sum_{i=1}^N \alpha_i \tau_{ij}^{1-\sigma} p_i^{1-\sigma} \right)^{\frac{1}{1-\sigma}} \quad (4.5)$$

is a CES index of the trade costs faced in exporting to j , that is an index of trade remoteness of country j ; Y_j is total income in country j where $Y_j = p_j Q_j$. Following (4.4) the actual – free on board – value of exports of country i to country j is given by

$$X_{ij} = C_{ij} p_i = \frac{\alpha_i Y_j}{\tau_{ij}^\sigma} \left(\frac{\Pi_j}{p_i} \right)^{\sigma-1} \quad (4.6)$$

If we aggregate all bilateral exports from one source as defined in (4.6), we obtain the equation for the total value of exports from country i :

$$X_i = \frac{N \alpha_i}{p_i^{\sigma-1}} \sum_{j=1}^N \frac{Y_j \Pi_j^{\sigma-1}}{\tau_{ij}^\sigma} \quad (4.7)$$

This implies that the exports from i are positively related to countries' preferences for goods from i (i.e. a measure of how appealing good i is in the global market), to the demand capacity of all potential importing countries j (i.e. Y_j) and negatively related to trade costs faced by i in exporting to all other destinations. The direction of influence of the price of i on exports depends on σ ; in particular, if $\sigma > 1$ then $\partial X_i / \partial p_i < 0$. This condition states that, when the elasticity of substitution (between goods) is high, an increase in price yields a more than proportionate reduction in export volumes.

AfT enters the picture in (4.7) essentially by influencing two parameters of the equation: τ_{ij} and α_i . Following Bouet et al. (2008), the former can be expressed as a function of administrative and legal barriers, distance and infrastructure:

$$\tau_{ij} = (1 + t_{ij})b_i b_j f(I_i, I_j) d_{ij} \quad (4.8)$$

where t_{ij} is the bilateral import duty applied by country j on exports from i , and b_i (b_j) is the cost of processing exports (imports) in the exporting (importing) country; transportation costs are assumed to be a positive (linear) function of d_{ij} and a negative function of the level of economic infrastructures I in country i and j (i.e. $\partial f / \partial I_i < 0$ and $\partial f / \partial I_j > 0$). AfT to country i may affect both b_i and I_i . In particular, trade facilitation (TF) may reduce the time and costs of processing trade (b_i); and aid to economic infrastructure (AINFRA) may increase the level of I_i . To the extent that these types of AfT affect these variables, from (4.8) we have that $\partial \tau / \partial TF > 0$ and $\partial \tau / \partial AINFRA > 0$. It is important to note that our empirical analysis looks at the effects of AfT on a country's total exports (rather than bilateral exports) over time. Thus we are able to use country-fixed effects, which take care of the effects of bilateral distance in (4.8) (i.e. the country's location in our framework). Also, given the framework we use, we are interested not in bilateral trade costs but rather in unilateral trade costs, that is the costs of trading of country i with all other countries. Because of this, the other determinants of trade costs in (4.8) specific to the importing country j (i.e. b_j and I_j) can be approximated by time dummies in a panel data analysis (which capture the average level of these determinants across countries in any year). Finally, we would ideally need to have the bilateral tariffs faced by country i in each country; such tariffs have a fairly high variation across countries but a relatively small one over time, so country-fixed effects should be able to capture most of the variation in this case.

The other channel through which AfT may affect exports is by strengthening country i 's production competitiveness, which would in turn raise α_i . This is the kind of assistance that aid to productive capacity (Apc) could provide. We can think of this as an improvement in the quality of good i which induces a relative increase in the preference of the rest of the world towards i . Given equation (4.7), other things being equal this would translate in an increase in exports.

Using this framework, we can speculate on the possible SVE-specific effects of AfT. One of the main features of SVEs is that d_{ij} is usually higher than average, thus the effects of any reductions in the other parameters in (4.8) may yield above-average decreases in trade costs. Thus AfT aimed at reducing the value of b or increasing the

level of I_i has the potential to yield substantial gains for SVEs. Another way in which (some of the) SVEs may be characterised in the model is through a comparatively high value of α in (4.7) for those preference-receiving countries. This follows from the fact that preferential market access (in markets such as bananas and sugar) guarantees artificially high preferences from goods from some SVEs (i.e. high values of α_i). As these preferences are going to be phased out, the value of α_i is likely to reduce in those countries receiving preferences, thus reducing the value of exports from them. AfT could help counter this reduction in α_i (through aid for productive capacity).

4.5.2 How effective have the programmes been?

After analysing the possible effect of AfT interventions, it is worth examining to what extent this assistance has been effective in removing the constraints to trade development faced by developing countries and by SVEs in particular.

This examination is challenging because of the difficulty in isolating the impact of AfT programmes on the recipients' economy. It is methodologically complicated to discern, for instance, what part of the changes in the export performance of a country could be attributed to more micro-level technical assistance programmes. This attribution problem has often resulted in a lack of clear and measurable objectives and indicators in programming documents (Lesser and Hayashikawa 2006).

This may be an important reason why the general evidence on the evaluation of the effectiveness of trade-related assistance programmes has mixed results. The OECD (2006) reviews the findings of various evaluations and identifies a number of problems across different donor programmes. The specific needs of a beneficiary country or programme were not always properly assessed in advance, and, even when such an exercise was carried out, the criteria set out tended to be too broad. This in turn made an accurate evaluation of the programmes more problematic. On the other hand, when AfT was targeted at specific stakeholders (e.g. private sector) or at particular participants – as in the case of certain United States Agency for International Development (USAID) and UN Economic and Social Commission for Asia and the Pacific (ESCAP) programmes – the evaluators found better results. However, in some instances it is possible to attribute more general positive results to AfT programmes, such as an improvement in the trade-negotiating environment or an increase in the awareness and knowledge of trade policy issues, for example the UK Department for International Development DFID and JITAP projects.

Another common shortcoming of trade-related programmes emerging out of the OECD review relates to issues of governance, on the part of both the donor community and the beneficiary country. For instance, DFID's Africa Trade and Poverty Programme (ATPP) suffered from inadequate management and the absence of clear governance structures as multiple agencies were responsible for the disbursement of funds and implementation of activities. The Dutch multilateral trade assistance programmes also failed to take other bilateral and private sector partners into account, to the detriment of the programme's effectiveness. There are also reports of lack of adequate communication between headquarters and field missions, with the result that the latter failed to take ownership of the initiated programmes – as in the case of JITAP (OECD 2006).

Existing conditions in the beneficiary country can also be held responsible for the lack of success of some AfT programmes. The OECD identifies two necessary preconditions for aid to have a sustainable impact: the existence of a favourable domestic business environment and the political will to use trade as an engine for development. The case of Cambodia is an oft-cited success story; trade-related assistance provided by the WTO/ESCAP training programme has been given credit for contributing to the country's accession to the WTO. However, it has also been pointed out that the determining factor was the involvement of the government and the level of interaction between officials across different ministries, who jointly took ownership of the entire process. This has not been the case in several trade-related technical assistance programmes, and a number of programmes are either unsuccessful or unsustainable owing to the lack of involvement from the beneficiary country's organisations.

4.5.3 Specific programmes

The evaluations of specific AfT programmes have tended to yield the same mixed results. We review a number of them here, covering both national as well as multilateral evaluations, and then we address programmes which are more geared towards helping countries tackle the types of challenges faced by SVEs.

Zaken (2005) evaluates the success of Trade-Related Technical Assistance (TRTA) programmes funded by the Netherlands – that is all programmes that aimed at strengthening the trade-related negotiating capacity, national trade policy and/or capacity to trade of developing countries. The main focus of the study was on multilateral programmes (IF, JITAP, UNCTAD technical assistance) and programmes funded through international organisations (Advisory Centre on WTO Law [ACWL], Agency for International Trade Information and Cooperation [AITIC] and Quaker United Nations Office [QUNO]). The results of the desk and case studies conducted suggested that the funds disbursed by the Dutch Ministry of Foreign Affairs (a total of €109.9 million from 1992 to 2002) were not very effective in achieving the intended aims.

The main finding of the study was that TRTA activities often lacked an adequate design and did not give due consideration to formulating and using measurable indicators to assess the success of the implemented programmes.⁷ Large-scale multilateral programmes (such as the IF and JITAP) that specifically targeted least-developed economies were also considered mostly ineffective in achieving the stated objectives of enhancing trade-negotiating capacities and strengthening the ability to formulate pro-poor national trade policies. The failure of the integrated multilateral programmes was related to the limited absorptive capacity, to the lack of political commitment of the LDCs concerned and to the weak involvement of the private sector and civil society in these programmes. The report (Zaken 2005) also blamed poor communication between the Dutch embassies and the multilateral programmes, mainly since the former concentrated mainly on bilateral funding mechanisms. On the other hand, funds that were channelled through small and single-issue organisations to non-LDCs were considered to have been more effective, mainly since some of these countries' representatives were already quite active within multilateral and other trade negotiations.

The mid-term evaluation of JITAP II was carried out by the International Trade Centre (ITC), the managing agency for the programme (Divvaaker 2006). The beneficiary countries under study were a number of developing countries, including ten LDCs, and the study period extended from 2003 to 2007.

The main findings of the evaluation exercise were that the authorisation and disbursement of funds from donors and the Trust Fund to beneficiary countries had been efficient, but that the same could not be said for decentralised funds, whose utilisation had been poor. The report found that JITAP's most important contribution was to have enabled a cross-section of stakeholders in its beneficiary countries to develop and better articulate their negotiating priorities at the WTO. In terms of strengthening national trade negotiating capacities, however, high staff attrition rates at such centres had dispelled any chances of further dissemination of knowledge. This mainly arose from the lack of ownership and a lack of conviction of the effectiveness of these programmes on the part of the beneficiary country.

As noted above, there are no programmes of external assistance specifically targeted at SVEs but a number of programmes (described above) addressed specific challenges faced by SVEs. Among these programmes, the EU-funded banana and sugar special adjustment funds are ones for which some assessment is available.

As far as the **SFA for bananas** is concerned, the Commission had initially specified that funds be used for investments in the affected industry and, later, insisted on diversification. The low share of SFA funds spent on diversification has been raised as an important factor in the low levels of growth experienced in traditional ACP banana-producing countries, despite substantial financing. Support has not been the critical factor in increasing investment in the industry: prospects for market access and prices have been more important determinants. Most of the diversification projects funded under the SFA have been small-scale pilot projects within the agricultural sector. The approach has been rather ad hoc and has not addressed the key constraints in the wider business environment (e.g. public sector reform).

In designing its **sugar action plan**, the Commission and member states explicitly cited the precedent of the banana programme as an example of a badly designed programme. Gillson et al. (2004) refer to several critical evaluations. A major failure has been its tendency to support banana production in those countries that have limited potential to become competitive. Several country programmes (e.g. Jamaica, and St Vincent and the Grenadines) have used the funds provided to subsidise farmers' operating costs rather than finance new investments, hindering efforts to improve competitiveness. Only in some African countries has financing been effective in increasing productivity in the banana industry. This was largely as a result of it being used by multinational companies to complement their own investments (in productive facilities) by funding the development of cableways, drainage and irrigation.

CTA (2006) highlights that another problem for these SFA programmes is that ACP governments face major constraints in providing a lead in responding to production and trade adjustment challenges, whereas working through governments is central to the EC aid deployment process. With the growing emphasis on budget

support and the distinct preference for the deployment of sugar protocol, working through government is a central component of the EC approach to the extension of production and trade adjustment support. However, most ACP governments face constraints at two levels. The first relates to the understanding of ACP governments of the nature of the production and trade adjustment challenges (and opportunities) faced. This problem is particularly acute in those countries facing the greatest competitiveness challenges. The second relates to the administrative capacity of governments to effectively channel and deploy available support to what would need to be private sector-led restructuring efforts. The administrative constraints faced by ACP countries in dealing with EU procedures usually lead to very slow rates of aid disbursement, which may undermine the value of the assistance extended in support of time sensitive adjustment processes. Cali et al. (2011) illustrate the extent of this problem as far as SFA is concerned for a number of SVEs.

The results point towards the importance of ownership, alignment and harmonisation as critical factors of success of AfT, much in line with the traditional aid effectiveness literature (Rogerson 2005). The implications mainly refer to the need to involve stakeholders (e.g. private sector and civil society), and trade and other officials in beneficiary countries, at the very beginning, to help design programmes, devise specific objectives and implementation strategies, keeping country-specific conditions in mind. While this would ensure the evolution of better ways to measure the impact of such programmes, it would also create the necessary conditions for ownership of the programme within the partner country, which in turn would ensure long-term sustainability. An inclusive consultative process would also encourage partner country officials to be trained in assessing their trade performance through various toolkits provided by the World Bank and the ITC. This serves the dual purpose of developing skills and disseminating information at the same time.

Recommendations also include more specific targeting of sectors and activities which are aimed explicitly at poverty reduction or the inclusion of disadvantaged sections of society in trade; for example, DFID targeted small farmers in western Kenya through its bee-keeping project as a part of its business partnership programme. Other, more general, recommendations are aimed at enhancing the quality of communication channels across and within donor agencies, to avoid confusion with regard to delivery channels and programme implementation.

It is important to note that the impact evaluation of AfT has been carried out almost exclusively through success stories (see, for example, UNIDO 2008) which are usually self-assessed, and through ad hoc case studies, such as those presented above, which look at specific projects or programmes. In any instance, lack of proper data and benchmarks (e.g. in terms of outcome variables to rate the project against) has often constrained the possibility of properly assessing the effectiveness of AfT. A relevant exception is the recent work by Brenton and Von Uexkull (2008), who use quantitative techniques to study the systematic effect of product-specific AfT on countries' exports. They match data on technical assistance projects from German Development Cooperation (GIZ) with data on developing countries' trade performance on for the period 1975–2000. A partial equilibrium adjustment model is used to study

the impact of AfT on specific export goods: 88 export development programmes across 48 developing and LDCs. The results strongly suggest that exports may have increased owing to the effect of donor-funded export development programmes in a number of countries. However, a few caveats apply; although the programmes have preceded stronger export performance, causality cannot be expressly determined. As the authors point out, factors such as the initial size of the export sector, or selection bias (i.e. technical assistance may target products with already promising prospects) may be the real reasons behind the better performance of the targeted commodities.

We aim to bring out new, more systematic, evidence, looking at the overall impact of different types of trade-related assistance on specific trade-performance indicators. Our coverage is wider than that of Brenton and Von Uexkull (2008) in that it accounts for all AfT disbursements rather than only a sub-set of projects. Also, we rely on more indicators than only exports as dependent variables. Importantly, we try to identify the impact of this type of assistance on SVEs and other developing countries.

4.6 Empirical analysis on the effects of Aid for Trade on SVEs

We build on the previous study by Cali and te Velde (2008) to assess the impact of AfT on SVEs empirically and compare it with the rest of developing countries. Consistently with the rest of the work, we adopt the Commonwealth Secretariat definition of SVEs as the main way to identify those countries. As a robustness check, we also test the findings by using the WTO definition of SVEs.

Following the theoretical framework in the previous section, we use two ways of assessing the impact: first, a relatively narrow one looking at the effects of a specific category of AfT (i.e. trade facilitation) on the costs of trading; second, a broader assessment of the effects of AfT on exports, which represents an empirical implementation of equation (4.7).

4.6.1 The empirical models

Aid for Trade and the costs of trading

First, we estimate whether particular types of AfT have affected trade costs, namely whether trade facilitation (TF) has had any impact on b_i defined in equation (4.8). This is measured by investment climate indicators at the macro level, such as the time taken by customs to clear imports and exports, and the cost of exporting and importing goods across countries and over time (conditioning on other variables). These variables measure separately the time and costs (in US dollars) of handling and transporting a 20-foot container to (or from) the port of departure (or entry). In the case of costs, these include costs for documents, administrative fees for customs clearance and technical control, terminal handling charges and fees for in-country transport. The cost measure does not include tariffs or trade taxes. Only official costs are recorded. These cost and time variables only capture the efficiency with which exports and imports are handled *within* the country of interest. For instance, in the case of exports, procedures start after the goods are packed at the factory and include all official costs until the goods' departure from the point of exit. For imports,

procedures start when goods are unloaded from a vessel at the port of entry or when the vehicle carrying them has crossed the border, and go on until delivery at the factory or warehouse (see Calì et al. 2011 for a more complete description). Therefore these measures are not affected by the degree of isolation of the country (e.g. its distance from its trading partners), as the costs of transporting the goods from (or to) the point of departure (or destination) are excluded. In any case, we use country-fixed effects in some of the specifications to account for the potential influence of any time-invariant country-specific factor, such as geography and location. This analysis is important, as the costs faced and the time taken by firms to trade goods are significant determinants of a country's competitiveness. Djankov et al. (2006) find that each additional day that a product is delayed prior to shipping reduces trade by at least 1 per cent.

We employ a number of different specifications for the test at the macro level. We use both a semi-log (equation 4.9) and a log log specification (equation 4.9'):

$$\ln(IC)_{it}^Z = \alpha_i + \beta Atf_{it-1} + \Gamma Z_{it-1} + \gamma_t + \varepsilon_{it} \quad (4.9)$$

$$\ln(IC)_{it}^Z = \alpha_i + \phi \ln(1 + Atf)_{it-1} + KZ_{it-1} + \gamma_t + \mu_{it} \quad (4.9')$$

where IC is a trade-related investment climate indicator for country i , such as the cost of trading, Atf is Aid for Trade facilitation (in millions of US dollars) lagged one year, α_i is country-fixed effects, γ_t are time effects, Z is a vector of other determinants of IC , and ε and μ are the error terms.⁸

Specifications (4.9) and (4.9') test whether or not this type of AfT does indeed determine significant changes in the procedural costs of, and the time taken to, trade across borders. This is a direct test, as virtually all Aid for Trade facilitation is aimed at reducing the costs of trading across borders. According to the data description by OECD/DAC (2009), trade facilitation assistance is aimed at the simplification and harmonisation of international import and export procedures (e.g. customs valuation, licensing procedures, transport formalities, payments, insurance); support to customs departments; tariff reforms.⁹ We specifically test whether or not the effects of Atf are different for SVEs from those for other developing countries.

We will also test for the effects of Aid for Trade education/training ($Atedu$) on IC variables. This type of aid is directed at human resources development in trade, including university programmes in trade (OECD/DAC 2009).

Other controls which may also affect trade include variables such as being landlocked, income levels, the size of the country and governance indicators from Kaufmann et al. (2008). Kaufmann indicators measure perceptions of the effectiveness of government. Income levels are important because higher levels are usually associated with better institutions and rules. The size and geographical status of countries clearly affect trade costs.

Aid for trade and exports

Second, we will estimate the effects of AfT on exports directly, using an augmented export demand equation which includes different types of AfT: (aid to) infrastructure

and productive capacities. This test follows from the theoretical model and represents a reduced form of equations (4.7) and (4.8).

$$X_{it} = \alpha_i + \gamma_1 Apc_{it-2} + \gamma_2 Ai_{it-2} + \gamma_3 MP_{it} + \gamma_4 p_{it} + \lambda_t + \varepsilon_{it} \quad (4.10)$$

where X is the (log of) exports value in constant prices (country i , time t), Apc is (log of 1 +) aid disbursed to productive capacity and Ai is (log of 1 +) aid disbursed to economic infrastructure, MP is a market potential measure and p is the level of prices (both in log); α_i country effects, λ_t estimation period effects. Unlike expression (4.9), we use a two-year lag for the AfT variables here, as AfT may take some time before affecting the level of exports, as its impact is mediated through other variables. On the other hand, the impact of Atf on trading costs is more direct and thus a one-year lag seems more appropriate. The results from (4.10) are generally robust to including one instead of two lags (results are available upon request). MP is computed as a distance weighted measure of other countries' GDP:

$$MP_{it} = \sum_{j=1}^N \frac{GDP_{jt}}{d_{ij}} \quad (4.11)$$

where GDP_{jt} is total GDP of country j at time t and d_{ij} is the distance in km between country j and country i (measured as the great circle distance between the respective capital cities).¹⁰

There are still a couple of potential problems with running specification (4.12). First, the AfT variables are possibly endogenous to exports. This is the case, for example, if better-performing and/or faster-reforming countries tend to receive more AfT than others. This would generate an upward bias in the AfT coefficients. Also, there could be some error in the measurement of the AfT variables, as this is based on voluntary reporting of disbursements by donors to the OECD secretariat. Such error could be caused by inefficiency in reporting and/or misclassification of projects and, if it is correlated to (time-varying) unobserved characteristics of recipients, could make the AfT coefficients inconsistent. In order to control for these potential issues, we use an instrument for AfT based on the degree of respect for civil liberties, as measured by Freedom House (2009). There is consistent evidence that donors tend to give relative more aid to countries which are considered to respect civil liberties and human rights (Alesina and Dollar 2000; Macdonald and Hoddinott 2004 for Canada). The Millennium Challenge Corporation, one of the major providers of US AfT, explicitly uses Freedom House indicators on respect for civil liberties and for political rights as criteria for recipient countries to be eligible for assistance. Other than being a good predictor of future aid allocation, this variable (*civil liberties*) is also not related to exports in any meaningful way, thus satisfying the conditions of exclusion restriction. It is hard to find any clear link between a country's respect of civil liberties and its capacity to export. This is also confirmed by the insignificant coefficient of *civil liberties* when we include it in specification (4.10).¹¹

Another potential issue with the estimation of (4.10) is its lack of dynamics property. It is generally acknowledged (Senhadji and Montenegro 1999; Santos-Paulino and

Thirlwall 2004) that exports are fairly persistent over time, as they tend to depend on previous exports. Thus we test our results against a dynamic specification as well. We employ a first difference approach:

$$\Delta X_{it} = \gamma_1 \Delta Apc_{it-2} + \gamma_2 \Delta Ai_{it-2} + \gamma_3 \Delta MP_{it} + \gamma_4 \Delta p_{it} + \gamma_5 \Delta X_{it-1} + \lambda_t + \Delta \varepsilon_{it} \quad (4.12)$$

where $\Delta X_{it} = X_{it} - X_{it-1}$

By construction ΔX_{it-1} is correlated with $\Delta \varepsilon_{it}$ in (4.14) (as X_{it-1} is correlated to ε_{it-1}). Hence we resort to the generalised methods of moments (GMM) estimator, which generates internal instrument using appropriate lagged values of the explanatory variables (Arellano and Bond 1991). The GMM technique serves also as a robustness test for the impact of AfT variables on exports, as it allows controlling for (weak) endogeneity of the AfT variables by using a different type of instrumental variables from that employed above. To make the analysis more robust, we also use the excluded instrument *civil liberties* in the GMM estimation of (4.12).

As the measurement error of the AfT variables could be determined not only by random errors but also by recipient-specific characteristics (e.g. if the disbursement process is cumbersome and thus under-reported in certain countries), we employ the GMM system estimator rather than the GMM difference estimator (Blundell and Bond 1998). This estimator uses the explanatory variables in levels in the regression and instruments them through their past values of first differences. In this way it allows controlling for unobserved recipient-specific effects that are potentially correlated with the explanatory variables.

We estimate (4.10) and (4.12) separately for SVE and non-SVE countries to check if aid to economic infrastructure (*Ainfra*) and aid to productive capacity (*Apc*) have a differential impact on SVEs (relative to other developing countries) along the lines described in Section 4.4.

Aid for Trade and sectoral exports

Aid to productive capacities (*Apc*) is usually targeted at specific sectors; it is typically provided to firms or (public and private) institutions active in a particular sector. Thus the identification of its effects on total exports – as it is the case in the specifications above – may be weak. Moreover, specifications (4.12) and (4.14) may still suffer to some extent from omitted variable bias of cross-country regressions due to unobservable time-varying differences across countries (e.g. country-specific shocks to productivity or institutions). These issues call for an identification strategy based on sectoral exports.

We divide *Apc* into aid to the different sectors and then relate sectoral aid to sector-specific exports. This helps to identify if sectors in the same country that receive more aid experience relatively faster growth in their exports (between-group component), as well as if exports of a sector grow faster in years in which that sector receives relatively higher levels of aid (within-group component). We also use value of exports as the dependent variable instead of real exports (as in specification (4.3)), which allows us to have more observations. This could be justified because we are now

comparing exports in the same sectors so the price effects may be less relevant in this instance. We use four large sectors of the economy for which export data (from the World Development Indicators) are available: food production, manufacturing, mineral extraction and tourism. These account for all exports of goods and some exports of services from the countries in the panel. We match these sectors with their counterparts in the aid data: agriculture and fishing, industry, mining and tourism.

We estimate the following equation for each of the four sectors separately (for SVEs and non-SVEs separately):

$$X_{ijt} = \alpha_{it} + \lambda_{jt} + \gamma_{ij} + \delta_1 Apc_{ijt-1} + \varepsilon_{ijt} \quad (4.13)$$

and

$$\Delta X_{ijt} = \Delta \alpha_{it} + \Delta \lambda_{jt} + \Delta \gamma_{ij} + \Delta X_{ijt-1} + \delta_1 \Delta Apc_{ijt-1} + \Delta \varepsilon_{ijt} \quad (4.14)$$

where X is the (log of) value of exports (for country i , sector j and time t), Apc is (log of 1 +) aid to productive capacity, α_{ij} is country–year fixed effects, λ_{jt} is time-varying sector-fixed effects and γ_{ij} is sector–country fixed effects. Given the discussion above, we estimate (4.13) through ordinary least squares (OLS) and (4.14) through GMM. Note that we do not have appropriate external instruments (i.e. country–sector time-specific variable) for Apc_{ijt} .

4.6.2 Data

We employ data from a variety of sources. Aid data come from the OECD/DAC (2009) Creditor Reporting System (CRS) database on disbursements. This database has covered a number of AfT activities since the mid-1970s, and reporting to the CRS is improving. However, data until 1994 have substantial gaps, so we base most of the analysis on the post-1994 period. We use different types of AfT data from this database, including Aid for Trade facilitation, for trade-related education, for productive capacity (both total and sectoral) and for economic infrastructure. These categories as well as the basic structure of the database are described in Box 4.1.

Data on investment climate indicators have become available for a large number of countries through the World Bank's 'Doing Business Report'. These surveys cover the number of documents, and the time and costs required to change a certain regulation (e.g. registering property, or dealing with licenses). We focus on indicators for trade across borders, provided in the 'Doing Business Report' report (see Appendix 3.1).

Exports data and most other controls, including population, CPI and GDP data, are from World Bank (2009). We also use the real effective exchange rate (REER) from the IMF (2009). Data on bilateral distances between capital cities come from Mayer and Zignago (2006), who compute geodesic distances through the great circle formula. Data on foreign market potential are computed by Mayer (2008) for the period 1970–2003. Government effectiveness indicators come from Kaufmann et al. (2008), while the index of *civil liberties* is computed by Freedom House (2009). This index is measured on a one-to-seven scale, with one representing the highest degree of freedom and seven the lowest.

Box 4.1 Aid for Trade data in the OECD CRS database

The OECD Development Co-operation Directorate bases its classification of the destinations of aid on the specific area of the social or economic structure in the receiving country that the aid transfer is intended to foster. The categories therefore refer to the overarching goal (e.g. trade facilitation), rather than the service provided through the funds (e.g. funding of regional trade agreements (RTAs) or training). The system of purpose codes summarises this classification in five digits: the first three refer to the respective DAC5 sector, and the remaining two represent numbering from more general (10–50) to more specific (60–90).

- **Ainf** *Aid to economic infrastructure*, coded as number 200, includes Transport & Storage, Communications, Energy, Banking & Financial Services and Business & Other Services, each with its own sub-components.
- **Apc** *Aid to production sectors*, coded as 300, includes the four sectors Agriculture–Forestry–Fishing, Industry–Mining–Construction, Trade Policy & Regulations and Tourism, treated separately.
- **Atf** *Aid for trade facilitation*, coded as 33120, is a single category.
- **Atredu** *Aid to trade education/training*, coded as 33181, is also a single category.

Tourism has only one final component: Tourism policy and administrative management. The other destinations for sectoral aid for productive capacity all have multiple ramifications and are further focused. Under the category Agriculture–Forestry–Fishing, *Agriculture* (coded 311) has 18 final components, ranging from the general Agricultural policy and administrative management (31110) to the specific Livestock/veterinary services (31195). *Fishing* (313) incorporates five possible destinations for aid. Also, the category Industry–Mining–Construction has among its sub-sections *Industry* (321) and *Mineral resources and mining* (322), which we use for proxying aid to manufacturing and minerals sectors respectively in the analysis below.

Source: OECD CRS website; also see Turner (2008)

4.6.3 Results

AfT and the cost of trading

We first test for the impact of Aid for Trade facilitation (*Atf*) on the costs of exporting (through equation (4.9)) using a repeated cross-section of 89 developing countries for which data is available. Table 4.4 presents the results, which show that *Atf* substantially reduces the cost of exporting.

Results reported in Table 4.4 suggest that a US\$1 million increase in *Atf* (equivalent to a 171 per cent increase relative to the mean value) is associated with a 5.4 per cent or US\$63 reduction in the cost of packing goods and loading them into a 20-foot

Table 4.4 The effects of Aid for Trade on the costs of export (without fixed effects)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	<i>Lcosexp</i>	<i>Lcosexp</i>	<i>Lcosexp</i>	<i>Lcosexp</i>	<i>Lcosexp</i>	<i>Ltimexp</i>	<i>Lcosexp</i>	<i>Lcosexp</i>	<i>Lcosexp</i>
<i>Atff</i> (<i>t</i> -1)	-0.085*** (-6.49)	-0.054*** (-5.23)		-0.055*** (-5.41)		-0.041*** (-4.20)	-0.056*** (-5.42)	-0.058*** (-4.01)	-0.058*** (-4.01)
<i>Ln Atff</i> (<i>t</i> -1)			-0.191*** (-4.39)		-0.188*** (-4.20)				
<i>Atredu</i> (<i>t</i> -1)								-0.255 (-1.45)	-0.261 (-1.49)
<i>Gov. Eff.</i> (<i>t</i> -1)		-0.217*** (-3.82)	-0.209*** (-3.73)	-0.219*** (-3.84)	-0.212*** (-3.77)	-0.053 (-0.84)	-0.218*** (-3.82)	-0.172 (-1.56)	-0.222* (-1.98)
<i>Ln pop</i> (<i>t</i> -1)		0.114 (0.57)	0.154 (0.78)	-0.027 (-1.56)	-0.025 (-1.46)	-0.005 (-0.38)	0.110 (0.54)	-0.028 (-1.01)	-0.043 (-1.60)
<i>Ln pop</i> (<i>t</i> -1) sq.		-0.004 (-0.66)	-0.005 (-0.87)				-0.004 (-0.62)		
<i>GDP</i> (<i>t</i> -1)		-0.002 (-0.059)	-0.009 (-0.24)	0.007 (0.20)	0.001 (0.018)	-0.134*** (-3.30)	-0.002 (-0.045)	-0.008 (-0.11)	0.013 (0.19)
<i>Landlocked</i>		0.565*** (7.49)	0.570*** (7.67)	0.596*** (7.71)	0.601*** (7.88)	0.466*** (5.84)	0.565*** (7.43)	0.588*** (4.07)	0.516*** (3.78)
<i>Asia</i>		-0.322*** (-4.93)	-0.304*** (-4.67)	-0.340*** (-5.52)	-0.327*** (-5.35)	0.038 (0.70)	-0.324*** (-4.89)	-0.319*** (-3.36)	-0.271*** (-2.81)
<i>America</i>		-0.152* (-1.86)	-0.134 (-1.65)	-0.178** (-2.14)	-0.159* (-1.93)	-0.069 (-0.85)	-0.157* (-1.84)	-0.144 (-1.17)	-0.166 (-1.31)

(continued)

Table 4.4 The effects of Aid for Trade on the costs of export (without fixed effects) (continued)

Europe	-0.348*** (-3.27)	-0.322*** (-3.05)	-0.396*** (-3.62)	-0.370*** (-3.39)	-0.426*** (-2.88)	-0.348*** (-3.26)	-0.090 (-0.49)	-0.110 (-0.62)
<i>Atf(t-1)* SVEs</i>			-1.265** (-2.04)		-0.528 (-1.05)			3.528* (1.90)
<i>Ln Atf(t-1)* SVEs</i>				-1.214* (-1.96)		0.012 ^a (0.30)		
<i>Atredu(t-1)* SVEs</i>								-24.223** (-2.57)
Obs.	203	201	201	201	201	201	89	89
R-squared	0.089	0.551	0.555	0.560	0.490	0.552	0.581	0.609

^a SVEs as defined by the WTO
Robust *t*-statistics in parentheses; * significant at 10 %; ** significant at 5 %; ***significant at 1 %

container, transporting them to the port of departure and loading them on the vessel or truck (column 2). Considering that in the year 2000 the number of 20-foot containers loaded and unloaded in African ports reached almost 7.3 million, including 2.5 million in sub-Saharan countries (UNCTAD 2003), the return on *Atf* is likely to be substantial. The control variables are in line with expectations: good governance reduces the costs of exports, whereas being landlocked considerably increases them. Asia and Europe have the lowest costs, with Africa having the highest.¹² The other variables are not significant, including population and GDP per capita. The insignificance of the latter is surprising but it is likely to be determined by two contrasting effects: on the one hand, higher income per capita is associated with higher costs of non-tradables, which in turn drive up the costs of exporting; on the other hand, higher income tends to be associated with higher efficiency in handling transport, logistics and administrative procedures, which bring the costs down. This is confirmed by the negative and significant coefficient of GDP per capita when using the time of processing exports – whose value is purged of the price effect – as the dependent variable (column 6). The results are also robust to using the double-log specification as in (4.9'), although the cost reduction is much higher in this case: a US\$1 million increase in *Atf* is associated with a US\$178 decrease in the costs of exporting (column 3).¹³

Importantly, this cost-reducing effect of *Atf* appears to be more relevant for SVEs than for other developing countries (column 4). This is also the case when using the double-log specification (column 5). When using the time taken to process exports, the differential impact of *Atf* on SVEs is negative but insignificant, whereas *Atf* has a significant time-reducing impact (column 6). On the other hand, there is no differential impact of *Atf* on the costs of exporting for SVEs identified according to the WTO definition (column 7). This is a much broader (and loosely defined) category than the one defined by the Commonwealth Secretariat and that may explain the insignificant differential impact. We also test for the effects of aid to trade-related education (*Atredu*) on the costs of exporting, and find a negative (though not significant) effect in a specification in levels (column 8). Interestingly, when we test for the differential impact of *Atf* and *Atredu* on SVEs, the latter turns out to have a significant reducing effect on the costs of exporting, while *Atf* has a differential positive impact (column 9) on SVEs. This reversal of the result of previous columns may be due to the restricted sample (less than half of the observations available) and to the high collinearity between the two SVEs interaction terms.

Table 4.5 gives the results of the fixed effects specifications that relate the changes in *Atf* to the changes in the cost of exporting, controlling for time-invariant characteristics of countries. The coefficient of *Atf* is still significant but is half of that in the specification without fixed effects (column 1). Now an increase in *Atf* of US\$1 million is associated with a reduction in the cost of exporting of around US\$30 (i.e. 2.5 per cent at the mean). This means that slightly over half of the impact of *Atf* is captured by time-invariant characteristics of recipient countries. This elasticity is robust to the exclusion of Egypt, although it shrinks a little (column 2). Again, the double-log specification yields a higher *Atf* elasticity of cost reduction (column 3), which is around twice as large as that in column 1. On the other hand the intensity of the effect of *Atf* on the timing of exports is analogous to that on the cost of exporting

Table 4.5 The effects of Aid for Trade on the costs of export (with fixed effects)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Sample	All	No Egypt	All	All	All	All	TrEdu avail	TrEdu & TF avail	SVEs	Others	SVEs	Others
									(WTO)	(WTO)	(WTO)	(WTO)
Dep	ln(X Cost)	ln(X Cost)	ln(X Cost)	ln(Xtime)	ln(Xtime)	ln(X Cost)	ln(X Cost)	ln(X Cost)	ln(X Cost)	ln(X Cost)	ln(X Cost)	ln(X Cost)
<i>Atff(t-1)</i>	-0.025*** (-3.53)	-0.020*** (-2.26)		-0.024*** (-2.71)		-0.018* (-3.16)		-0.029*** (-3.93)				
<i>Ln Atff(t-1)</i>			-0.074** (-2.14)		-0.048 (-1.23)				-0.223 (-1.34)	-0.079** (-2.20)	-0.150 (-1.68)	-0.054 (-1.36)
<i>Atredu(t-1)</i>							-0.187* (-1.90)	-0.293*** (-3.28)				
<i>Gov. Eff. (t-1)</i>	0.0986 (0.78)	0.0630 (0.49)	0.105 (0.79)	0.159 (0.75)	0.180 (0.84)	0.0618 (0.61)	0.355* (1.78)	0.380*** (2.18)	0.0483 (0.26)	0.0969 (0.58)	0.121 (0.60)	0.130 (0.84)
<i>Ln pop (t-1)</i>	8.622* (1.83)	5.960 (1.16)	10.27* (1.84)	11.88 (1.30)	12.10 (1.24)	-0.277 (-0.25)	3.846 (0.35)	20.71 (1.61)	-10.33 (-0.87)	12.98** (2.30)	-11.25 (-0.56)	10.72 (1.64)
<i>Ln pop (t-1)</i>	-0.274* (-1.91)	-0.191 (-1.21)	-0.326* (-1.89)	-0.383 (-1.26)	-0.397 (-1.23)		-0.170 (-0.45)	-0.813** (-2.31)	0.260 (0.58)	-0.401** (-2.23)	0.234 (0.40)	-0.317 (-1.56)
<i>sq.</i>												
<i>GDP (t-1)</i>	0.0177 (0.051)	0.0762 (0.22)	0.232 (0.66)	-1.332** (-2.04)	-1.115 (-1.46)	-0.150 (-0.44)	-0.0572 (-0.094)	-0.662 (-1.07)	1.506* (1.91)	0.230 (0.58)	0.0323 (0.031)	0.340 (0.94)
Ln documents				0.0222 (0.15)								
Constant	-59.87 201	-39.33 197	-74.37 201	-77.90 201	-79.35 201	12.54 201	-9.194 138	-102.9 89	88.18 24	-98.39** 177	123.8 52	-84.86 149
Observations												
R-squared	0.372 86	0.335 85	0.330 86	0.361 86	0.342 86	0.353 86	0.208 76	0.561 48	0.770 11	0.327 75	0.511 25	0.328 61
Countries												

All regressions include country and year effects; robust *t*-statistics in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %

(column 4), while it is smaller (and not significant) in the double-log specification (column 5). The coefficient of *Atf* remains robust also to the inclusion the (log of the) number of documents necessary to export (column 6). *Atredu* is negative and significant in both specifications without and with *Atf* (columns 7–8).

We then test the impact of *Atf* separately for SVEs and non-SVEs (according to both definitions). In line with the results of the previous table we find that *Atf* has a (much) larger cost-reducing impact on SVEs than on non-SVEs. The coefficient for the former (column 9) is almost three times as large as that for the latter (column 10). This result is also valid when using the semi-log specification (results available from the authors upon request). Interestingly, this result applies (with similar relative magnitudes) to the case of SVEs defined according to the WTO definition (see columns 11 and 12), although the elasticity of cost reduction with respect to *Atf* is lower than for SVEs defined by the Commonwealth (see columns 9 and 11).

Overall, *Atf* seems to have a significant cost-reducing effect on the costs of handling exports, and back of the envelope calculations indicate that this appears to be an investment with an interesting return, especially for SVEs. These results appear all the more remarkable because cost of trading variables show substantial persistence over time, especially considering the short time frame of this analysis.

AfT and exports

Table 4.6 presents the results using the augmented export demand equation as in (4.10) estimated separately for SVEs and other developing countries. The results suggest the positive impact of aid to economic infrastructure (*Ainfra*) on exports, while aid to productive capacity (*Apc*) does not seem to have a significant effect on exports. However, these effects appear to differ over time. The first two columns present the results of the estimation for the 1995–2007 period only. Neither *Ainfra* nor *Apc* seems to have a significant effect on exports of SVEs (and the latter has a somewhat negative impact). On the other hand *Ainfra* has a positive effect on non-SVEs, while *Apc* has no effects (column 2). Restricting the analysis to a more recent period (1999–2007), the effect of *Ainfra* on SVEs becomes more positive, although it remains insignificant, while *Apc* becomes less negative. The coefficients of the aid variables are higher in the case of non-SVEs. Taken these results at their face value, they indicate that the support granted to the productive sector may have improved over time.¹⁴ Also, trade-related assistance seems to be more effective in raising exports for non-SVEs than for SVEs. However, we still need to control for the endogeneity of the aid variables.

We do that only for the *Ainfra* variable for a number of reasons. First, we have one reliable excludable instrument available – civil liberties (CL) – and that happens to explain a much larger part of *Ainfra* than *Apc*. Second, leaving *Apc* out in the estimation of equation (4.10) turns out to affect the value of *Ainfra* (and the explanatory power of the regression) very marginally, whereas the opposite is not true (not shown here). The results are presented in columns 5 and 6. The coefficient of *Ainfra* seems to be robust to the endogeneity of aid; and the IV estimation (using CL as instrument for *Ainfra*) suggests that this endogeneity biases the coefficient of *Ainfra* downwards. The IV coefficient is three times larger than the OLS one for non-SVEs

Table 4.6 Total exports and Aid for Trade (1995–2007)

	(1)	(2)	(3)	(4)	(5)	(6)
Countries	SVE	Non-SVE	SVE	Non-SVE	SVE	Non-SVE
Period	1995–2007	1995–2007	1999–2007	1999–2007	1999–2007	1999–2007
Method	FE	FE	FE	FE	FE IV	FE IV
Aid for infra	0.005	0.029*	0.023	0.032**	0.170	0.100***
(<i>t</i> –1)	(0.16)	(1.94)	(0.68)	(2.21)	(0.97)	(2.71)
Aid to prod.	–0.054	0.004	–0.044	0.020		
capacity	(–1.25)	(0.23)	(–1.08)	(1.47)		
(<i>t</i> –1)						
CPI	0.475	–0.038	0.418	–0.082**	0.291	–0.061***
	(1.28)	(–0.89)	(0.88)	(–2.33)	(0.75)	(–3.15)
Market	–1.756	5.890***	0.799	5.088***	1.986	5.763***
potential						
	(–0.38)	(4.10)	(0.34)	(4.44)	(0.90)	(7.19)
Constant	33.704	–27.654**	11.978	–21.877**		
	(0.85)	(–2.29)	(0.62)	(–2.17)		
Observations	143	876	121	665	123	682
R-squared	0.571	0.641	0.505	0.649	0.299	0.609
Countries	17	83	17	83	17	82
Excluded instruments						
Civil					–0.280*	–0.465***
Liberties					(–1.71)	(–5.72)
(<i>t</i> –3)						
1st stage F-Stat (for Aid for infra)					2.91	32.77

Dependent variable is value of total exports in constant 2000 US\$. All variables are in log; all regressions include year effects; robust *t*-statistics in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %

(compare column 6 with column 4) and over six times larger for SVEs (column 5 versus column 3). The value of the F-statistics of the first stage along with the high significance of the CL coefficient indicates that the latter is a valid instrument for *Ainfra*. The downward bias from endogeneity may suggest that countries with poorer export capacity tend to receive proportionally more aid, which is somewhat intuitive. This is especially true for SVEs. Correcting for this bias makes the *Ainfra* coefficient larger for SVEs than for non-SVEs. This may represent some suggestive evidence of a differential effect of aid to infrastructure to SVEs: export performance in these countries seems to be more positively affected by support to infrastructure than in other developing countries. This is consistent with the idea that SVEs are relatively isolated from the main markets and, because of that and of the small population, suffer from an under-provision of trade-related infrastructure.

In order to take into account the persistence of exports we employ the dynamic specification described by equation (4.12) estimated through system GMM. Table 4.7 presents the results, which confirm the main findings of the previous analysis. For the period 1995–2007 the aid variables have an insignificant effect on exports for SVEs

Table 4.7 Total exports and Aid for Trade, GMM estimation

	(1)	(2)	(3)	(4)	(5)	(6)
Period	1995–07	1995–07	1999–07	1999–07	1999–07	1999–07
Countries	SVE	non SVE	SVE	non SVE	SVE	non SVE
Sample	Aid > 0	Aid > 0	All	All	All	All
Exports ($t-1$)	0.988*** (91.2)	0.990*** (202)	0.989*** (77.2)	0.993*** (151)	0.992*** (85.1)	0.996*** (185)
Aid for infra ($t-1$)	0.004 (0.44)	0.013** (2.29)	0.014 (1.31)	0.010 (1.62)		
Aid to prod. capacity ($t-1$)	-0.019 (-1.33)	-0.005 (-0.57)	-0.023 (-1.24)	0.006 (0.55)		
Aid for infra ($t-2$)					0.004 (0.47)	0.018*** (2.74)
Aid to prod. capacity ($t-2$)					-0.014 (-1.03)	-0.008 (-0.78)
CPI	0.052 (0.61)	-0.003 (-0.27)	0.063 (0.51)	-0.019* (-1.90)	0.037 (0.30)	-0.020** (-2.11)
Market potential	-0.006 (-0.14)	0.019 (1.47)	-0.003 (-0.056)	0.039** (2.25)	-0.015 (-0.31)	0.035** (2.23)
Observations	142	869	120	660	118	652
Countries	17	82	17	82	17	82

Dependent variable is value of total exports in constant 2000 US\$. All regressions are estimated through the GMM-system estimator. All variables are in log; endogenous variables are lagged exports; *Ainfra* and *Apc* across all the specifications; civil liberties is included as excluded instrument; all regressions include year effects. Robust t -statistics in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %

(column 1), while *Ainfra* has a positive impact for non-SVEs (column 2). In the period 1999–2007 the impact of *Ainfra* on exports appears to be more positive for SVEs (column 3) than for non-SVEs (column 4), while *Apc* has a negative value for SVEs (although it is not significant). These results change when lagging the aid variables two years. In the case of SVEs, the coefficients of both aid variables become smaller (column 5), while that of *Ainfra* increases for non-SVEs (column 6). This suggests that the bulk of the effects of *Ainfra* on exports occur over a shorter time frame for SVEs than non-SVEs.

Aid for Trade and sectoral exports

We also examine the effects of the two main types of AfT on exports in four broad sectors separately, using both specifications (4.13) and (4.14). The results are presented in Table 4.8 for tourism and food and Table 4.9 for manufacturing and minerals. For each sector we estimate separately for SVEs and non-SVEs a static specification with fixed and year effects and a dynamic specification with system GMM. The period we consider is 1999–2006. As far as tourism is concerned, the results suggest that sectoral aid (i.e. aid to productive capacity in the tourism sector) is particularly beneficial in

Table 4.8 Sectoral exports and Aid for Trade

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Tourism				Food			
Sample	SVE	Non-SVE	SVE	Non-SVE	SVE	Non-SVE	SVE	Non-SVE
Method	FE	FE	Sys-GMM	Sys-GMM	FE	FE	Sys-GMM	Sys-GMM
Aid sector ($t-1$)	0.153 (0.50)	0.007 (0.12)	0.196 (1.30)	0.064* (1.88)	-0.157 (-1.71)	0.058 (1.54)	-0.047 (-0.57)	0.049** (2.31)
Aid Infra ($t-1$)	-0.071 (-1.05)	-0.001 (-0.043)	-0.001 (-0.026)	-0.008 (-0.67)	0.139 (1.37)	0.044 (1.14)	-0.002 (-0.033)	-0.007 (-0.39)
CPI	-0.266 (-1.17)	0.034 (0.39)	0.194* (1.98)	-0.017 (-0.52)	-1.403 (-1.57)	-0.102 (-1.48)	-0.068 (-0.15)	-0.010 (-0.32)
Market Potential	3.303 (1.29)	2.908 (1.08)	0.012 (0.15)	0.150*** (2.79)	6.285 (1.30)	1.878 (0.80)	-0.113 (-0.80)	0.092*** (2.78)
Pop	-7.373 (-0.53)	8.091 (0.92)	-0.196 (-0.60)	-0.039 (-0.30)	-16.805 (-0.52)	-32.295 (-1.49)	-0.171 (-0.26)	0.087 (1.09)
Pop squared	0.345 (0.60)	-0.278 (-0.99)	0.008 (0.59)	0.002 (0.57)	0.795 (0.64)	0.944 (1.42)	0.009 (0.33)	-0.003 (-1.02)
Exports ($t-1$)			0.979*** (49.1)	0.947*** (46.6)			0.931*** (31.7)	0.981*** (70.2)
Constant	29.001 (0.32)	-62.788 (-0.77)			53.346 (0.23)	278.102* (1.71)		
Excl. instrument		CL		CL		CL		CL
Observations	161	625	158	620	147	606	135	580
Countries	25	86	25	86	25	86	23	82
R-squared	0.266	0.445			0.254	0.296		

Dependent variable is value of exports of the sector indicated in the second row; all regressions include year and country effects; all variables are in log; endogenous variables in the GMM specifications are lagged exports; *Ainfra* and *Apc*; all regressions include year effects; robust *t*-statistics in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %

Table 4.9 Sectoral exports and Aid for Trade

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Manufacturing			Minerals			
	SVE	Non-SVE	SVE	Non-SVE	SVE	Non-SVE	SVE
	FE	FE	Sys-GMM	Sys-GMM	FE	Sys-GMM	Sys-GMM
Aid sector ($t-1$)	-0.278 (-0.65)	0.009 (0.32)	0.027 (0.15)	-0.001 (-0.049)	0.038 (0.18)	-0.096 (-1.58)	0.329 (1.22)
Aid Infra ($t-1$)	-0.113 (-1.13)	0.048 (1.24)	-0.073 (-0.97)	0.029 (1.32)	0.405** (2.09)	-0.032 (-0.71)	0.128 (0.62)
CPI	0.576 (0.95)	0.035 (0.76)	0.622** (2.11)	0.064** (2.42)	1.769 (1.00)	-0.082 (-1.09)	0.908 (1.53)
Market Potential	16.238 (1.16)	2.754** (2.01)	-0.026 (-0.22)	0.100** (2.29)	-16.62* (-1.84)	3.395* (1.87)	-0.049 (-0.11)
Pop	9.686 (0.34)	-8.967 (-0.82)	-0.906 (-1.51)	0.055 (0.52)	-107.17 (-1.07)	-10.37 (-0.97)	-0.648 (-0.21)
Pop squared	-0.511 (-0.43)	0.320 (0.96)	0.038 (1.55)	-0.001 (-0.35)	3.721 (1.04)	0.298 (0.88)	0.036 (0.29)
Exports ($t-1$)			0.962*** (26.5)	0.974*** (77.6)		0.804*** (8.66)	0.946*** (49.2)
Constant	-163.25 (-0.62)	56.724 (0.58)			904.432 (1.35)	79.210 (0.83)	
Excl. instrument		CL		CL		CL	CL
Observations	147	603	135	577	141	606	128
R-squared	0.156	0.392	.	.	0.144	0.405	.
Countries	25	86	23	81	24	86	23

Dependent variable is value of exports of the sector indicated in the second row; all regressions include year and country effects; all variables are in log; endogenous variables in the GMM specifications are lagged exports; *Ainfra* and *Apc*; all regressions include year effects; Robust *t*-statistics in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %

SVEs (the coefficient is three times that for non-SVEs). On the other hand *Ainfra* is not significant for either group, suggesting that tourism exports are not highly constrained by the lack of infrastructure. This may not be surprising, as a lot of SVEs are heavily reliant on tourism, and activities that support the development of the sector may have high returns for the export activities. AfT seems to be ineffective for food exports in SVEs (columns 5 and 7), whereas sectoral aid has a positive effect on exports for non-SVEs (columns 6 and 8). Similarly, the impact of AfT is negligible on manufacturing exports in SVEs, whereas *Ainfra* has a positive effect in non-SVEs (columns 1–4, Table 4.8). Finally, AfT appears to have a positive (although significant only for *Ainfra* in the FE specification, see column 5) effect on mineral exports in SVEs, especially as far as sectoral aid is concerned (column 7), but not in other developing countries (columns 6 and 8).

4.7 Conclusions and policy implications

This study represents one of the first attempts to focus on effects of AfT in SVEs. The evidence in this chapter suggests that SVEs fall in a category of countries in special need of AfT because of their relative disadvantage in international trade and their higher expected adjustment costs to trade integration relative to other developing countries. Although the rationale for AfT is particularly clear for SVEs, no donor has a specific AfT focus on these countries. There are a number of programmes that may be particularly relevant for SVEs, as they address some of the trade-related shocks likely to be faced by these countries, such as the EU SFA for bananas, the Special Fund for Rum and the trade integration mechanism. However, there is no programme we are aware of that addresses specific trade constraints of SVEs such as dealing with consequences of remoteness and smallness. This may be a useful addition to consider, if SVEs are to compete effectively in an integrated trade regime.

Despite the lack of specific programmes for SVEs, these countries receive relatively higher levels of AfT per capita. Small countries, and thus SVEs as well, receive higher per capita amounts of AfT – just like general aid. However, AfT to SVEs often have large swings suggesting that there may not be a long-term strategy in terms of allocating AfT to them.

We then investigate in more detail how AfT is expected to influence trade performance. Using a simple export demand model we show how AfT may benefit exports of developing countries, and of SVEs in particular. The review of the evidence available on the effectiveness of past AfT on trade performance is mixed. This examination is challenging owing to the difficulty in isolating the impact of AfT programmes on the recipients' economy. This attribution problem has often resulted in a lack of clear and measurable objectives and indicators in programming documents. However, some problems in the programming and delivery of AfT seem apparent. For example, administrative constraints faced by ACP countries in dealing with EU procedures usually lead to very slow rates of aid disbursement, which may undermine the value of the assistance extended in support of time-sensitive adjustment processes. Moreover, our review suggests the importance of ownership, alignment and harmonisation as critical factors of success of AfT, much in line with the traditional aid effectiveness literature. The implications mainly refer to

the need to involve stakeholders, and trade and other officials, in beneficiary countries at the very beginning – to help design programmes, devise specific objectives and implementation strategies, keeping country-specific conditions in mind.

Lack of proper data and benchmarks (e.g. in terms of outcome variables to rate the project against) has often constrained the possibility of properly assessing the effectiveness of AfT over a large number of projects. By using a large panel dataset of developing countries we provide new systematic evidence on the effectiveness of AfT. Using original empirical models, we examine the overall impact of different types of trade-related assistance on specific trade-performance indicators. Importantly, we identify the impact of AfT on SVEs and other developing countries separately. The results suggest that a particular type of AfT, that is Aid for Trade facilitation, seems to have a significant cost-reducing effect on the costs of handling exports, and back of the envelope calculations indicate that this appears to be an investment with an interesting return. SVEs seem to enjoy particularly high returns on Aid for Trade facilitation, which is consistent with these countries having, on average, higher unit transaction costs on exports (as these are spread over smaller volumes of exports). Our results further suggest that aid to economic infrastructure increases overall exports for developing countries, and more so for SVEs, while aid to productive capacity has no significant effect on exports for either SVEs or non-SVEs. The weak effect of aid to productive capacity may be partly explained by a poor identification strategy, as this type of aid is mostly sectoral and thus should be measured against sectoral exports. When we do this (using sectoral exports and sectoral aid for four broad sectors), we find heterogeneous effects of AfT across sectors. In particular, sectoral AfT seems to have a positive impact on tourism and mineral exports, which is considerably larger in SVEs than in non-SVEs. On the other hand, food and manufacturing exports do not appear to benefit from higher AfT.

On the basis of these findings and the review of the evidence we provide suggestions for AfT by donors as well as for SVEs.

- First, donors could consider introducing AfT programmes (or projects) addressing specific trade-related constraints faced by SVEs, including remoteness and isolation, as these seem to be binding, especially in a world of trade. AfT could help by, inter alia, funding connective infrastructure and improving the efficiency of existing infrastructure.
- Second, donors should increase the speed of AfT disbursement, as slow disbursement tends to undermine the value of the assistance extended in support of time-sensitive adjustment processes, such as the trade-related ones experienced by SVEs.
- Third, it would be desirable for donors to programme their trade-related activities for longer time spans and with more active participation by the recipients. This would increase the predictability and ownership of AfT flows. These recommendations are in line with those for general aid, but, given the high variability of trade-related aid in particular towards SVEs, they may be of particular importance in this context.
- Fourth, donors could consider scaling up the level of Aid for Trade facilitation, as this appears to be a particularly cost-effective investment. This is particularly the case for SVEs.

- Fifth, as the impact of aid to economic infrastructure on exports seems to be especially high in SVEs, it would be worth considering the opportunity of increasing it.
- Sixth, donors should work with recipients to identify those contexts in which there is more need for aid to productive sectors, considering that this form of aid seems to work better in certain sectors in SVEs, such as tourism and minerals.

Notes

- 1 The Doha Ministerial Declaration of the WTO, adopted in 2001, established a Work Programme with the objective of framing responses to the trade-related issues identified for the fuller integration of small, vulnerable economies into the multilateral trading system. However, this was not meant to create a sub-category of WTO members. Although many SVEs receive trade preferences under various bilateral and regional arrangements, under the multilateral trade talks they are not considered for special preferences that are generally granted to the other group of countries known as the least developed countries (LDCs). For details on the status of SVEs in the WTO see Smith (2009).
- 2 See Qureshi and te Velde (2008) for a more complete analysis of the challenges faced by small states.
- 3 The study included also a substantial data collection effort on relevant indicators, such as wages of skilled, semi-skilled and unskilled labour, airfreight, sea freight and telecommunication costs.
- 4 These countries are Antigua and Barbuda, The Bahamas, Belize, Bhutan, Botswana, Brunei, Cape Verde, Comoros, the Cook Islands, Cyprus, Djibouti, Dominica, Equatorial Guinea, Fiji Islands, Gabon, The Gambia, Grenada, Guyana, Jamaica, Kiribati, Lesotho, Maldives, Malta, the Marshall Islands, Mauritius, Micronesia, Montenegro, Nauru, Niue, Palau, Papua New Guinea, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Samoa, Seychelles, Solomon Islands, Suriname, Swaziland, Timor-Leste, Tonga, Tuvalu and Vanuatu. The reported trade shares of these countries have been estimated based on the data (on total trade in goods and services of different countries in current US dollars) provided by the United Nations Conference on Trade and Development (UNCTAD).
- 5 Data for ODA are obtained from the OECD/DAC database on aid flows.
- 6 This means that, if an amount x_{ij} of good is shipped from i to j , only x_{ij}/τ_{ij} will reach location j .
- 7 More specifically, the impact of technical papers and regional seminars within UNCTAD's technical assistance programmes was in doubt, and the report also concluded that the former was not a transparent and efficient channel for allocation of TRTA funds.
- 8 We use $\ln(1 + Atpr)$ to avoid missing and negative values. The main results are robust to using $\ln(Atpr)$ as well.
- 9 This is reinforced by the data description given by WTO/OECD (2008), according to which 'trade facilitation relates to a wide range of activities such as import and export procedures (e.g. customs or licensing procedures); transport formalities; and payments, insurance, and other financial requirements [...] Cutting red tape at the point where goods enter a country and providing easier access to this kind of information are two ways of "facilitating" trade.'
- 10 We also check the robustness of the results to using a foreign market potential measure computed by Mayer (2008) through bilateral trade data.
- 11 Not shown here, available from the authors upon request.
- 12 We include Oceania in Asia.
- 13 The average value of $\ln(1 + Atf)$ is 0.35; thus a 100 per cent increase in $(1 + Atf)$ is equivalent to an increase in Atf of US\$1.35 million, which is associated with a 20 per cent decrease in costs of exporting. This means that a US\$1 million rise in Atf is associated with a reduction in costs of 14.5 per cent (US\$178).
- 14 Given the consistency of the *Ainfra* coefficients across the different samples, we can probably rule out the other potential explanation for this change in the *Apc* coefficient, i.e. that reporting has improved over time, thus limiting the measurement error of the earlier period, which was driving the insignificant results of the 1995–2007 period.

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Chapter 5

Aid for Trade: Impact on Sub-Saharan Africa

Massimiliano Calì and Mohammad Razzaque

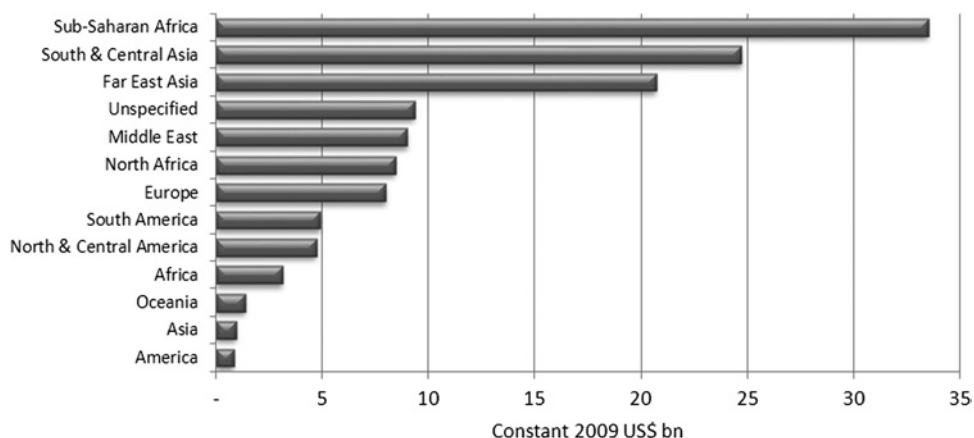
5.1 Introduction

One of the major constraints facing the poor countries in sub-Saharan Africa (SSA) has been their disappointing trade performance. Although there are recent signs of their enhanced participation in the global trading system, largely due to the buoyant commodity prices that have now been sustained for a considerable time, the region's relative significance in world trade in value terms still hovers around at a level which is just half the 3 per cent share it had enjoyed almost 50 years ago.

Moreover, the growth and levels of intra-regional trade in sub-Saharan Africa are also low despite a high level of ambition and progress made in regional integration efforts. At barely 10 per cent, the share of regional exports in total exports from Africa is amongst the lowest compared with other regions and it is also the share showing the slowest long-term growth.¹ This is consistent with generally high trade costs in the whole region. A review by Morrissey (2009) suggests that SSA on average has far higher transport costs than elsewhere and that such costs have been a major constraint to trade and growth in the region. Evidence provided in Portugal-Perez and Wilson (2008) suggests that the gains for African exporters from cutting trade costs has a greater effect on trade flows than a substantive cut in tariff barriers, whereas Djankov et al. (2006) stress the constraint posed by high internal transport costs and long delays. Given these types of constraints, it is no wonder that the recent launch and developments of the Aid for Trade (AfT) initiative were followed with great interests by policy-makers in SSA, as one of the main aims of AfT is to lift supply-side constraints in developing countries to enable them to participate effectively in the world trading system.

The resources necessary to that end are likely to be very large. Calì et al. (2007), for instance, review some estimates of only the annual (trade-related) infrastructure needs in Africa, which are considered to be in the US\$10–20 billion range. Donors have started to appreciate the specific challenges posed by trade-related constraints in SSA that have prevented trade in SSA from taking off more decisively, and SSA has become the largest recipient of AfT among developing regions since 2006 (Figure 5.1). It is, however, not only the total AfT resources that matter in helping the region to become a more prominent trade player internationally. Rather, what is perhaps more important is the extent to which these flows are effective in lifting the specific trade constraints. So far, relatively little attention has been devoted to the impact assessment of these flows, although more studies looking at the effectiveness of AfT are starting to appear (e.g. Brenton and von Uexkull 2008; Calì and te Velde 2009;

Figure 5.1 Total Aid for Trade flow by geographical region, 2006–10 (constant 2009 US\$ billion)



Source: Basnett and Kennan (2012)

Karingi and Leyaro 2010). Without a proper assessment of the impact of different types of AfT flows, it is difficult to identify what works and what does not and in what contexts. This chapter aims to shed some new light on the effectiveness of these flows, especially in the context of SSA. Using an empirical approach, the analysis presented here aims to examine the impact of different AfT categories on an important part of trade costs (i.e. costs of processing imports and exports), as well as on total exports. We examine the effects for a large sample of developing countries, as well as for SSA and for three major regional economic communities in SSA: the Southern African Development Community (SADC), the Economic Community of West African States (ECOWAS) and the Common Market for Eastern and Southern Africa (COMESA).

This chapter is organised as follows: after this introduction, Section 5.2 provides a brief discussion on trade and economic performance of sub-Saharan Africa and how AfT can be of help; Section 5.3 outlines the methodology and data; Section 5.4 provides the results of empirical assessment; and finally Section 5.5 concludes.

5.2 Trade and economic performance of sub-Saharan Africa: how AfT could help

In the economic development landscape, SSA, containing 33 out of a total of 48 least developed countries (LDCs), generally lags behind other regions. The LDCs are recognised as highly disadvantaged in their development process and face a disproportionate risk of failing to overcome poverty and other consequences associated with weak resource capacity and economic vulnerability.² The high concentration of LDCs in SSA clearly demonstrates the severity of economic challenges faced by the region.

Table 5.1 GDP per capita (constant 2005 US\$)

	1970	1980	1990	2000	2011	Compound annual growth: 1970–2000 (%)	Compound annual growth: 1970–2011 (%)	Compound annual growth: 2000–2011 (%)
World	4,160	4,995	5,710	6,510	7,520	1.50	1.45	1.32
Developing economies	810	1,130	1,290	1,735	2,740	2.57	3.02	4.24
LDCs	350	330	320	340	530	−0.11	1.02	4.12
Sub-Saharan Africa (excluding South Africa)	540	570	505	500	685	−0.26	0.58	2.9

Source: Authors' estimates using data from UNCTAD (2013)

For much of the past half-century, LDCs and SSA have remained trapped in low-income situations and slow progress in social and human capital development. Between 1970 and 2000, the per capita incomes of LDCs and SSA actually fell absolutely in real terms (Table 5.1), while those of developing countries more than doubled. Growth in the most recent past decade (2000–10) has, however, been impressive. Because of the 'lost three decades' (1970–2000), LDCs and SSA registered compound annual per capita income growth of barely 1.02 per cent and 0.58 per cent respectively, just over the 40-year period since 1970, in comparison with more than 3 per cent growth in developing countries as a group.

Between the early 1950s and the mid-1990s, the shares of LDCs and SSA in global merchandise export trade secularly declined from more than 3 per cent, in each case, to less than 0.5 per cent and 1 per cent respectively. In the last decade (2000–10), both the groups of countries showed some sign of reversing the trend; at the time of writing, LDCs have a share of just over 1 per cent and SSA 1.5 per cent. In commercial service exports as well, LDCs and SSA's shares have stagnated at around just above 0.5 per cent and 0.75 per cent respectively.

Lack of productive capacity is considered to be the most important constraint facing SSA countries.³ To put things into perspective, with a total population of 827 million (i.e. about 12 per cent of the global population), the combined merchandise exports from SSA excluding South Africa in 2011 stood at about US\$338 billion, while for Malaysia, a country of 27.8 million people, they were US\$228 billion. Similarly, the annual production in SSA, as measured by gross domestic product (GDP), is estimated at US\$860 billion (1.24 per cent of world GDP), in contrast to US\$775 billion in Turkey, which has a population of 74 million.

One salient feature of limited productive capacities is the lack of diversification. Whereas economic development would imply countries' progressing from primary and traditional activities to more productive manufacturing and modern services sectors, in an overwhelming majority of SSA countries such a transformation mechanism

has largely been absent. For instance, during the 2000s these countries demonstrated remarkable economic performance, recording average annual GDP growth of 6 per cent. However, this has not been translated into an improved relative amount of manufacturing activities: in fact, the share of manufacturing in GDP remained stagnant at around 10 per cent. Similarly, fuels and other raw materials contributed to about 90 per cent of all SSA merchandise exports.

On an index of export diversification, which compares individual countries' export structures with the world average, ranging from a value of 0 (for highly diversified, reflecting the world average) to 1 (highly concentrated and thus far away from the world average), the average value for SSA countries turns out to be 0.78 as against 0.22 for the developing countries as a group.⁴ There is now strong evidence to show that high export concentration adversely affects income growth.⁵ Therefore, both domestic production and export structures vividly portray the challenge of achieving structural transformation in SSA.

It is against this backdrop that the role of trade becomes most critical for promoting development in SSA. International trade overcomes the problems of small domestic markets accentuated by the low purchasing power of the populations, helps achieve gains from allocative efficiency, facilitates transfer of modern and more productive technology and fosters positive spillover effects from export activities. Aid for Trade is supposed to be particularly helpful in materialising all positive aspects of the trade-led development paradigm. Most important outcomes for SSA countries in this respect could be (i) improved supply response due to enhanced productive capacity supported by AfT and (ii) reduced costs of trading as a result of AfT-supported infrastructure and trade facilitation programmes.

The impact of AfT is likely to be much broader. te Velde (2008), as mentioned in Chapter 3 in this volume, summarises the main examples of market and governance failures that can harm the development of trade in developing countries. It also identifies possible policy responses to address these failures and examines whether such a response may be assisted by an AfT package and what part of the package would be relevant to the task (on the basis of its current classification in the OECD CRS aid statistics).

This approach suggests that, if employed effectively, AfT can be instrumental to achieve a number of trade-related goals, in line with the AfT categorisation proposed by the WTO Task Force on AfT. These include improving trade policy co-ordination (AfT category: trade development); developing standards to improve access for exports (trade facilitation); improving skill formation (trade-related adjustment); improving infrastructure (trade-related infrastructure); and overcoming governance failures, such as weak institutions or weak administrative procedures (trade policy and rules).

The actual macroeconomic effects of AfT depend on the functioning of a number of channels, for example whether the exchange rate appreciates as a result of inflationary expansion, so that exports are affected, or whether aid actually improves trade competitiveness through better infrastructure. From an economic point of

view, if more support goes through investment and productive uses, rather than to consumption or other projects with less growth potential, this will help to remove or reduce the Dutch disease effects of increased aid, as is confirmed by Adam and Bevan (2006). They use a computable general equilibrium model to show that aid-funded increases in public investment yield potentially large medium-term welfare gains, as public infrastructure investments offset short-run Dutch disease effects.

We do not have enough information to predict what channels may be relatively more important for trade-related outcomes. Our hypothesis is that both direct and indirect effects of AfT are potentially important to stimulate competitiveness and exports. These effects are the product of a complex causality chain running from aid to country outcomes and mediated by domestic policy-makers, implementation agencies, policies and country conditions. Bourguignon and Sundberg (2007) define this chain as a 'black box'. 'If a dollar of aid produces little discernible change, was the objective ill-defined, the service delivery inefficient, bureaucratic measures inadequate, or was money diverted?' (Bourguignon and Sundberg 2007: 317). This problem applies to our analysis as well, but it is less significant than for models which estimate a relationship between aid and growth, as the links between AfT and trade-related performance are more direct. This, in turn, implies more precision in the definition of the aid objectives.

In order to formalise these intuitions, we present in Annex 5.1 the simple exports' demand model built by Cali and te Velde (2009) on the basis of Fontagné et al. (2002), which shows how some of the types of AfT presented above may influence exports. From the model we derive the two specifications we test. The first test concerns the effects of Aid for Trade facilitation (*Atf*) and Aid for Trade policy and regulation (*TPR*) on the costs of trading (equation 5.A7 in the annex). The former type of AfT has the explicit objective of reducing the costs and the time to process trade, whereas the second is a broader category which encompasses other types of training and support that may affect the processing of trade (see the data description in the next section).

From the equilibrium equation of the model (equation 5.A8 in the annex), we also derive the other specification which (positively) links the two main types of AfT to exports. There are two intuitions behind these positive relationships in the export demand equation used in the model:

- i. Other things being equal, aid for productive capacity (*Apc*) should increase the attractiveness of the products from country *i* (which receives *Apc*), for example through support to public institutions to market these products abroad, or through the introduction of better production techniques which raise the quality of the products. In the model, that is represented by an increase in the share of good from *i* in total expenditure in importing country *j*.
- ii. Other things being equal, aid for economic infrastructure (*Ainfra*) should reduce the transport costs from country *i* to country *j*, thus making products from *i* more attractive for consumers in *j*.

We refer the reader to Annex 5.1 for further details on how these theoretical specifications are translated into the empirical framework, to which we turn in the next section.

5.3 Empirical methods

Building on Cali and te Velde (2009), we use two ways of assessing the impact of AfT which reflect the working of the model described above: first, a relatively narrow one looking at the effects of a specific category of AfT (i.e. *Atf* and *TPR*) on the costs of trading; second, a broader assessment of the effects of *Apc* and *Ainfra* on exports.

5.3.1 AfT and the costs of trading

First, we estimate whether or not particular types of AfT have affected trade costs. This is measured by investment climate indicators at the macro level, such as the time taken by customs to clear imports and exports, and the cost of exporting and importing goods across countries and over time (conditional on other variables). As the majority of developing countries, especially in Africa, import a larger variety of goods than they export, the cost of importing is often more important than the cost of exporting. Therefore we mainly examine the former (although we perform some robustness tests using the latter as well).

We use the following fixed-effect (FE) specification to test for the effects of *Atf* and *TPR* on the costs of trading:

$$Cimp_{it} = \alpha_i + \beta ATF_{(it-1)} + \chi TPR_{(it-1)} + \Gamma Z_{it-1} + \gamma_t + \varepsilon_{it} \quad (5.1)$$

where *Cimp* is cost of importing for country *i* at time *t*, *Atf* is Aid for Trade facilitation (as defined by the Organisation for Economic Co-operation and Development (OECD) Creditor Reporting System (CRS) database), *TPR* is Aid for Trade policy and regulation (excluding *Atf*), and *Z* is a vector of other determinants of *Cimp*, including income levels, population size and governance indicators. All of these variables are lagged one year to partly address the problem of endogeneity. Finally, α_i is country-fixed effects and γ_t are time effects.

This is a direct test of the effects of AfT, in particular as far as *Atf* is concerned. According to the data description by OECD/DAC (2009), trade facilitation assistance is aimed at the ‘Simplification and harmonisation of international import and export procedures (e.g. customs valuation, licensing procedures, transport formalities, payments, insurance); support to customs departments; tariff reforms’. We would expect that $\beta < 0$ and possibly also $\chi < 0$.

As we are interested in the impact on SSA countries, we also run a modified version of (5.1) to test for any eventual differential impact of these types of AfT on SSA as well as on the main regional economic communities (RECs):

$$Cimp_{it} = \alpha_i + \beta_1 ATF_{(it-1)} + \chi_1 TPR_{(it-1)} + \beta_2 ATF_{(it-1)} \times SSA_i + \chi_2 TPR_{(it-1)} \times SSA_i \\ + \Gamma Z_{it-1} + \gamma_t + \varepsilon_{it} \quad (5.1')$$

The β_2 and χ_2 coefficients indicate whether or not these types of trade-related assistance have an impact different in SSA than in other developing countries. We

apply the same type of test to the main SSA RECs as well, that is SADC, ECOWAS and COMESA.

5.3.2 AfT and exports

We also estimate the effects of AfT on exports directly, using an augmented export demand equation which is directly derived from the model developed in the annex:

$$E_{it} = \alpha_i + \gamma_1 Apc_{it-2} + \gamma_2 Ai_{it-2} + \gamma_3 MP_{it} + \gamma_4 p_{it} + \lambda_t + \varepsilon_{it} \quad (5.2)$$

where E is the (log of) exports value in constant prices (country i , time t), Apc is (log of) aid disbursed to productive capacity and Ai is (log of) aid disbursed to economic infrastructure, MP is a market potential measure, and p is the level of prices (both in log); α_i country effects, λ_t estimation period effects. Unlike expression (5.1), we use a two-year lag for the AfT variables here, as AfT may take some time before affecting the level of exports, as its impact is mediated through other variables. On the other hand, the impact of AfT on trading costs is more immediate and thus a one-year lag seems more appropriate. The results from (5.2) are robust to including one instead of two lags (results are available upon request). MP is computed as a distance weighted measure of other countries' GDP:

$$MP_{it} = \sum_{j=1}^N \frac{GDP_{jt}}{d_{ij}}$$

where GDP_{jt} is total GDP of country j at time t and d_{ij} is the distance in km between country j and country i (measured as the great circle distance between capital cities).

Ideally we would want to use the real effective exchange rate (REER) as a control for prices of the domestic economy relative to its trading partners in (5.2). However, the use of REER would halve the number of observations available, so we use the Consumer Price Index (CPI) instead. We note that the results are robust to using REER instead of CPI with the sub-sample of observations for which REER is available.⁶

Again, we add a series of interaction terms to (5.2) to test for any eventual differential impact of AfT interventions in SSA and its main RECs:

$$E_{it} = \alpha_i + \gamma_1 Apc_{it-2} + \gamma_2 Ai_{it-2} + \phi_1 Apc_{it-2} \times SSA_i + \phi_2 Ai_{it-2} \times SSA_i + \gamma_3 MP_{it} + \gamma_4 p_{it} + \lambda_t + \varepsilon_{it} \quad (5.2')$$

There are still a couple of potential problems with running specifications (5.2) and (5.2'). First, the AfT variables are likely to be endogenous to exports. This is the case, for example, if better-performing and/or faster-reforming countries tend to receive more AfT than others. This would generate an upward bias in the AfT coefficients.

Also, there could be some error in the measurement of the AfT variables, as this is based on voluntary reporting of disbursements by donors to the OECD secretariat. Such error could be caused by inefficiency in reporting and/or misclassification of projects and, if it is correlated to (time-varying) unobserved characteristics of recipients, could make the AfT coefficients inconsistent. In order to control for these potential issues, we use a series of instruments for A_{pc} and A_{infra} .

The first of them is based on the degree of respect for civil liberties, as measured by Freedom House (2009), which is used by Cali and te Velde (2009) as well. There is consistent evidence that donors tend to give relatively more aid to countries which are considered to respect civil liberties and human rights (Alesina and Dollar 2000; Macdonald and Hoddinott 2004 for Canada). The Millennium Challenge Corporation, one of the major providers of US AfT, explicitly uses Freedom House indicators on respect for civil liberties and for political rights as criteria for recipient countries to be eligible for assistance. Other than being a good predictor of future aid allocation, this variable (*civil liberties*) is also not related to exports in any meaningful way, thus satisfying the exclusion restriction's conditions. It is hard to find any clear link between a country's respect of civil liberties and its capacity to export. This is also confirmed by the insignificant coefficient of *civil liberties* when we include it in the specification.⁷

The second instrument is calculated as the total AfT provided by the largest AfT bilateral donor, that is Japan (net of the part accruing to the specific recipient to ensure exogeneity), divided by the recipient's distance from Japan. This variable should capture the part of the changes in AfT received by a country due to the change in total AfT disbursed by Japan (which is exogenous to whatever occurred in that country). The distance weight provides a good proxy for the extent to which recipient countries may be affected by such exogenous changes (with more distant countries likely to be less affected than countries closer to Japan). Using distance from Japan as the weighting dimension is consistent with the determinants in the pattern of AfT allocation by Japan, which is skewed towards Asian, and particularly East Asian, countries.

The final set of instruments used for the AfT variables in (5.2) is based on the 'affinity' in foreign policy between each recipient and the four major bilateral donors for which data are available, that is Japan, the USA, the UK and France. This degree of affinity is measured by an affinity index computed by Gartzke (2009) on the basis of dyadic UN voting patterns. Annex 5.2 provides more details about the calculation of these affinity indices.

We instrument the interaction terms testing for the differential impact on SSA through a series of interactions between the instruments and the SSA (or REC) dummy.

Another potential issue with the estimation of (5.2) is its lack of dynamics property. It is generally acknowledged (Senhadji and Montenegro 1999; Santos-Paulino and Thirlwall 2004) that exports are fairly persistent over time, as they tend to depend on previous exports. Thus we test our results also against a dynamic specification. In particular, we estimate a version of (5.2), which includes the lagged value of exports

E_{it-1} . As this lagged value is endogenous to the error term ε_{it} , we need to take the first differences of the variables to purge the fixed-effect terms (Bond 2002):

$$\Delta E_{it} = \gamma_1 \Delta Apc_{it-2} + \gamma_2 \Delta Ai_{it-2} + \gamma_3 \Delta MP_{it} + \gamma_4 \Delta p_{it} + \gamma_5 \Delta E_{it-1} + \lambda_t + \Delta \varepsilon_{it} \quad (5.3)$$

where $\Delta E_{it} = E_{it} - E_{it-1}$

By construction, ΔE_{it-1} is correlated with $\Delta \varepsilon_{it}$ in (5.3) (as E_{it-1} is correlated to ε_{it-1}). Hence we resort to the generalised methods of moments (GMM) estimator, which generates internal instrument using appropriate lagged values of the explanatory variables (Arellano and Bond 1991). The GMM technique serves also as a robustness test for the impact of AfT variables on exports, as it allows controlling for (weak) endogeneity of the AfT variables by using a different type of instrumental variables from that employed above. As the measurement error of the AfT variables could be determined not only by random errors but also by recipient-specific characteristics (e.g. if the disbursement process is cumbersome and thus under-reported in certain countries), we employ the GMM system estimator (Blundell and Bond 1998). This estimator uses the explanatory variables in levels in the regression and instruments them through their past values of first differences. In this way we control for unobserved recipient-specific effects that are potentially correlated with the explanatory variables.

5.3.3 Data

We employ data from a variety of sources. AfT data (constant 2008 US\$million disbursements) come from the OECD/DAC (2010) CRS database on disbursements. This database has covered a number of AfT activities since the mid-1970s, and reporting to the CRS is improving. However, disbursements data until 2001 have substantial gaps, so we base the analysis on the post-2001 period. We use different types of AfT data from this database, including Aid for Trade facilitation, for trade policy and regulation, for productive capacity (both total and sectoral) and for economic infrastructure.

The OECD Development Co-operation Directorate bases its classification of the destinations of aid on the specific area of the social or economic structure in the receiving country that the aid transfer is intended to foster. The categories therefore refer to the overarching goal (e.g. trade facilitation), rather than the service provided through the funds (e.g. funding of regional trade agreements (RTAs) or training). The system of purpose codes summarises this classification in five digits: the first three refer to the respective DAC5 sector, and the remaining two represent numbering from more general (10–50) to more specific (60–90). We use the following categories:

1. **Ainfra:** *Aid to Economic Infrastructure*, coded as number 200, includes Transport & Storage and Communications, Energy, Banking & Financial Services and Business & Other Services, each with its own sub-components.
2. **Apc:** *Aid to Production Sectors*, coded as 300, includes the four sectors *Agriculture–Forestry–Fishing, Industry–Mining–Construction, Trade Policy & Regulations* and *Tourism*, treated separately.

3. **Atf:** *Aid for Trade Facilitation*, coded as 33120 (single category).
4. **TPR** *Aid for Trade Policy and Regulation*, coded as 331, includes *Trade policy and administrative management*, *Trade facilitation*, *Regional trade agreements (RTAs)*, *Multilateral trade negotiations*, *Trade-related adjustment* and *Trade education/training* (we exclude the *Trade facilitation* part of TPR in the analysis, as we test for its effect separately).

For data on the cost (and time) of trading, we use the World Bank's 'Doing Business Indicators' dataset. In particular we use the 'Trading across borders' section of this survey, which gathers data on the number of documents, time and costs required to process exports and imports of goods across borders. These variables measure separately the time and the costs (in US\$) of handling and transporting a 20-foot container to (or from) the port of departure (or entry). In the case of costs, these include costs for documents, administrative fees for customs clearance and technical control, terminal handling charges and fees for in-country transport. The cost measure does not include tariffs or trade taxes. Only official costs are recorded. These cost and time variables capture the efficiency with which exports and imports are handled within the country of interest. For instance, in the case of exports, procedures start after the goods are packed at the factory and include all official costs until the goods' departure from the point of exit. For imports, procedures start when goods are unloaded from a vessel at the port of entry or when the vehicle carrying them has crossed the border, and go on until delivery at the factory or warehouse. Therefore these measures are not affected by the degree of isolation of the country (e.g. its distance from its trading partners), as the costs of transporting the goods from (or to) the point of departure (or destination) are excluded. In any instance we use country-fixed effects in some of the specifications to account for the potential influence of any time-invariant country-specific factor, such as geography and location.

Export data and most other controls, including population, CPI and GDP data, are from World Bank (2010). We also use REER from the International Monetary Fund (IMF 2009). Data on bilateral distances between capital cities come from Mayer and Zignago (2006), who compute geodesic distances through the great circle formula. Government effectiveness indicators come from Kaufmann et al. (2008), and the index of *civil liberties* is computed by Freedom House (2009). This index is measured on a one-to-seven scale, with one representing the highest degree of freedom and seven the lowest. Finally, foreign policy affinity index data come from Gartzke (2009). Table 5.2 presents the summary statistics for the main variables.

5.4 Results

5.4.1 Aid for Trade and the cost of trading

We first carry out the analysis on the effect of AfT on the cost of trading variables by implementing equation (5.2).

Table 5.3 presents the results, which show that Aid for Trade facilitation (Atf) has a consistently negative impact on the cost of trading, when measured both as cost

Table 5.2 Summary statistics for the main variables

	Obs	Mean	Std Dev.	Min	Max
Cosimp	282	1,523.81	933.25	367	5520
Cosexp	282	1,291.15	754.68	390	4867
Timimp	401	35.93	20.29	3	104
tf_disb	677	0.59	3.34	−0.07	53.96
tpr_tf_disb	677	3.52	13.86	0.00	194.52
Goveff	642	−0.34	0.80	−2.51	2.53
Lpop	636	15.31	2.17	9.90	21.00
lpop2	636	239.06	65.57	98.01	441.19
lgdpcons	567	7.31	1.37	4.48	11.19
lexpcons	594	22.01	1.97	17.13	27.83
Laidinf	747	2.35	1.76	0.00	7.64
Laidprod	863	1.83	1.46	0.00	6.54
lMkt_pot	888	8.66	0.36	7.95	9.77
CL	848	3.71	1.63	1.00	7.00
a4tnet_japan	844	337.78	243.93	0.00	2,001.36
japan_aff	896	0.51	0.18	−0.26	1.00
uk_aff	896	0.28	0.19	−0.21	1.00
france_aff	896	0.33	0.19	−0.21	1.00
usa_aff	896	−0.53	0.28	−1.00	0.98
Lcpi	731	4.96	0.74	4.37	18.44

of imports (column 1) and as cost of exports (column 2). On the other hand, the rest of Aid for Trade and policy and regulations (TPR) – i.e. excluding *Atf* – has a negative but insignificant impact. This suggests that it is the specific assistance to customs authorities for import and export procedures that is particularly effective at reducing the costs of trading. After all, this type of assistance has the stated objective of reducing these costs. These results are consistent with those of Cali and te Velde (2009), although the magnitude of the effect is different, as here the period of analysis is longer, the sample slightly larger and the specification somewhat different, as explained above. An increase of US\$1 million in *Atf* is associated with a reduction by between US\$15 and US\$20 in the cost of packing goods and loading them into a 20-foot container, transporting them to the port of departure and loading them onto the vessel or truck. Considering that, in 2000, the number of 20-foot containers loaded and unloaded in African ports reached almost 7.3 million, including 2.5 million in sub-Saharan countries (UNCTAD, 2003), the return on *Atf* is likely to be substantial.

The virtuous effect of *Atf* does not apply to the time taken to process imports instead (column 3). However, it is robust to the inclusion of the number of import documents as a control (which is, as expected, negatively related to the costs of importing, column 4) and to restricting the sample to those observations with a positive value of *Atf* (column 5). This should limit the potential error in reporting aid data, that is if the zeros are in fact unreported data rather than actual zero *Atf*.

In columns (7) and (8) we examine whether or not these effects are different in the case of SSA, by introducing a series of interaction terms between the AfT variables and

Table 5.3 The impact of Aid for Trade on the cost of trading, 2005–09

Sample Dep. Var.	(1) All cosimp	(2) All cosexp	(3) All timimp	(4) All cosimp	(5) $A_{TF} > 0$ cosimp	(6) All cosimp	(7) All cosexp
Trade fac. ($t-1$)	-15.00** (6.54)	-12.68* (7.31)	-0.21 (0.21)	-12.93** (6.48)	-19.70** (7.87)	-12.86** (6.39)	-14.49* (7.60)
Other TPR ($t-1$)	-2.10 (1.89)	-3.06 (2.12)	0.12 (0.08)	-2.05 (2.01)	-0.90 (2.51)	1.27 (2.30)	-0.48 (2.04)
Atf ($t-1$) $\times$ SSA						-19.89 (30.72)	24.42 (24.66)
Other TPR ($t-1$) $\times$ SSA						-4.84* (2.71)	-2.96 (3.38)
Import doc				-24.07 (17.53)			
Gov. Eff ($t-1$)	159.27 (108.10)	-6.33 (110.07)	-1.27 (1.34)	135.52 (84.97)	41.42 (153.61)	164.73 (109.98)	0.10 (109.21)
Ln pop ($t-1$) ('000)	63.67** (29.79)	10.46 (33.86)	1.66* (9.28)	70.50** (27.26)	351.65** (143.93)	63.51** (31.05)	13.66 (37.10)
Ln pop ($t-1$) sq. ('000)	-2.30* (1.23)	0.03 (1.40)	-62.18* (32.75)	-2.56** (1.10)	-10.67** (4.23)	-2.28* (1.29)	10.10 (1.51)
Ln GDP pc ($t-1$)	-324.05 (366.96)	296.49 (332.64)	-0.31 (7.71)	-333.14 (362.06)	-1,538.21* (897.08)	-312.43 (371.24)	267.92 (294.07)
Observations	501	501	607	501	266	501	501
R-sq. (within)	0.801	0.760	0.900	0.809	0.882	0.803	0.755
Countries	128	128	129	128	101	128	128

Robust standard errors in parentheses; * significant at 10 %; ** significant at 5 % *** significant at 1 %. All regressions include country-fixed effects, year effects and country-specific time trends.

the SSA dummy. The results suggest that, although there is no significant differential SSA impact for *Atf*, the other TPR aid has a significantly more negative impact on the cost of imports than in the other developing countries (column 6). In particular, every US\$1 million disbursed in TPR is associated with a US\$5 greater reduction in the cost of imports for every 20-foot container. This result suggests that the more general support for trade policy and regulation, such as trade-related human resource development and support to ministries and departments responsible for trade policy, is likely to yield particular benefits in SSA over and above those of other developing regions. The same does not apply to the cost of export (column 7).

After examining the impact of AfT on the cost of trading for the entire SSA region, in Table 5.4 we present the results for the major African RECs. We test for a differential impact, first vis-à-vis the entire sample of developing countries and then vis-à-vis the SSA region only. The results suggest that *Atf* has a more negative effect for SADC than for the rest of developing countries (column 1) as well as for the rest of SSA (column 2), although the coefficient is not significant at the standard levels. There is no differential impact for other TPR instead. The opposite holds for ECOWAS, where TPR has a more cost-reducing effect than in other developing countries (column 3) but not relative to the rest of SSA (column 4), while *Atf* has a less cost-reducing effect than in the rest of SSA (column 4). Finally, there is no discernible differential impact of *Atf* or TPR in the case of COMESA, vis-à-vis both the rest of developing countries (column 5) and SSA region (column 6).

5.4.2 Aid for Trade and exports

Table 5.5 presents the analysis of the impact of the two major categories of AfT, aid for infrastructure (*Ainfra*) and aid for productive capacity (*Apc*), on real exports. Again we follow Calì and te Velde (2009) closely, although we introduce a couple of more instruments to account for the endogeneity of the AfT variables. To minimise the possible measurement error we use only the period 2002–07, which guarantees a good coverage of the disbursement data. Column (1) confirms the results in Calì and te Velde (2009) that *Ainfra* has a positive and significant influence on exports, while *Apc* has a positive but not significant effect. Interestingly, these results change once we account for the differential impact of these variables on SSA in column (2). The coefficient of *Apc* becomes positive and significant while that of *Ainfra* remains significant but reduces in size.

This change is even more evident when we employ the FE IV estimation to account for the endogeneity of the AfT variables. We use a large battery of instruments, some of which are used for the first time in the literature on the impact of aid. In particular we use the index of civil liberties (CL), as in Calì and te Velde (2009), the total AfT provided by Japan (net of the part accruing to the specific recipient to ensure exogeneity) weighted by the recipient's distance to Japan, and the affinity index of the recipient with Japan, the USA, France and the UK (computed by Gartzke 2009 on the basis of UN voting patterns). The results suggest that *Ainfra* exerts a positive and significant impact on real exports (column 3), whose magnitude is six times as large as that in column (1). On the other hand, *Apc* exerts a negative but not significant

Table 5.4 The impact of Aid for Trade on the cost of trading in SSA, 2005–09

Var. Dep. Sample	(1) cosimp All	(2) cosimp SSA	(3) Cosimp All	(4) cosimp SSA	(5) cosimp All	(6) cosimp SSA
Trade fac. ($t-1$)	-13.54** (6.40)	-32.45** (15.21)	-15.24** (6.83)	-108.87* (58.44)	-13.95** (6.58)	-40.87* (21.11)
Other TPR ($t-1$)	-2.16 (2.00)	-5.17*** (1.58)	-1.32 (2.38)	-4.14** (1.96)	-1.66 (2.34)	-5.84** (2.48)
Trade fac. ($t-1$) × SADC	-64.12 (53.26)	-58.71 (50.53)				
Other TPR ($t-1$) × SADC	-0.47 (4.02)	3.79 (6.65)				
Trade fac. ($t-1$) × ECOWAS			2.59 (9.58)	80.01 (55.79)		
Other TPR ($t-1$) × ECOWAS			-4.14 (2.94)	-2.60 (2.99)		
Trade fac. ($t-1$) × COMESA					-120.43 (143.55)	-120.20 (120.89)
Other TPR ($t-1$) × COMESA					-1.02 (3.50)	1.62 (3.13)
Other controls	YES	YES	YES	YES	YES	YES
Observations	501	176	501	176	501	176
Number of recipients code	128	45	128	45	128	45
R-squared	0.802	0.901	0.802	0.902	0.802	0.901

Robust standard errors in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %. All regressions include country-fixed effects, year effects and country-specific time trends.

Table 5.5 The impact of Aid for Trade on real exports, 2002–07

	(1) AII FE	(2) AII FE	(3) AII FE IV	(4) AII FE IV	(5) AII – SSA FE IV	(6) SSA FE IV	(7) SSA FE IV
Aid for infra ($t-2$)	0.027*** (0.009)	0.019* (0.010)	0.173*** (0.063)	-0.017 (0.050)	0.110 (0.069)	0.326*** (0.115)	0.309*** (0.111)
Aid to prod. capacity ($t-2$)	0.012 (0.009)	0.016* (0.009)	-0.150 (0.135)	0.144* (0.077)	-0.033 (0.099)	-0.255 (0.167)	-0.278* (0.158)
Aid for infra ($t-2$) $\times$ SSA		0.033 (0.026)		0.181 (0.121)			
Aid to prod. capacity ($t-2$) $\times$ SSA		-0.020 (0.026)		-0.314* (0.186)			
CPI	-0.050 (0.043)	-0.040 (0.038)	0.049 (0.063)	0.010 (0.067)	0.228 (0.188)	0.127 (0.083)	0.120 (0.081)
Market potential	4.381*** (1.481)	4.310*** (1.519)	5.815*** (1.505)	4.985*** (1.311)	5.335*** (1.165)	-6.862 (9.845)	-6.420 (9.900)
Market potential							0.007* (0.004)
Observations	506	506	442	442	273	169	169
R-sq. (within)	0.590	0.592	0.167	0.395	0.683	-0.539	-0.484
Countries	99	99	88	88	54	34	34

Robust standard errors in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %. All regressions include country-fixed effects and year effects. *Ainfra* and *Apc* are instrumented through civil liberties (lagged one year), total AFT by Japan weighted by the recipient's distance from Japan, and the affinity index of the recipient with Japan, the USA, France and the UK (computed by Gartzke 2009).

impact on exports this time. Interestingly, these results are mainly explained by the differential impact that AfT has in SSA, as shown in column (4). Once we account for this differential impact, *Ainfra* becomes insignificant while *Apc* turns positive and significant as a result of the positive differential impact of *Ainfra* in SSA and the negative and significant differential impact of *Apc* in SSA. Taken at their face value, these results suggest that the negative impact of *Apc* on exports is *entirely* explained by the negative impact in SSA, and a good part of the positive impact of *Ainfra* on exports is also explained by its differential impact in SSA. In other words, a lot of the different impact of *Ainfra* (largely positive) and *Apc* (mainly negative) is explained by their behaviour in SSA. As a further confirmation of this pattern, we run the FE IV regressions separately for the non-SSA (column 5) and SSA (col. 6) sub-samples. The results suggest that *Ainfra* has a positive effect on exports for non-SSA which is only significant at the 11 per cent level, while *Apc* has an insignificant impact for the same sample. On the other hand, *Ainfra* has a strongly positive impact on exports, which is three times as large as the impact on non-SSA countries, while the *Apc* coefficient is much more negative (and significant at the 13 per cent level) than for the non-SSA sub-sample. Interestingly, the market potential coefficient is insignificant for the SSA sample, which is probably explained by the limited intra-regional trade in SSA (thus reducing the dependence of exports on the income of neighbouring countries). On the basis of this result, we then try to examine the extent to which *Ainfra* may increase the dependence of SSA exports on the income of neighbouring countries by facilitating trade between African countries. We do so by adding an interaction term between *Ainfra* and the market potential variable in column (7). The positive and significant coefficient of this interaction suggests that indeed part of the beneficial effect of *Ainfra* in SSA occurs through the facilitation of intra-SSA trade (which increases the coefficient of the distance-weighted market potential variable). This interaction term is instead insignificant for the overall sample of developing countries (not reported here), suggesting that *Ainfra* reduces the barriers to trade with neighbouring countries mainly in SSA.

Table 5.6 presents the results for the main SSA RECs. Again, there are marked differences across them. Similarly to SSA as a whole, *Apc* in SADC has a more negative impact than in other developing countries. That is valid for both FE and FE IV estimations (columns 1 and 2). On the other hand, there is no differential impact of *Ainfra* in SADC. In ECOWAS (columns 3 and 4) there seems to be no differential impact of either *Ainfra* or *Apc*, except for a slightly more positive impact of *Apc* vis-à-vis the rest of developing countries when using FE IV estimation (column 4). Finally, both *Ainfra* and *Apc* appear to impact exports in COMESA in the same way as they do in the overall sample of developing countries (columns 5 and 6).

We also check the robustness of the results to employing a dynamic specification with lagged exports estimated through system GMM, as explained in the previous section. Table 5.7 presents the results, which broadly confirm the differential impact of *Ainfra* vis-à-vis *Apc*, with the former exerting a positive and significant effect on exports while the latter has an insignificant impact on exports. This time, however, there does

Table 5.6 The impact of Aid for Trade on real exports in SSA, 2002–07

	(1) FE	(2) FE IV	(3) FE	(4) FE IV	(5) FE	(6) FE IV
Aid for infra ($t-2$)	0.027** (0.011)	0.020 (0.056)	0.025** (0.010)	0.157*** (0.059)	0.023** (0.011)	0.176** (0.076)
Aid to prod. capacity ($t-2$)	0.019** (0.009)	0.168 (0.114)	0.014 (0.009)	-0.104 (0.100)	0.020** (0.009)	-0.175 (0.147)
Aid for infra ($t-2$) $\times$ SADC	0.016 (0.032)	0.013 (0.105)				
Aid to prod. capacity ($t-2$) $\times$ SADC	-0.046 (0.038)	-0.266 (0.191)				
Aid for infra ($t-2$) $\times$ ECOWAS			0.042 (0.037)	-0.064 (0.088)		
Aid to prod. capacity ($t-2$) $\times$ ECOWAS			-0.037 (0.054)	0.163 (0.107)		
Aid for infra ($t-2$) $\times$ COMESA					0.045 (0.030)	-0.084 (0.123)
Aid to prod. capacity ($t-2$) $\times$ COMESA					-0.053 (0.035)	-0.039 (0.165)
CPI	-0.052 (0.045)	-0.060 (0.049)	-0.049 (0.043)	0.043 (0.058)	-0.039 (0.044)	-0.017 (0.085)
Market potential	4.404*** (1.481)	5.203*** (1.329)	4.418*** (1.486)	5.539*** (1.390)	4.357*** (1.475)	5.611*** (1.577)
Observations	506	442	506	442	506	442
R-sq. (within)	0.593	0.398	0.591	0.333	0.595	0.026
Countries	99	88	99	88	99	88

Robust standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%. All regressions include country-fixed effects and year effects. *Ainfra* and *Apc* are instrumented through civil liberties (lagged one year), total AIT by Japan weighted by the recipient's distance to Japan, and the affinity index of the recipient with Japan, the USA, France and the UK (computed by Gartzke 2009).

Table 5.7 The impact of Aid for Trade on real exports, dynamic estimations, 2002–07

Sample Method	(1) All Sys GMM	(2) All Sys GMM	(3) All – SSA Sys GMM	(4) SSA Sys GMM	(5) All Sys GMM	(6) All Sys GMM	(7) All Sys GMM
Exports ($t-1$)	0.604*** (0.082)	0.685*** (0.058)	0.563*** (0.066)	0.740*** (0.052)	0.641*** (0.075)	0.630*** (0.064)	0.655*** (0.075)
Aid for infra ($t-2$)	0.014** (0.006)	0.012* (0.006)	0.017* (0.009)	0.008 (0.011)	0.006 (0.006)	0.014** (0.007)	0.007 (0.006)
Aid to prod. capacity ($t-2$)	0.004 (0.007)	0.010 (0.007)	0.007 (0.006)	0.003 (0.011)	0.009 (0.008)	0.005 (0.007)	0.010 (0.008)
Aid for infra ($t-2$) $\times$ SSA		–0.015 (0.011)					
Aid to prod. capacity ($t-2$) $\times$ SSA		–0.006 (0.017)					
Aid for infra ($t-2$) $\times$ SADC					–0.002 (0.012)		
Aid to prod. capacity ($t-2$) $\times$ SADC					–0.018 (0.015)		
Aid for infra ($t-2$) $\times$ ECOWAS						0.003 (0.021)	
Aid to prod. capacity ($t-2$) $\times$ ECOWAS						–0.012 (0.030)	
Aid for infra ($t-2$) $\times$ COMESA							0.011 (0.012)
Aid to prod. capacity ($t-2$) $\times$ COMESA							–0.015 (0.014)
CPI	–0.031* (0.018)	–0.035* (0.018)	0.048 (0.072)	–0.011 (0.014)	–0.034** (0.017)	–0.023 (0.019)	–0.021 (0.015)
Market potential	1.798** (0.801)	1.836** (0.745)	2.838*** (0.825)	–2.526 (3.675)	1.637** (0.734)	1.863** (0.794)	1.565** (0.690)
Observations	491	491	307	184	491	491	491
Countries	96	96	61	35	96	96	96

Robust standard errors in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %. All regressions include country-fixed effects and year effects. Dependent variable is value of total exports in constant 2000 US\$. All variables are in log; endogenous variables are lagged exports; *Aidfra* and *Apc* across all the specifications.

not appear to be any differential effect of *Ainfra* or of *Apc* on exports in SSA (column 2). If anything, there is a slightly, albeit not significantly, less positive impact of *Ainfra* in SSA. This is confirmed also when we run the estimations separately for SSA (column 4) and for other developing countries (column 3). Similarly, no differential impact of either *Ainfra* or *Apc* is visible for the three main RECs in SSA (columns 5–7). These results suggest that the differential impact of *Ainfra* and *Apc* in SSA does not hold on short-term export growth (i.e. controlling for lagged exports), whereas it seems to apply for medium-term growth of exports.

Having established the positive impact of *Ainfra* on exports, it is worth examining in some more details what types of intervention drive such a positive impact. We do so by decomposing the *Ainfra* variable into its main categories: transport and storage, energy, and financial and business services infrastructure. We present the results in Table 5.8. As we do not have an appropriate set of instruments for all of the aid variables now in the specification, we run only the FE and GMM estimations. The results suggest that it is aid to financial and business infrastructure (F&B) that has the strongest effect on exports for the entire sample of developing countries (column 1). The other infrastructure aid types have positive but not significant effects. The impact of F&B seems to be even stronger for SSA (column 2). In general, the other two types of infrastructure also have larger returns to exports in SSA, although the differential impact is not significant at standard levels. When we run the estimation only for SSA (column 3), the coefficients of the *Ainfra* terms are larger than for the entire sample of developing countries, with F&B having the largest effect, followed by transport (which is only mildly significant) and then energy (significant at the 10 per cent level). These results lose significance in the system GMM estimations (columns 4 and 5), although the message that F&B has the strongest impact on exports among the types of infrastructure aid is retained. In the system GMM however, it is transport aid that has the strongest differential impact in SSA among the infrastructure aid categories. Although preliminary, and bearing in mind the notes of caution required to interpret them in the absence of appropriate instruments, these results point to the relative importance of soft infrastructure investments in developing countries and in SSA in particular. They also suggest that other forms of infrastructure support are important as well, especially in SSA, including transport and energy. They broadly confirm the higher returns to *Ainfra* in SSA.

5.5 Summary and policy implications

This chapter has provided one of the first empirical examinations of the impact of AfT on the SSA region. Building on Cali and te Velde (2009), it has analysed to what extent AfT flows have translated into improved trade performance in SSA and its main RECs and how this compares with other developing countries. We employed two different types of analysis to that end: one examining the effect of specific types of aid to trade policy and regulations on the cost and time of processing imports and exports; and one looking at the effect of the two broad categories of AfT on exports. In line with the results in Cali and te Velde (2009), we found that *Atf* has a positive

Table 5.8 The impact of Aid for Trade on real exports, infrastructure types, 2002–07

Method sample	(1) FE All	(2) FE All	(3) FE SSA	(4) Sys GMM All	(5) Sys GMM All
Aid to transport infra ($t-2$)	0.010 (0.007)	0.004 (0.006)	0.032 (0.021)	−0.001 (0.004)	−0.003 (0.004)
Aid to energy infra ($t-2$)	0.006 (0.005)	0.002 (0.005)	0.030* (0.017)	−0.002 (0.004)	−0.002 (0.004)
Aid to financial and business infra ($t-2$)	0.018** (0.008)	0.004 (0.009)	0.060*** (0.020)	0.011 (0.008)	0.005 (0.004)
Aid to prod. capacity ($t-2$)	−0.001 (0.013)	0.010 (0.011)	−0.061 (0.037)	0.000 (0.007)	0.005 (0.008)
Aid to transport infra ($t-2$) × SSA		0.027 (0.022)			0.013 (0.012)
Aid to energy infra ($t-2$) × SSA		0.019 (0.016)			−0.004 (0.011)
Aid to financial and business infra ($t-2$) × S SA		0.048** (0.022)			0.010 (0.022)
Aid to prod. capacity ($t-2$) × SSA		−0.059 (0.040)			−0.016 (0.016)
CPI	−0.064 (0.040)	−0.044 (0.035)	−0.031 (0.033)	−0.025* (0.013)	−0.014 (0.014)
Market potential	3.314** (1.568)	3.211* (1.625)	−15.993 (11.834)	1.510** (0.723)	1.164* (0.655)
Exports ($t-1$)				0.709*** (0.044)	0.739*** (0.050)
Observations	423	423	156	379	379
Countries	89	89	33	81	81
R-squared	0.588	0.604	0.431	—	—

Robust standard errors in parentheses; * significant at 10 %; ** significant at 5 %; *** significant at 1 %.

All regressions include country-fixed effects and year effects. Dependent variable is value of total exports in constant 2000 US\$. All variables are in log; endogenous variables in GMM estimations are lagged exports and all Aft variables.

and significant effect on the cost of importing and exporting. In particular an increase of US\$1 million in *Atf* is associated with a reduction by between US\$15 and US\$20 in the cost of packing goods and loading them into a 20-foot container, transporting them to the port of departure and loading them on the vessel or truck. Moreover, although there is no significant differential SSA impact for *Atf*, the other TPR aid has a significantly more negative impact on the cost of importing in SSA than in the other developing countries. Looking at specific effects in the main RECs, the results suggest that *Atf* has a more negative effect for SADC than for the rest of developing countries as well as than for the rest of SSA, whereas, in ECOWAS, TPR has a more cost-reducing effect than other developing countries but not relative to the rest of

SSA, while *Atf* has a less cost-reducing effect than in the rest of SSA. The effects of *Atf* or TPR in COMESA are in line with the other developing countries rather than SSA.

In terms of the broad impact of AfT on exports, consistently with Calì and te Velde (2009), we find that *Ainfra* has a positive and significant impact on exports, whereas *Apc* has no significant impact. Interestingly, these results seem to be at least partly driven by the differential impact of these types of AfT in SSA. Whereas the returns to *Ainfra* on exports are much larger in SSA than in the other developing countries, the opposite is true for *Apc*. It looks as if SSA benefited significantly from infrastructure investments, but not from direct support to its productive sectors. It is mainly SADC (rather than ECOWAS and COMESA) that seems to drive this differential pattern of *Ainfra* and *Apc* in SSA. Our analysis further suggests that part of the beneficial effect of *Ainfra* in SSA occurs through the facilitation of intra-SSA trade. Finally, the analysis points to the relative importance of soft infrastructure investments (finance and business services) in developing countries and in SSA in particular, but it also suggests that other forms of infrastructure support are important as well, especially in SSA, including transport and energy.

Annex 5.1 The full working of the theoretical model

In the model, each country produces only one good, differentiated from the others by the place of origin; the supply of each good is fixed; and consumers have identical and homothetic preferences represented by a constant elasticity of substitution (CES) utility function. The collective utility function of individuals in country j is denoted by:

$$U_j = \left(\sum_{i=1}^N \varphi_i^{1/\sigma} C_{ij}^{(\sigma-1)/\sigma} \right)^{\frac{\sigma}{\sigma-1}} \quad (5.A1)$$

where σ is the elasticity of substitution between all goods, φ is the share of good from i in total expenditure in j and c_{ij} the value of consumption of the good produced in country i by individuals in country j , with $i, j \in [1, N]$.

The utility function is subject to the budget constraint stating that the value of goods consumed by individuals in country j needs to equal the national income of j :

$$y_j = \sum_{i=1}^N C_{ij} p_{ij} \quad (5.A2)$$

where p_{ij} is the price in j of the good produced in i . Defining p_i as the exporter's supply price, then $p_{ij} = p_i \tau_{ij}$ where $\tau_{ij} \geq 1$ and includes all types of trade costs, for example transportation, tariffs, administrative costs of trade and information costs. These costs are modelled as the standard iceberg type.⁸

Maximising equation (5.A1) subject to the budget constraint (5.A2), and after some manipulation, we obtain the total (real) consumption (i.e. import) of good i by country j :

$$C_{ij} = \frac{\phi_i Y_j}{\tau_{ij} p_i} \left(\frac{\tau_{ij} p_i}{\Pi_j} \right)^{1-\sigma} \quad (5.A3)$$

where

$$\Pi_j = \left(\sum_{i=1}^N \phi_i \tau_{ij}^{1-\sigma} p_i^{1-\sigma} \right)^{\frac{1}{1-\sigma}} \quad (5.A4)$$

is a CES index of the trade costs faced in exporting to j , that is an index of trade remoteness of country j ; Y_j is total income in country j ($Y_j = p_j Q_j$). Following (5.A3) the actual – free on board – value of exports of country i to country j is given by:

$$X_{ij} = C_{ij} p_i = \frac{\phi_i Y_j}{\tau_{ij}^\sigma} \left(\frac{\Pi_j}{p_i} \right)^{\sigma-1} \quad (5.A5)$$

Aggregating all bilateral exports from one source as defined in (5.A5), we obtain the equation for the total value of exports from country i :

$$X_i = \frac{\phi_i}{p_i^{\sigma-1}} \sum_{j=1}^N \frac{Y_j \Pi_j^{\sigma-1}}{\tau_{ij}^\sigma} \quad (5.A6)$$

This implies that the exports from i are positively related to countries' preferences for goods from i (i.e. a measure of how appealing good i is in the global market) and to the demand capacity of all potential importing countries j (Y_j), and negatively related to trade costs faced by i in exporting to all other destinations. The direction of influence of the price of i on exports depends on σ : in particular, if $\sigma > 1$ then $\partial X_i / \partial p_i < 0$. This condition states that, when the elasticity of substitution (between goods) is high, an increase in price yields a more than proportionate reduction in export volumes.

AfT enters the picture in (5.A6) essentially by influencing two parameters of the equation: ϕ_i and τ_{ij} . First, AfT may affect exports by strengthening country i 's production competitiveness, which would in turn raise ϕ_i . This is the kind of assistance that aid to productive capacity (Apc) could provide. We can think of this as an improvement in the quality of good i which induces a relative increase in the preference of the rest of world towards i . Given equation (5.A6), other things being equal, this would translate in an increase in exports.

Second, following Bouet et al. (2008), τ_{ij} can be expressed as a function of administrative and legal barriers, distance and infrastructure:

$$\tau_{ij} = (1 + t_{ij}) b_i b_j f(I_i, I_j) d_{ij} \quad (5.A7)$$

where t_{ij} is the bilateral import duty applied by country j on exports from i , b_i (b_j) is the cost of processing exports (imports) in the exporting (importing) country; transportation costs are assumed to be a positive (linear) function of d_{ij} and a negative function of the level of economic infrastructures I in country i and j (i.e. $\partial f/\partial I_i < 0$ and $\partial f/\partial I_j < 0$). A few studies have already quantified the effects of infrastructure provision on trade, finding a positive correlation.⁹ AfT to country i may affect both b_i and I_i . In particular, Aid for Trade facilitation (Atf) may reduce the time and costs of processing trade (b_i); and aid to economic infrastructure (AINFRA) may increase the level of I_i . To the extent that these types of AfT affect these variables, from (5.A7) we have that $\partial \tau/\partial ATF < 0$ and $\partial \tau/\partial AINFRA < 0$.

In order to make the hypotheses on the relation between exports and AfT explicit, let us assume a simple inverse relation between trade costs and infrastructure and let us re-express total infrastructure in country i as the sum of AINFRA and domestically financed economic infrastructure I_D such that (5.A7) becomes:

$$\tau_{ij} = \frac{(1 + t_{ij})b_i(ATF)b_jd_{ij}}{(AINFRA + I_D)_i + I_j} \quad (5.A7')$$

Plugging (5.A7') into (5.A6), the export equation then becomes:

$$X_i = \frac{[\varphi_i(APC)](AINFRA + I_D)_i^\sigma}{p_i^{\sigma-1}[b_i(ATF)]^\sigma} \sum_{j=1}^N \frac{Y_j \Pi_j^{\sigma-1}}{K_{ij}^\sigma} \quad (5.A8)$$

where $K_{ij} = ((1 + t_{ij})b_jd_{ij})/I_j$

This is a given component in our empirical model, as the analysis looks at the effects of AfT on a country's total exports (rather than bilateral exports) over time. Thus we are able to use country-fixed effects, which take care of the effects of bilateral distance d_{ij} (i.e. the country's location in our framework). Also, given the framework we use, we are interested not in bilateral trade costs as such but rather in unilateral trade costs, that is the costs of trading of country i with all other countries. Because of this, the other determinants of trade costs in K_{ij} specific to the importing country j (i.e. b_j and I_j) can be approximated by time dummies in a panel data analysis (capturing the average level of these determinants across countries in any year). Finally, we would ideally need to have the bilateral tariffs (t_{ij}) faced by country i in each country; such tariffs have a fairly high variation across countries but a relatively small one over time, so country-fixed effects should be able to capture most of the variation in this case.

According to equation (5.A8), various types of AfT have all a positive impact on exports. In particular:

$$\frac{\partial X_i}{\partial (APC)_i} = \frac{\partial X_i}{\partial \varphi_i} \frac{\partial \varphi_i}{\partial (APC)_i} > 0 \text{ (as both terms are positive)}$$

$$\frac{\partial X_i}{\partial(ATF)_i} = \frac{\partial X_i}{\partial b_i} \frac{\partial b_i}{\partial(ATF)_i} > 0 \text{ (as both terms are negative)}$$

and $(\partial X_i)/(\partial(AINFRA)_i) = W_i Z_{ij} (AINFRA + I_D)_i^{\sigma-1} > 0$, where W_i and Z_{ij} are constant positives from equation (5.A8) (referred to country i and country pairs i – j respectively).

Given the availability of data, we empirically implement a reduced form of (5.A8), measuring $\partial X_i/\partial(APC)_i$ and $\partial X_i/\partial(AINFRA)_i$. We also separately compute $\partial b_i/\partial(ATF)_i$. We cannot include b_i in the empirical analysis of (5.A8), as data are available only for the last three years. However, the analysis of ATF 's impact on b_i is important, as the costs faced and the time taken by firms to trade goods are significant determinants of a country's competitiveness. Djankov et al. (2006) find that each additional day that a product is delayed before shipping reduces trade by at least 1 per cent.

Annex 5.2 The Affinity of Nations Index

This index, calculated by Gartzke (2009), measures the political affinity of pairs of states (dyadic) on the basis of voting patterns at the UN General Assembly (UNGA). It relies on the theory defined by Signorino and Ritter (1999), which identifies a suitable measure of strategic similarity in foreign policy on the basis of a metric distance between states within a policy space. This space is determined by the kind of policy decisions that each state makes, on trade agreements, strategic alliances and votes at the UN. The use of this index assumes, thus, that voting patterns at the UNGA are a fundamental component of the foreign policy portfolio of each state. Formally, the index is computed as follows:

$$S_{i,j} = 1 - 2 \frac{d(V_i, V_j)}{d_{MAX}}$$

where i and j denote the countries in the dyad, $d(V_i, V_j)$ is the difference between countries in terms of UNGA votes (1 = approval; 2 = abstention; 3 = disapproval) and d_{MAX} is the largest possible difference in UNGA votes for a given year. For instance, if there have been 100 resolutions in a year, $d_{MAX} = 200$. The index therefore ranges from -1 (minimum affinity) to 1 (maximum affinity). We compute four variables for each recipient country i by using the four major AfT bilateral donors for which data are available as counterpart countries j , that is Japan, the USA, the UK and France.

Notes

- 1 Authors' calculations on the basis of UNCTAD (2009) data.
- 2 The categorisation of LDCs is due to the United Nations. A country is classified as an LDC based on three criteria: low income, weak human resource base and economic vulnerability. The United Nations Committee for Development Policy (CDP) is responsible for assessing LDC status, based on a set of indicators under the above criteria. When it was initiated in 1971, the group comprised 25 countries. The membership swelled to reach 50 over the next two decades. Only three countries have ever graduated from the list: Botswana in 1994, Cape Verde in 2007 and Maldives in 2011.

- 3 According to the United Nations Conference on Trade and Development (UNCTAD), productive capacities include physical and human resources, entrepreneurial capabilities and productive linkages, which together determine the capacity of a country to produce goods and services. This definition is broad and includes infrastructural development, accumulation of factors of production in agriculture, industry and services sectors, and enhancement of productivity etc.
- 4 This is based on the widely used UNCTAD export diversification index.
- 5 Hesse (2008) provides recent empirical evidence.
- 6 Results available from the authors upon request.
- 7 Results available from the authors upon request.
- 8 This means that, if an amount x_{ij} of good is shipped from i to j , only x_{ij}/τ_{ij} will reach location j .
- 9 For example, François and Manchin (2007) estimate that an increase of one standard deviation (from the mean) in the communications infrastructure raises the volume of trade by roughly 11 per cent, compared with a 7 per cent effect on transport infrastructure and a 2 per cent effect on trade for tariffs. Buys et al. (2006) find that upgrading a primary road network connecting the major 83 urban areas in SSA would expand overland trade in the region by around US\$250 billion over 15 years.

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Chapter 6

Aid for Trade in Practice: Addressing Political Economy Barriers to Improve Development Outcomes

Yurendra Basnett and Jakob Engel

6.1 Introduction: Aid for Trade within a changing global economy

The consensus among World Trade Organization (WTO) member states on the need for a more structured and enhanced approach to trade-related development assistance, or Aid for Trade (AfT), was formalised through Article 57 of the 2005 Hong Kong Ministerial Conference (WTO 2005).¹ This marked a significant change in global trade and development policy. It implicitly recognised that supply-side investments and complementary policies to help developing countries lower the cost of trading, increase the productivity of producers, help firms diversify into new export products and integrate into global value chains are essential to maximising the benefits from trade reforms and to cushion them against potential adverse welfare impacts.

Since then donor spending on programmes and projects aimed at supporting developing countries' ability to trade has increased rapidly, standing at over US\$32 billion in 2010. AfT now constitutes up to one-third of all official development assistance (ODA). While many of these investments originate from Organisation for Economic Co-operation and Development (OECD) donor countries, emerging economies – most notably China, India, South Africa and Brazil, among others – have been increasingly providing trade-related support.

However, eight years after the launch of the AfT initiative, optimism is punctuated by the ongoing global economic crisis, which is continuing to have important implications for trade and development. First, the feeble economy, particularly in the Global North, means that world trade is only expanding slowly, which in turn reduces developing countries' opportunity to use trade as a source of growth and economic development. Second, the implications of the crisis on advanced economies are already affecting levels of ODA, which in 2011 declined for the first time since the early 2000s. Within the context of fiscal austerity, donors are facing an increasing need to justify large aid flows and demonstrate that taxpayer funds are generating 'value for money' and that interventions are 'working'.

In this context, an emergent focus of the 2013 AfT Global Review is examining how AfT can help developing countries integrate in global value chains (GVCs). There is also increasing interest in exploring how AfT can act as a catalyst for private sector investments. As the nature of trade-related development challenges change, so will

the focus of AfT. In this chapter, we argue that in order for AfT to achieve its intended impacts, whether it is reducing trade cost, helping integrate into GVCs or mobilise private sector investment, it will need to be mindful of the frequent political economy barriers that undermine effectiveness that in some cases are common to ODA in other sectors, some of which is exacerbated by the unique challenges and context of AfT.

This chapter draws on the broader literature on aid effectiveness, as well on country and donor experiences of AfT, to better understand what enables greater effectiveness and what kind of factors constrain it. It analyses where barriers to effectiveness emerge and then examines circumstances that affect outcomes at each phase of the AfT project or programming cycle. While this will provide only indicative guidance for policy-makers, as much depends on the context of AfT interventions, we can highlight some of the factors most likely to facilitate improved outcomes at different entry points.

This chapter is structured as follows: the next section explains our analytical framework in greater depth. Sections III to IV explain each of the four stages within this framework: (1) determining AfT priorities; (2) structuring AfT delivery; (3) design and implementation of AfT projects and programmes; and (4) monitoring and evaluation of impacts. The conclusion draws out some of the overarching lessons that a political economy framework to AfT effectiveness can provide for officials in donors and recipient countries.

6.2 The Aid for Trade project cycle as a series of complex collective action problems: an analytical framework

The empirical literature tends to support the assumption that expanding trade is likely to increase growth and reduce poverty for most countries in the long run (Rodrik 2008).² In theory, for developing countries (which tend to have scarce capital and abundant labour), increased trade allows for a higher return to labour and an improvement in the income distribution towards wages and the poor (Page 2007). This can happen through a number of different transmission channels, including lower prices, increased competition and the creation of economies of scale, as well as the development of new industries and their integration into global value chains (McCulloch et al. 2001).

However, the exact implication of trade reforms for poverty reduction is complex and nuanced (see Bird 2004). The effect of increased trade (particularly following liberalisation) on growth and poverty will depend on the structure of the economy and whether trade-induced growth occurs in sectors where a large number of the poor are economically active; whether import-competing industries can adjust to foreign competition; to what extent growth translates into job creation and wage increases; whether excess labour can be absorbed; and whether the poor are equipped to take advantage of new job opportunities. As such, the aggregate and distributional impact of trade reforms depends significantly on complementary policy choices.

In addition to countries fearing the erosion of preferential market access, AfT is relevant for countries facing supply-side constraints to improving trade performance. The 'Commission for Africa' (2005), for example, identifies geographical constraints

as one of the two root causes of Africa's poor development performance (the other being governance). It points out that these landlocked countries, where more than a quarter of Africa's total population lives, face a substantial competitive disadvantage and therefore are much more likely to remain poor.

While the literature confirms that AfT can be effective at the macro and the micro levels, its impacts may vary considerably depending on the type of intervention, the income level and location of the recipient country and the sector to which AfT flows are directed. For example, the empirical literature tends to confirm that AfT has been effective in raising exports and improving the investment climate. However, the evidence on the effectiveness of different types of AfT flows is mixed (Basnett et al. 2012): results are not always comparable because of different definitions of its specific categories. However, most studies find that the benefits from AfT tend to increase with more targeted flows.³

Notwithstanding the above, many AfT interventions are failing to deliver desired outcomes and impacts. This is largely because AfT is susceptible to the same collective action problems faced by other forms of ODA, as the leading actors, organisations and incentives are likely to be very similar for both. While such issues have been analysed at length with regards to ODA at large, examination of these issues as they relate to AfT remains largely missing. Overcoming problems of collective action and making AfT effective will require paying attention to potential barriers at each stage of the AfT programme cycle.

This draws on an extensive body of work over the past decade examining aid effectiveness through an institutional or political economy lens (see e.g. Ostrom et al. 2001). This has been seminal in recognising that institutional and organisational structures and relationships may affect the effectiveness and sustainability of interventions, and the nature of these bottlenecks has become central to discussions on aid programming in recent years in the delivery of public services, ranging from social sectors to transport and agriculture (see e.g. Pritchett and Woolcock 2004; Keefer 2008; Booth and Golooba-Mutebi 2009; Wild et al. 2012). However, their specific relevance to AfT, and the potential constraints in cases where the overarching objective is to alleviate barriers to trade, remains underexamined. As such, this study aims to provide an indicative overview of how these barriers to effectiveness manifest themselves in the trade context and what the potential entry points might be for addressing them.

We propose a framework entailing four stages within the AfT programming cycle in which donor and recipient behaviour, as well as the relationship between donors and recipients, influences the effectiveness of AfT (Basnett and Engel 2013). We suggest examining AfT through a political economy lens and analysing how conflicting incentives for different actors often lead to bottlenecks. We examine what the available qualitative and quantitative data suggest about the main barriers to greater effectiveness at each stage of the programming cycle, what individual country experiences tell us and, finally, how both donors and recipients can address some of these barriers to ensure greater AfT effectiveness. These four stages are:

1. **determining AfT priorities**, including the identification of binding trade-related constraints to growth, the needs assessment process, the integration of needs

into national development plans and how donors respond to trade-related needs through their country or regional programmes;

2. **structuring AfT delivery**, examining particularly what we know about the different delivery instruments, the benefits and drawbacks of bilateral and multilateral programmes as well as pooled funds and regional approaches entailing multiple recipients (including AfT to regional economic communities (RECs) and transport corridors);
3. **the design and implementation of projects and programmes**, focusing on delivery of national and regional AfT programmes, issues of intra and interdonor co-ordination, integration of country systems, interministerial co-ordination on the recipient side and the linkages of programmes to the transnational and regional levels;
4. **monitoring and evaluation (M&E)**, including different methodologies used and how this informs ongoing and future programmes at the global, regional, national and project level.

6.3 Needs identification

6.3.1 Identifying binding constraints

The prioritisation of AfT interventions is usually carried out through a needs assessment process that reveals the key constraints countries face on their more active participation in global trade. These are intended to guide the integration of trade into national development plans. While the level of consultation and analysis varies among developing countries, this process and its translation into programming helps to determine the effectiveness of AfT.

For least developed countries (LDCs), this has become more formalised through the Diagnostic Trade Integration Study (DTIS) process of the Enhanced Integrated Framework (EIF). In the EIF process, a DTIS is generally led by a trade expert who assesses the viability of all trade-related economic sectors in order to determine the most urgent constraints. Prioritised recommendations are provided through a DTIS ‘action matrix’. A stakeholder workshop validates these findings. Furthermore, the EIF process establishes an institutional mechanism to guide the setting and addressing of identified AfT priorities, including an EIF steering committee.⁴ The actors in this committee play an important role in translating the articulation of needs into priorities and actions as well as in mobilising resources around these priorities.⁵ While the DTIS process for articulating AfT needs is far from ideal, it provides a largely predictable process for articulating an approximated hierarchy of AfT needs. In its absence, how well AfT needs are articulated is often determined by the availability and enthusiasm of officials and policy advisors in the recipient country’s Ministry of Trade.

The above frequently raises questions of representativeness. In some countries, the needs assessment process is seen as just a project of the Ministry of Trade and select

donors. As such, it fails to incorporate the cross-cutting significance of trade-related constraints for other ministries. It therefore lacks the necessary cross-governmental prioritisation and action matrices are followed up on, either by the governments or by donors. Failure to follow up, Hallaert and Munro argue, 'can be attributed, at least in part, to the structure of the template and the process that is more conducive to the identification of overall needs rather than the identification of the binding constraints' (Hallaert and Munro 2009: 21).

6.3.2 Mainstreaming Aid for Trade priorities

AfT needs can best be addressed when trade is mainstreamed into the national development agenda, with linkages between trade and the rest of the economy comprehensively analysed and articulated, and the weakest links within the export economy identified and strategies devised to address these. There has been progress in this area and, in many developing countries, trade is increasingly seen as a lever for growth and a prerequisite for poverty reduction. In surveys carried out for the 2009 Global Review, 96 per cent of recipients claimed that trade had been partly or fully mainstreamed into development strategies (Hallaert 2012).⁶

However, there are differences in the degree and scope to which trade is mainstreamed into plans and strategy documents, including the extent to which actual quantitative targets and implementation plans are set out that go beyond the very general rhetoric of mainstreaming. In many developing countries, trade remains of secondary importance and is mentioned merely passively in national plans (Basnett et al. 2012). Further, even when trade priorities are mainstreamed into the national development agenda, it provides a necessary though not sufficient condition for donors to respond and prioritise this in their programming. As a result, although the majority of countries increasingly recognise the crucial role of trade for growth and development, according to surveys carried out for the most recent Global Review, strategies frequently 'lack operational objectives and action plans' (OECD/WTO 2011: 32). Further, needs assessments often do not provide information about which interventions work and which do not, and which interventions are most cost effective (Cadot et al. 2011). They therefore provide limited guidance over what kinds of interventions are most needed to alleviate trade-related constraints and which are likely to be most effective given the particular country context.⁷

In many cases, particularly in LDCs, trade policies are either absent or muted or exist parallel to the national development agenda. When trade is mentioned in the national development agenda, it is often limited to 'improving performance' and does not accompany associated policies and strategies to achieve such goals. Furthermore, trade is not proactively leveraged as an integral component in achieving border developmental outcomes. For example, while Malawi's National Development Plan reflects trade objectives for ten key policy areas, Said and colleagues argue that 'trade does not appear to be mainstreamed in a substantive manner', that donors believe that trade has not been integrated at the programme level and that 'no link has been made between the [Aid for Trade] agenda and the development agenda' (Said et al. 2011: 23).

Table 6.1 Identifying Aid for Trade needs

Key processes within stage	Potential barriers to effectiveness
Determining relevance of trade-related constraints in poor development outcomes	• Availability of data on the impact of trade-related constraints • Selecting appropriate tools to analyse constraints • Competing priorities in other sectors. • Lack of familiarity with country context by experts identifying constraints.
Prioritising binding constraints to improved Trade performance	• Limited resources to prioritise among large number of needs. • Lack of capacity or agreement on priorities between actors. • Frequent lack of consultation of other line ministries, The private sector and other non-state actors.

A commonly cited counter-example is Cambodia's experience of integrating its trade reforms and AfT needs into its national development strategies through its sector-wide approach (SWAp) for trade. The effectiveness of Cambodia's mainstreaming efforts have been attributed to strong government leadership, a movement away from projects towards the SWAp model, generous funding through a multidonor trust fund (MDTF), co-ordinated donor support and private sector involvement (Haddad 2009). Throughout the process, the Ministry of Commerce engaged line ministries through trade SWAp working groups (*ibid.*). Particularly important was the prime minister's explicit support.

AfT can be integral to addressing trade-related constraints but, as outlined above, there are numerous barriers both to determining the relevance and nature of these constraints and to prioritising them. Substantial investments in needs assessments frequently do not translate into the actual direction of programming, as donors often support projects that may not address the most binding constraints to trade. Therefore, AfT is likely to be most effective if constraints are identified through a comprehensive analysis and data collection process, and context-appropriate interventions are prioritised and costed. A government-led consultation and negotiation process including the private sector, civil society interests and donors should determine a clear implementation and financing strategy that is integrated into the national development plan and contains measurable targets and a clear lead agency or ministry (Table 6.1).

6.4 Selecting the most effective structure for AfT delivery

6.4.1 Loans, grants and pooled funds

Recent years have seen increased AfT commitments and a growing diversity in approaches to delivering funds. There has been a broad spread of AfT coverage but, as a result, some areas are undersupplied, whereas shifting donor priorities mean a lack of funding consistency for recipients. Recent movement towards more pooling of funds, more transnational and corridor approaches to AfT and a greater focus on effectiveness is likely to have helped address some of these concerns.

There is a broad literature on the key features as well as the advantages and disadvantages of different aid modalities (see e.g. Foster and Leavy 2001; DFID 2008a; Tavakoli et

al. 2013) and of using loans instead of grants (see ETTG 2011).⁸ While exceeding the scope of this chapter, blending mechanisms (i.e. adding grants to loans) aim to achieve a number of objectives, including the increase of the volume of development finance in a context of constrained resources. According to the most recent AfT review (OECD/WTO 2011), increases in total AfT commitments have resulted in a shift towards grants, especially to LDCs and for projects aiming to build productive trading capacity. However, in 2009, there were substantial increases in other official flows (i.e. non-grants) in areas related to trade. Overall flows totalled US\$50.5 billion, an increase of US\$26.7 billion (112 per cent) on 2008. Middle-income countries (MICs) received 91 per cent of all trade-related concessional loans. There is also an increased focus by some (especially European) donors on pooling AfT funds through trust funds or multilateral agencies. Donor commitments to multilaterals have increased rapidly. Multilateral flows have increased by almost US\$6 billion to almost US\$17 billion and now represent 42 per cent of AfT flows, up from 28 per cent in 2008 (OECD/WTO 2011). At the same time, total commitments from bilateral donors have declined by almost 20 per cent.

The pooling of funds creates economies of scale and helps avoid risks of fragmentation and donors spreading themselves too thinly.⁹ However, there have been general concerns about donor pooling through multilateral agencies. In the independent evaluation of Finnish AfT (Bird et al. 2011), concerns are raised about the fact that many projects are initiated and managed at the headquarters of Geneva-based trade and development organisations, thereby mitigating country ownership.

6.4.2 Regional Aid for Trade

There is an increased focus on regional approaches to AfT. A total of US\$7 billion has been committed to multi-country programmes (i.e. global and regional), more than triple the amount allocated during the 2002–05 baseline period. Both global and regional programmes have reached around US\$3.5 billion and their combined share in total AfT has doubled from roughly 9 per cent in 2002–05 to 18 per cent in 2009. The country-based approach of most bilateral aid programmes has meant problems in garnering support for multi-country projects. This can include regional facilities, such as ports, or bilateral arrangements, such as a road from a landlocked country to a port in another country (UNIDO 2010a).

Pooled funding for regional projects has been most apparent in the context of the EU–ACP (African, Caribbean and Pacific) Economic Partnership Agreement (EPA) negotiations. Parallel to these negotiations (and to respond to the ACP countries' growing AfT needs), the EU has set in motion a process to promote integration efforts in ACP regions through regional AfT packages. It aims to provide co-ordinated, more effective and increased EU financial support to its regional integration agendas within ACP regions in order to respond to the needs and priorities imposed on ACP countries and regions, including the implementation of EPAs agreed on or being negotiated between the EU and ACP regions (EC 2009).

However, supporting Regional Economic Communities (RECs) is not uncomplicated and it is worth bearing in mind that there may be clear or even implicit conflicts

of interest between, for example, EU (or EU Member State) support for policy and regulation projects in ACP countries and the simultaneous negotiations on the EPAs. An analysis of the AfT package to the Economic Community of West African States (ECOWAS) finds that capacity building efforts have not been very successful and that donors have struggled to harmonise support (Turner and Tracy 2011). Further, the implementation of European Development Fund (EDF) programmes has been hampered as a result of lack of national level support, co-ordination and communication for regional level priorities. Moreover, the integration of aid with the negotiation of trade agreements creates the potential for conflicts of interest, as the perception of aid being tied to negotiation outcomes is hard to avoid if the donor is also one of the parties to the trade negotiation.

Corridor approaches can be an effective way to overcome many of the policy co-ordination issues inhibiting movement of goods, services and people. The North–South corridor in Africa and the Greater Mekong Initiative in Southeast Asia serve as examples. The North–South corridor provides the physical and institutional support for the movement of goods, services and people in three overlapping developing regions and common markets: the East African Community (EAC) Common Market, the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA). Byiers and Lui (2013) in this volume (Chapter 8) examine the regional corridor approaches in delivering AfT. They argue that corridors, by providing a focused and targeted approach to addressing trade-related bottlenecks, can alleviate many of the challenges related to the effectiveness of AfT. However, they also point to practical constraints, such as the need for specific financial mechanisms to establish and operate joint programmes at borders (Table 6.2).

Table 6.2 Selecting the most effective structure for the delivery of Aid for Trade

Key processes within stage	Potential barriers to effectiveness
Developing AfT objectives and strategies	• Lack of familiarity among officials with donor's own AfT strategy and priorities. • No linkages between AfT and other related development strategies (e.g. agriculture, infrastructure, SME development). • Lack of understanding at country level of AfT as a concept and its objectives (and what projects are considered AfT)
Selection of appropriate aid instruments and modalities	• Assessing the relative benefits and risks of loans and grants (and blended finance). • Donor pooling may improve efficiency it can create uniformity in provision.
Structuring transnational programmes	• Lack of co-ordination between regional recipients and/or member states of Regional Economic Communities (RECs). • RECs frequently lack capacity. • Potential linkages/conditionality between AfT and regional agreements. • Lack of donor structures to deliver regional AfT.

6.5 Design and implementation of AfT

6.5.1 Matching supply and demand

At a global level and in aggregate there is some evidence that AfT seems largely to be reaching the countries facing the biggest barriers to trade (Gamberoni and Newfarmer 2009). However, Karingi and Fabberoni (2011: 83) find very large disparities in AfT per capita in Africa as well as high volatility. More importantly, the fact that supply may be aligned with demand globally does not mean that the most critical projects are in fact being implemented at the national level and attention to this may neglect the fact that high-demand countries are frequently not those capable of absorbing large amounts of assistance. Thus, although there is a breadth of AfT support (see UNIDO 2010a,b), it is not clear that this is being matched with recipient needs. This can be attributed in part to a number of co-ordination failures within donor agencies and among donors, within recipient governments, between recipient governments and donors and at the regional level.

6.5.2 Donor–recipient co-ordination

As discussed earlier, many countries face considerable difficulties developing bankable projects and programmes based on identified needs (UNECA 2011). Although there has been increased alignment between the needs of recipients and investments by donors, according to the most recent OECD/WTO Global Review, only 60 per cent of countries report better alignment on national trade policies since 2009 and there is still frequently a lack of co-operation (OECD/WTO 2011). This is mirrored in a recent case study on Nepal (Adhikari et al. 2011): although AfT tends to be going to priority areas, donors still tend to promote their own priorities and agendas, especially at the activity level. This owes in part to weak prioritisation capacity and donors' preferences for designing projects on their own.

Despite the increased integration of trade into national development plans (NDPs) and the growing number of needs assessments (especially through the EIF), projects are often not aligned with country priorities. Donors tend to have their separate areas of focus with very little aid provided through sector-wide trade plans. In particular, the proliferation of parallel implementation units creates an additional burden for governments and weakens government capacity by siphoning off competent officials. In Cambodia, the lack of alignment with country systems is said to owe to 'donors' preference for using their own templates/formats; and perceptions from donors that government systems are still underdeveloped and lack credibility and full accountability' (Sok et al. 2011: xi). In many ways, this is a chicken and egg problem: Global Review surveys indicate that donors feel that structures are too weak for effective alignment, whereas numerous recipient countries 'point explicitly or implicitly to the problem of donors having specific interests in certain sectors that do not necessarily coincide with government priorities' (WTO/OECD 2011: 81).¹⁰

A central concern implicit in it is its impact on the sustainability of AfT. The aforementioned case study on Malawi finds that donor incentives to focus on short-term results and strong disbursement data mean that there is insufficient focus on long-term

investments in institutional and human capacity. Cambodia, which pioneered the use of SWAp, nonetheless faces a situation where donors still perceive government systems as underdeveloped and lacking in credibility and full accountability (Sok et al. 2011).¹¹ In Nepal, there has been a general reliance on donor systems, which the ministry is aiming to counter by bringing AfT under a SWAp model and creating a Trade Trust Fund.

This is further complicated by the frequent absence of consistent and predictable funding. The Global Review finds that late disbursements often have detrimental effects on a country's budget with only 10–15 per cent of respondents reporting having no problems accessing their AfT allocations. A further problem in this regard is the presence of conditionality – for example, when a change in the political system leads to the suspension of projects (as reported by the Lebanese respondent). Closely related to this, many developing countries state that AfT disbursements are liable to double accounting by donors. This is because it is difficult to isolate what is, for example, an infrastructure investment and what is AfT. Much of the problem arises from lack of co-ordination and clarity between donors and recipients at the point of disbursement of general ODA and AfT. This is compounded by a lack of AfT strategies in many developing countries.

6.5.3 Intradonor co-ordination

The co-ordination between donor headquarters and in-country field offices is frequently fraught with difficulties, particularly in terms of aligning behind a shared strategy. The Australian respondent in the AfT self-assessment survey stated that 'there is still very little understanding of [the objectives of AfT] on the ground, particularly among those that manage and deliver development assistance' (OECD/WTO 2011). Analysis of AfT in Malawi finds that, even within local donor offices, there is a general lack of in-country awareness of what AfT is (Said et al. 2011). Similarly, an evaluation of Finnish AfT finds that 'Aid for Trade thinking' is not mainstreamed across programmes; 'many projects tagged as Aid for Trade are not considered as such by [Ministry for Foreign Affairs] staff in embassies or project implementers' (Bird et al. 2011: 4). As a result, long-term predictable and sustained AfT programmes are more the exception than the norm.

6.5.4 Interdonor co-ordination

Existing case studies demonstrate a lack of co-ordination between donors. Although in Zambia there has been a relatively effective consultation process through the National Working Group on Trade, and donors have moved towards aligning or at least co-ordinating work, this has frequently been limited to the smaller bilateral donors (Makhan 2011). In Cambodia, Sok et al. (2011: xi) argue that 'coordination is better today than a decade ago'. However, most donors stressed that co-ordination is still a major problem owing to 'the prevalence of multiple uncoordinated donor-driven projects'.

The situation described in recent country case studies on Malawi (Said et al. 2011) and Nepal (Adhikari et al. 2011) is not much different. This is despite an increased

alignment in priorities among donors: EU Member States are supposed to have aligned their strategies with the EU's AfT strategy and in turn should have developed similar priorities on how to support trade in developing countries. However, this frequently does not filter down to individual project and programmatic support at a country level. Frequently, the level of donor co-ordination also depends on the main trade advisors in the country and their relationship with other donor officials and their recipient country counterparts. However, there are few clear structures in place to facilitate the development of donor co-ordination groups.

6.5.5 Interministerial co-ordination

On the recipient side, there are also numerous challenges in co-ordinating intergovernmentally in order to ensure policy coherence, manage cross-cutting issues and integrate trade agreements and policies into legislation. Trade ministries are frequently not well linked to other government departments and agencies and often have a relatively low standing and budgetary allocation compared with other ministries. Despite the impact of trade policy on numerous other areas of economic and social development, mainstreaming trade as a policy area is progressing slowly and in some cases backsliding. This lack of interministerial co-ordination and leadership by the Ministry of Commerce, Trade and Industry is particularly visible in Zambia (Makhan 2011): budgetary means and human resources are not being shifted towards trade to respond to cross-cutting policy linkages and a mushrooming of trade sub-committees and working groups dealing with specific sectors has overstretched ministry capacities.

Moreover, there is frequently little trade expertise outside of trade ministries and even representatives in Geneva (for countries that have these) are often not closely linked in to policy processes and must operate as independent agents. Typical of this is the view of line ministries in Cambodia that 'trade is the responsibility of the Ministry of Commerce alone, while their own work only marginally contributes to trade development' (Sok et al. 2011).

6.5.6 Government-REC co-ordination

Many of the aforementioned issues relating to inadequate co-ordination and principal agent problems are exacerbated at the regional level (see Turner and Tracy 2011). There is a strong economic rationale to strengthen regional institutions that address co-ordination failures. While AfT funding is increasingly supporting regional projects and regional economic communities (RECs), this creates a number of potential problems. First, RECs have very limited means of ensuring co-operation from member states and are frequently plagued by substantial capacity constraints. Many RECs also suffer from a legitimacy deficit among their members, who worry not only about the loss of competencies but also that the strengthening of regional organisations is mostly donor-driven and funded by those member states that have the most to gain. This combination of insufficient ownership of regional level programmes at national level, weak accountability mechanisms between RECs and partner states, inadequate capacity of regional organisations for monitoring and co-ordination of regional level

Table 6.3 Designing and Implementing Aid for Trade projects

Key processes within stage	Potential barriers to effectiveness
Developing programmes that reflect AfT priorities	• Lack of co-ordination between donor agencies can lead to duplication. • Frequently no central recipient focal point or co-ordination mechanism. • Lack of AfT awareness among donor field offices. • Lack of joint planning between donors and recipients.
Implementation of programmes	• Lack of co-ordination between ministries, and between implementing agents and ministries. • Short tenures of many officials on both sides impact coherence/consistency. • Donors frequently mistrust country systems and have tendency towards setting up PIUs.

commitments and the lack of political will or capacity for implementation is making the effective implementation of ambitious regional AfT programmes unrealistic.¹² Finally, there are few effective private sector and civil society interest organisations that operate regionally.

Despite the breadth of AfT currently being provided, it is useful to think where donors could add value moving ahead. Drawing on the analysis from the UN Industrial Development Organization (UNIDO) Guide on Aid for Trade, Page (2011) notes that there is still substantial scope for focusing on neglected areas. In the realm of market information, there is currently very little information for recipients on importing into donors' own markets, including meeting the administrative requirements of donors' own preference schemes or trading arrangements as well as meeting standards for non-agricultural trade. Moreover, although there is a great deal of support for preparing for multilateral negotiations, there is a lack of support to developing countries to identify or adjust to the impact on them of trading arrangements among other countries (Table 6.3).

6.6 Monitoring and evaluation

6.6.1 Responding to pressure to show results

Determining better ways of monitoring and evaluating the effectiveness of AfT has been a central policy concern since the start of the AfT initiative. The recommendations of the Task Force saw the strengthening of M&E as 'essential in building confidence that increased Aid for Trade will be delivered and effectively used' (WTO 2006: 3). The Task Force further emphasised the 'need for concrete and visible results on the ground' (ibid.). Towards this end, it determined three main methods of monitoring AfT:

- reporting on funds (through the OECD CRS);
- Aid for Trade assessments in the WTO Trade Policy Reviews;¹³
- the biannual OECD/WTO Global Review process, which assesses progress based on reports of Aid for Trade activities, progress and impact.

The above provide a global monitoring process and have aggregated a great deal of information on the increasing role of trade as a tool for development in the eyes of both donors and recipients. However, on many levels, there remains a lack of clarity on whether AfT is achieving its objectives,¹⁴ and whether growing funds are being used effectively. Although the difficulties of attributing outcomes to development interventions is part and parcel of the world of development co-operation more broadly, given the substantial increase in AfT funding in recent years there is increasing pressure among donors to demonstrate more visible results and use more modern methods to assess impact.¹⁵ This coincides with a general emphasis on demonstrating results in the context of growing scepticism about aid effectiveness and an ongoing economic crisis that is putting pressure on development budgets. Recognising this dynamic, the 2011 WTO/OECD Global Review took the theme of 'Showing Results'.¹⁶

The effectiveness of AfT can be monitored and evaluated at the global, national and project levels (see Hoekman and Wilson 2010). At the global level, this entails assessing whether AfT is associated with improved trade and development outcomes and determining whether funds are going to the countries and regions where they are most needed. WTO/OECD Global Reviews have shown that, over the years, global AfT funds have increased. Moreover, the self-assessment surveys carried out by donors and recipients suggest that donors believe their AfT is becoming more effective according to some indicators of aid effectiveness; to a certain extent, this corresponds with the views of (public) recipient surveys. Furthermore, the growing numbers of econometric studies examining the effectiveness of AfT show that it is likely to be reducing the cost of trade and improving export outcomes.

At the national level, the key question is whether AfT programmes and strategies are effective in achieving their objectives (e.g. expanding trade and increasing growth) and whether they are following the general principles of aid effectiveness (most notably, those set out in the Paris Declaration). Numerous countries have carried out independent AfT portfolio or strategy evaluations in recent years.¹⁷ Finally, at the intervention level, one can evaluate whether projects are achieving their stated goals (through a simple evaluation) and what kind of outcomes would have been achieved in the absence of interventions (through a more sophisticated impact evaluation). Following standard practices, most AfT projects include some form of evaluation at the end, generally following standard evaluation procedures. The rigour with which these are planned and carried out – as the next section discusses – varies substantially. However, the DAC Evaluation Resource Centre¹⁸ provides an overview of evaluations disaggregated by donor, sector (including trade) and country of focus.¹⁹

While not a lot of work has been carried out so far, according to the 2011 Global Review the vast majority of donors monitor their own projects and many are working to enhance M&E systems, in part because of domestic pressure. Many donor country reports, however, indicate a general absence of well-trained staff and appropriate resources for M&E, including access to reliable baseline data and funds for more sophisticated evaluations. Many projects and plans have both mid-term and final evaluations. Ideally, mid-term evaluations should allow those involved in implementation to refine their approaches during its application. Similarly,

final evaluations should inform future programming. However, evaluations may be burdened by unreasonably high expectations. They should ensure accountability, help us to learn what works and what does not, provide guidance on the sequencing of interventions, help improve design and implementation, help recipients identify priorities and strategies and enable the use of micro-level results to demonstrate impact (Hynes 2011). Three (interlinked) challenges complicate the M&E of AfT projects and programmes and will be examined in turn: attributing impact within a coherent results chain, quantifying results and ensuring more robust M&E procedures.

6.6.2 Attributing impact within a coherent results chain

The shared goals of AfT, according to the OECD and WTO monitoring framework, are to enhance capacity to trade (at the outcome level) and improve trade performance and reduce poverty (at the impact level). Many AfT programmes and projects are designed around similar broad goals.²⁰ However, at the project level, attributing trade outcomes to the intervention is difficult and plausibly linking these to the MDGs (Millennium Development Goals) is close to impossible. There have been significant efforts to understand the potential impact of AfT on poverty. However, in many cases, project and programme designs fail to adequately measure and evaluate the actual impact on poor and excluded groups. This risks creating an ‘emergent normativity-outcomes gap between Aid for Trade discourse and its tangible implications for “the poor”’ (Langan and Scott 2011: 23).

The Aid for Trade at a Glance report argues that, ‘for most DAC donors, attributing trade outcomes and impacts to Aid for Trade programmes and projects presents the biggest challenge’ (OECD/WTO 2011: 174).²¹ Australia in its self-assessment response, for example, stated that ‘there is still very little understanding of this on the ground, particularly among those that manage and deliver development assistance. The concept of Aid for Trade is an especially difficult challenge, not helped by the fact that there is no consistent definition of it, and the cross-cutting nature of Aid for Trade makes attribution to it of successful outcomes a very uncertain exercise’. This difficulty is also recognised in the recent evaluation of Sida’s AfT. The evaluators write that ‘causal linkages between what the Sida projects are delivering and reduced poverty continues to be based on a series of assumptions. These results chains have not been tested empirically’ (Goppers and Lindhal 2009: 10).

Although trade programmes are becoming increasingly realistic about what AfT can accomplish in terms of trade performance and competitiveness, there is still a desire to relate all project outcomes to results far beyond the realistically attributable scope of a trade facilitation or trade policy support programme (such as the MDGs). A meta-evaluation of 162 evaluations of AfT projects carried out in two countries (Ghana and Vietnam) and two sectors (transport and storage) supports this: evaluations tend to rely on general concepts, such as gender or poverty reduction, rather than on trade shares or income distribution, and the majority of evaluations of AfT operations do not say much about trade (Delpeuch et al. 2011). This is mirrored in the slight divergence between what bilateral donors see as the objectives of AfT that have gained most in importance (poverty reduction and growth, followed by regional integration) and the

areas that have become most important for recipients (competitiveness, followed by regional integration and poverty reduction).

6.6.3 Quantifying results

A second related challenge pertains to the frequent lack of appropriate and/or quantifiable indicators. Selecting indicators inevitably involves a trade-off between breadth and identification (Cadot et al. 2011) and there are two overriding challenges in this case. First, and related to the issue of attribution, indicators are selected that relate only indirectly (or via a very complex results chain) to the actual project or programme. The EIF's M&E framework (EIF 2011) includes some indicators that could plausibly be attributed to EIF projects (LDC members that have completed the WTO accession process; percentage share of non-oil trade from LDCs), but also some that are likely to be beyond this (poverty headcount; GDP growth; Gini coefficient). This is acknowledged in the 'Risks and Assumptions' column – 'it is recognised that the EIF may contribute towards progress on the context indicators but that direct attribution at this level cannot be established' (EIF 2011: 99) – but it does beg the question of how useful these indicators are in determining the effectiveness of the EIF.

Many projects, particularly relating to capacity building, do not lend themselves easily to quantifying outcomes, given a lack of baseline data or applicable indicators. Frequently, if quantitative results are used at all, they are at the input level (number of officials attending training course). This also comes out clearly in the case stories submitted for the Global Review, which contain few, if any, quantitative benchmark indicators of performance in either the number of outputs or the outcomes measured against baselines. Only 44 per cent of the case stories have *any* quantitative output measure and only 22 per cent have any quantitative indicator of outcomes or impacts (Cadot and Newfarmer 2011). This is in part a problem in the design of the project and its results framework; however, in many cases, a set of useful indicators with baseline data quite simply does not exist.²²

Finally, interministerial co-ordination failures exacerbate the confusions. For example, the Global Review survey is likely to have been filled in by trade officials, who may not necessarily be aware of the 'donor–recipient' discussion at the Ministry of Finance. Hence, lack of internal co-ordination in developing countries can also confound what is general ODA and what is AfT. These confusions can undermine the focus and momentum behind AfT and are difficult to overcome as long as strong incentives remain to over-report AfT in the reporting process.

6.6.4 Robustness of M&E procedures

The rigour and robustness of monitoring and evaluating AfT projects frequently leaves much to be desired. A review carried out by Cadot et al. (2011) of 85 recent World Bank projects revealed that only five included rigorous evaluation components and all of these were according to quite simple before/after processes, with little triangulation of results or more in-depth investigation of the causal role of the interventions. This is also the case for many of the Global Review case stories: very few focus on potential other explanatory variables beyond the intervention.

Evaluators rarely incorporate any relevant time dimension in their assessments and therefore little *ex ante* economic analysis is undertaken. As a result, the Global Review is based primarily on subjective self-evaluation, the monitoring of inputs and a review of case stories subject to selection biases in order to determine whether the effectiveness of AfT is improving.

Similarly, many strategy or portfolio evaluations carried out by donors rely mostly on relatively simple evaluation methodologies. Where more rigorous evaluations are conducted (such as the USAID portfolio evaluation), the rate of return is calculated based on evaluations primarily carried out by programme managers themselves and/or frequently lacking objectively verifiable indicators. Having programme managers carry out their own evaluations frequently means these are afterthoughts to the project and generally results in limited pressure to make these accessible to others to inform future design. Moving towards a culture of greater independence in evaluation, in which evaluators are not necessarily incentivised to provide favourable assessments, will contribute to more robust evaluations.

Assessing the impact of AfT is fraught with challenges because of the lack of credible data, attribution problems and, above all, an absence of counterfactuals. As a result, M&E is frequently not carried out in a manner that would facilitate achieving one of the main objectives: enabling improvements in ongoing implementation and ensuring lesson learning for future projects. This is not only because there is a lack of interest on the part of the recipient, but also generally because ministry officials are already overburdened by other responsibilities (UNECA 2011). Moreover, despite all the

Table 6.4 Monitoring and evaluation

Key processes within stage	Potential barriers to effectiveness
Developing a clear results framework	• Tendency to set objectives (e.g. MDGs) that are beyond scope of project.
Selection of appropriate indicators	• Results chains are frequently not tested empirically. • Generally few quantifiable indicators that translate up to national priorities. • Lack of clear indicators, esp. regarding institutional capacity.
Impact assessment	• Lack of baseline data. • Very limited use of sophisticated evaluation methods (due to cost, risk of negative results, etc.). • Absence of effective control for other policy variables.
Ensuring M&E and impact assessment informs on-going and future projects	• High costs of evaluations are seen as deterrent (would cut into programme budget). • Programme managers have few incentives to ensure rigour in evaluations. • Barriers to joint monitoring procedures. • Few consequences from evaluations and ‘on the ground studies’. • Country-wide evaluations are very expensive and are not necessarily applicable to project level.

work that is invested in assessing needs and mainstreaming trade into development plans, the role of many AfT projects in contributing to national trade priorities tends not be central to evaluations. There is thus considerable scope to triangulate existing approaches and develop feedback mechanisms between donor level evaluations of strategies and sector approaches, country evaluations and evaluations of what works at the project level. Although these problems are common to the M&E processes of aid projects in many areas of development co-operation, particularly for trade-related assistance, there has often been a notable lack of rigour, which is now being addressed only gradually. Investing in the collection of baseline data and providing measurable intermediate outcomes (e.g. port clearance time) and final outcomes to which AfT interventions have made a plausible contribution (e.g. trade volumes) would help to address concerns about attribution (Table 6.4).

6.7 Conclusion

AfT has emerged as an important vehicle to help developing countries improve their trade capacities and benefit from the expansion of global markets. These improvements are important for economic growth and job creation, helping developing countries to move from reliance on aid to the use of trade to generate higher standards of living. AfT can help countries diversify and reduce output volatility – particularly in times of uncertain export demand and fluctuating commodity prices. It can aid in improving productivity by addressing many of the market, co-ordination and governance failures. Finally, and importantly, it can be used to leverage private sector funds. Whereas in the past there was a distinct lack of private sector involvement, viewing AfT as a catalyst for private sector investment is likely to grow in the future.

Lack of progress in concluding the Doha Round of the WTO has meant that AfT has increasingly become divorced from the Doha Round and one of its central rationales – adjustment support for preference erosion – has become secondary. There is now greater and much needed recognition and focus on the role of AfT in supporting industrial upgrading, boosting productivity and structural economic transformation. However, although growing empirical and qualitative evidence indicates that AfT can have a positive overall impact, many individual projects are failing to deliver results, in part because of the issues discussed in this chapter.

Improving the effectiveness of AfT requires not only identifying the most binding constraints to trade, but also understanding and addressing bottlenecks within donor and recipient institutions that impede successful implementation of projects at various stages throughout the programming cycle. AfT effectiveness can be better examined not only in relation to the specific supply-side constraints it is attempting to alleviate, but also in terms of the frequently conflicting incentive structures and co-ordination failures within the complex national and regional political systems within which AfT projects and programmes are embedded. This chapter has attempted to demonstrate that many of these are highly specific to AfT programming and require an understanding of the nature and causes of trade-related co-ordination failures and information asymmetries specific to the institutional structure and political economy of recipient countries and regions as well as donor agencies.

Notes

- 1 Article 57 of the WTO Ministerial Conference's Declaration invited efforts by the WTO, its member states, the World Bank and the IMF to 'develop appropriate mechanisms to secure additional financial resources for Aid for Trade' and called for the creation of a task force to provide recommendations on operationalising AfT.
- 2 See, for example, Basnett et al. (2013) or Hallaert and Munro (2009) for an overview of this literature.
- 3 Some studies find that aid to trade facilitation and to trade policy and regulations is effective in promoting recipient countries' exports (Busse et al. 2011; Ivanic et al. 2006), while other studies have found that the aid to trade-related infrastructure is particularly effective in fostering exports (Vijil and Wagner 2010). Further, trade facilitation and aid to trade-related infrastructure have significant positive impacts on recipient countries' trade costs (Cali and te Velde 2011).
- 4 This is generally composed of key line ministries, donors and other non-state actors, a donor co-ordinator, usually one of the large bilateral donors responsible for co-ordinating donor-recipient interactions and an EIF focal person, usually from the Ministry of Trade, responsible for the day-to-day management of the EIF process.
- 5 See www.enhancedif.org
- 6 However, more independent assessments at the time were much more sceptical of how effectively this had been achieved. Hallaert particularly points to the IMF's Joint Staff Advisory Notes as well as concerns voiced at the same time by the UN Conference on Trade and Development (UNCTAD) that 'only a minority of country-level plans include trade-related policies' (UNCTAD 2009, in Hallaert 2012: 11).
- 7 Needs assessments can also be hindered by the lack of context-specific knowledge of the team or individuals carrying them out. In the past, they were often conducted primarily by external consultants with limited familiarity with the country they were working in and who did not necessarily have a full awareness of the feasibility of different interventions. Moreover, they may not have had an incentive to follow up to ensure a prioritised integration of these constraints. As a result, effective solutions and a prioritised ranking of constraints to assess the feasibility of addressing these within the national political economy were frequently absent.
- 8 For example, whereas grants allow for the funding of projects with positive externalities that are not financially viable and do not create a debt sustainability risk, they can lead to moral hazard, as this may be seen to be rewarding ineffective or inefficient policies. Loans can be flexible to specific project needs and can provide a larger volume of funding, but they are more complex and can also lead to a potentially unsustainable debt burden. In terms of their trade distorting effects, there tends to be little significant difference between grant and loan ODA (Clay et al. 2009).
- 9 The evaluation finds that 'a more strategic approach to identifying and planning Aid for Trade interventions might be called for: rationalise the number of projects and programmes and scale up resources towards larger-scale programming' (Bird et al. 2011: 64).
- 10 Similarly, in Namibia, donors indicated that the national AfT process only involves limited dialogue between the government and donors on trade issues broadly and on AfT issues specifically, and that the country lacks an effective and operational national AfT co-ordination process (Basnett 2011). Further, there is a lack of a comprehensive trade and development study to inform trade-related needs and strategy. As a consequence, it is difficult to comprehensively identify and quantify trade-related development needs.
- 11 Naturally, these issues are not unique to AfT. In their evaluation of the Paris Declaration, Wood et al. (2011) find that, although aid has become more transparent and less donor-driven than in the past, many donors have so far been less active than recipients in aligning their systems with the principles of the Paris Declaration. The authors argue that expectations for 'rapid, fundamental reforms by partner countries' being 'unrealistic and unreasonable, especially alongside the record of most donors and agencies' (ibid. xvi).
- 12 This is supported by analysis of both ECOWAS and the EAC (Turner and Tracy 2011) as well as COMESA (Makhan 2011). In the case of ECOWAS, capacity-building efforts have not been very successful and donors have struggled to co-ordinate and harmonise support. In the implementation of large-scale EDF programmes, there has been a perceived lack of national level co-ordination

and communication for regional level priorities, an insufficient mandate or guidance for national delegations and a lack of ECOWAS leadership. For the EAC, the lack of a legal mandate to enforce the implementation of regional legislation at the national level has meant there is no operational or enforcement mechanism to ensure this takes place. Thus, 'currently integration of regional level legislation at the national level is done according to the "good will" of the national governments' (ibid.: 13). In the case of COMESA, the fragmentation in decision-making between the national and regional dimension is problematic, with a widespread perceived lack of legitimacy by COMESA among member states, and national governments unwilling to delegate sovereignty to a regional authority. Incidentally, many of these problems, Makhan (2011) argues, also apply to the EU, where Member States lack a common operational framework and bilateral agendas still determine development co-operation programmes; bilateral projects often have little or no regional components.

- 13 Analyses of AfT in Trade Policy Reviews have been conducted for the following recipients: Belize, China, DRC, Honduras and Malawi, plus a joint one for Benin, Burkina Faso and Mali. The trade performance of the USA as a donor has also been examined.
- 14 The objectives of AfT identified by the Task Force were to enable developing countries, particularly LDCs, to use trade more effectively to promote growth, development and poverty reduction and to achieve their development objectives, including the MDGs; to help developing countries, particularly LDCs, to build supply-side capacity and trade-related infrastructure in order to facilitate their access to markets and to export more; to help facilitate, implement and adjust to trade reform and liberalisation; to assist regional integration; to assist smooth integration into the global trading system; and to assist in the implementation of trade agreements (WTO 2006).
- 15 The World Bank survey, for example, stated that 'the field still relies excessively on outdated methods compared to other fields of development work. An energetic push for the adoption of impact evaluation techniques and their mainstreaming in project design is needed'. See www.oecd.org/aidfortrade/48195075.pdf (accessed 29 July 2013).
- 16 This has been particularly pronounced in countries that have recently changed from a centre-left to a centre-right government. The UK's 2010/11 Global Review survey response, for example, stated that 'In 2010 the UK enhanced its approach to aid for trade with a stronger focus on driving results – both through programme planning and improving monitoring and evaluation techniques'. See www.oecd.org/aidfortrade/47643036.pdf (accessed 29 July 2013).
- 17 Even before the launch of the AfT initiative, donors had been carrying out thematic and portfolio evaluations on their trade-related assistance. An overview by the OECD (2006) of evaluations carried out by the EC, USAID, DFID, the Ministry of Foreign Affairs of the Netherlands, the World Bank, UNCTAD, the UN Economic and Social Commission for Asia and the Pacific (ESCAP) and the Integrated Framework found that half of the reviewed evaluations noted that, generally, trade-related assistance had increased partner country understanding of the importance of trade for growth and poverty reduction, raised awareness and knowledge of trade policy matters and strengthened national dialogue on these issues. Common weaknesses in donor programmes included unsystematic or incomplete needs assessments; weak project management and project governance structures; insufficient synergies with broader development assistance programmes; and insufficient donor co-ordination.
- 18 See www.oecd.org/derec/ (accessed 29 July 2013).
- 19 Other resources collating project level M&E tools include the websites of the World Bank's Independent Evaluation Group, the multilateral development bank run Evaluation Cooperation Group, UNDP's Evaluation Resource Centre and the Network of Networks for Impact Evaluation (comprising many of the above).
- 20 Both DFID and the EC (along with others such as the World Bank) highlight the importance of understanding the poverty impact of their work and designing projects and programmes that maximise the impact on poverty reduction. For instance, both DFID and the EU have developed AfT strategies that emphasise the pro-poor impact of AfT. DFID's AfT strategy states that 'a central purpose of Aid for Trade is to assist the poorest countries, and particular groups of the poor, to reap these benefits' (DFID 2008b: 17), whereas the EU AfT strategy (EU 2009) includes a pillar on 'Enhancing the

pro-poor focus and quality of EU Aid for Trade'. The EU also notes that 'in response to partner countries' own trade-related priorities, in the context of poverty reduction strategies, it will help facilitate, implement and adjust to trade reform and liberalization paying specific attention to their impact on poverty reduction' (EU 2009: 7).

- 21 This difficulty is not new: even prior to the launch of the AfT initiative, there was a substantial scaling up of trade-related assistance following the start of the Doha Round in 2001. An initial analysis of trade-related assistance evaluations found a lack of measurable objectives and indicators in programme documents as well as difficulty in attributing results (OECD 2006).
- 22 To quote the UK's Global Review self-assessment questionnaire, 'It would be helpful to have more programmes more consistently designed to deliver specific, quantifiable outputs and outcomes ... Process-oriented programmes may still be justifiable but with explicit, quantifiable and qualitative targets that clarify what improved capacity means'.

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Chapter 7

Assessing the Effectiveness of Aid for Trade: Lessons from the Ground

Vinaye Ancharaz, Paolo Ghisu and Christophe Bellmann

7.1 Introduction

This chapter enquires into the conditions that make Aid for Trade (AfT) effective by drawing on evidence on the ground. This evidence is not quantitative, nor does the chapter purport to undertake a systematic evaluation of the AfT initiative. Instead, it is based on a set of country-level case studies that the International Centre for Trade and Sustainable Development (ICTSD) has undertaken since mid-2010, using a unique methodology developed jointly with SAWTEE.¹

The ICTSD studies offer fresh insights into the dynamics of AfT on the ground, the institutional set-up underlying the initiative, and its weaknesses. The methodology, based broadly on the Paris principles, allows an assessment of AfT effectiveness using a combination of quantitative indicators and information from key stakeholders, obtained through interviews. Unfortunately, there is no way of aggregating these diverse indicators into a conclusive statement about AfT effectiveness. Hence, as far as possible, we shall avoid making inferences about whether AfT has or has not worked in a given country. We focus instead on pointing out those circumstances that appear to enhance the effectiveness of AfT with the aim of teasing out lessons of best practice that could inform and enhance the initiative in the future.

The findings, ultimately, have a sense of *déjà-vu*: AfT seems to have been most effective when it is additional and predictable; when AfT projects are owned by the host country and trade is mainstreamed into the national development strategy; when donor objectives are aligned with the recipient government's priorities; and, critically, when local absorptive capacity exists. The case studies also reveal a lack of awareness of the AfT initiative both in concept and in practice, even among those responsible for implementing such AfT projects in the country. It appears that this situation is due to a definitional problem as well as poor co-ordination among implementing agencies.

The rest of the chapter is organised as follows. The next section explains the need for AfT evaluation, presents some available evidence and describes briefly the methodology used in ICTSD country studies. Section 7.3 briefly discusses some trends in AfT to place in context the discussion in the following section on the additionality and predictability of AfT funds. Section 7.4, the core of the chapter, provides insights from the country studies. Section 7.5 summarises the key findings, draws out lessons of best practice and offers some thoughts on the way forward.

7.2 Evaluating Aid for Trade: why, how and what?

7.2.1 Why evaluate AfT?

The need to evaluate AfT is as old as the initiative itself. In its 2006 report, the WTO Task Force called for ‘concrete and visible results on the ground’, arguing that such results would ‘provide strong incentives to both donors and recipients to advance the Aid-for-Trade agenda’.² However, while the Task Force set a number of goals for the AfT initiative to pursue, it fell short of providing any guidelines on how to conduct a proper evaluation of the initiative. In the meantime, a number of developments have made evaluation more urgent than ever before. Donors are facing a tight budget situation at home, and perhaps more than ever before, there is a need to demonstrate to donors that AfT is value for money and that their disbursements help poor countries harness the benefits of trade as an engine of development.

7.2.2 Evaluation methods and difficulties

A variety of methods have been proposed to evaluate AfT, and these have generated evidence of various kinds. The Third Global Review, in 2011, threw the spotlight on 269 case stories of AfT and more than 140 self-assessments by partner countries and donors that the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO) had compiled. However, most of these case stories were based on specific AfT projects in a country or at the regional level. Inevitably, they told a rather positive story of AfT.

A meta-evaluation of AfT by the OECD, drawing on projects in two sectors – transport and storage – in two countries – Ghana and Vietnam – over the period 1999–2010 offers a more nuanced view on the effectiveness of AfT (OECD 2011). This study, based on a count of key words occurring in evaluations of trade-related operations by aid agencies, shows that trade or trade policy linkages hardly ever feature in these evaluations. More importantly, the evaluations provided little insight into AfT’s impact: causal links between projects and performance were hard to establish.

A more systematic approach to AfT evaluation centres on the Paris principles, as recommended by the WTO Task Force. This approach implicitly assumes that aid will be effective – in terms of achieving its goals – if it adheres to the Paris principles of strong ownership, alignment of aid along national priorities, co-ordination among donors, mutual accountability and transparency, and adequate absorptive capacity in the host country. An analysis of donors’ evaluations of trade-related technical assistance and capacity building (TRTA/CB) programmes by the OECD confirms that most of the ‘success stories’ were indeed cases where these good practices were faithfully adopted (OECD 2006).

Some studies have used econometric analysis to identify the impact of AfT programmes at the aggregate level on some quantifiable target, such as exports or export growth. In general, however, such studies have suffered from the lack of a long enough time series because the AfT initiative was formally established only in 2006. Another problem is reverse causality: since AfT is meant to boost exports, one should observe countries with large exports to be receiving small AfT flows. If this endogeneity problem is not

properly addressed, a regression of exports on AfT is most likely to yield a negative coefficient on AfT, which could lead to the misleading conclusion that AfT reduces exports!

Despite these problems, AfT assessments at the aggregate level, albeit scant, have been more common than project-based evaluations. These studies, such as by Ferro et al. (2011), Cali and te Velde (2011) and Brenton and von Uexkull (2009), have used regression to investigate the impact of AfT on exports. Several econometric studies have used gravity models (e.g. Portugal-Perez and Wilson 2012; Shepherd and Wilson 2009). Some – especially on trade facilitation – have also used CGE (computable general equilibrium) modelling (e.g. Zaki 2010) but these studies have not focused on any AfT projects as such; moreover, they have adopted a much larger view of trade facilitation than is commonly understood in the WTO circles.

The focus on aggregate-level analysis of AfT is not difficult to understand. It was long thought that AfT projects lacked the characteristics of ‘clinical’ policy interventions and were therefore not amenable to randomised control trials, which have been successfully used in project evaluations in other areas of development assistance (e.g. poverty alleviation or health). Moreover, externalities in AfT projects make it difficult to appropriate benefits and to assign them to a specific project. Incentives and costs are two other constraints to project evaluation (Cadot and de Melo 2013). AfT project evaluations are likely to suffer from a time-consistency problem: project managers generally loathe undertaking such evaluations knowing that they might be held accountable for poor results. They may find a convenient excuse in the fact that evaluation costs are typically high relative to the value of trade-related projects, making evaluations appear a waste of resources.

However, a ‘culture of rigorous evaluation’ among AfT donors and implementing agencies is emerging now (Cadot et al. 2011) as the demand for aid to show results has increased sharply. Even so, the uptake is very slow, and concrete evaluations of AfT projects at the national level remain rare.

7.2.3 Evidence

The body of evidence available on the effectiveness and impact of AfT varies in type and rigour, ranging from simple case stories to rigorous econometric studies. Here, we provide a selective review of the evidence, focusing on studies that have investigated the AfT–exports relationship. This evidence is the closest, and therefore most comparable, to the evidence from the country studies presented in this chapter.

Cadot et al. (2011) provide an up-to-date survey of the empirical evidence.³ Cali and te Velde (2011) consider the effects of (lagged) AfT flows among other control variables on trading costs and export value, in turn, in a panel of developing countries. They find that Aid for Trade facilitation and AfT disbursements on economic infrastructure tend to reduce trading costs and boost exports in a significant manner while aid for building productive capacity did not seem to have such effects.

Brenton and von Uexkull (2009) examine the impact of export-development aid from the German Development Cooperation (GIZ) on 48 developing-country exports at a matching product level. Their results show that AfT (both contemporaneous and lagged) had no significant effects on product-level exports. Conversely, there was a tendency for AfT to pick promising export sectors, suggesting a potential misallocation of AfT.

A notable recent study by Ferro et al. (2011) looks at the impact of AfT directed at *services* (such as transport, communications, energy, banking and business services) on the exports of downstream manufacturing sectors in a large panel of aid-receiving countries. They find that aid to the energy and banking sectors has a significant positive impact on exports of downstream manufacturing sectors.

7.2.4 The ICTSD–SAWTEE methodology

The methodology used in conducting the country-level studies is based on the Paris principles of aid effectiveness as highlighted above. However, it goes beyond the five key elements and includes several other quantitative and qualitative benchmarks. Specifically, the ICTSD–SAWTEE methodology assumes that additionality and predictability of AfT funds are important preconditions for AfT effectiveness, and proposes various indicators to track them. Essentially, we qualify AfT funds as additional if AfT flows to a country have not increased over time at the expense of non-AfT official development assistance (ODA) flows. A sufficient condition for additionality is that both AfT and non-AfT ODA increase consistently through time. Similarly, AfT is said to be predictable if disbursements, on average, keep pace with commitments. Quantitatively, the gap between disbursements and commitments should not widen, and preferably narrow down, over time.

The methodology also explains how some of the other elements of the Paris Declaration could be assessed using quantitative indicators (see Table 7.1). However, because of data limitations, not all of the proposed indicators could be computed in the country case studies. Ultimately, the methodology produces a combination of quantitative evidence and qualitative data that need to be judiciously used in determining the effectiveness of AfT. To this end, the narratives on impacts at both the macro and micro levels could be particularly instructive.

Our methodology does not purport to provide a binary answer to the question of whether AfT in a given context has been effective. It serves rather to draw attention to the essential conditions that affect aid effectiveness and weigh up their implications for the design and implementation of AfT projects in the future.

7.3 Aid for Trade global trends

7.3.1 Aid for Trade: is it additional?

The additionality of trade-related development assistance has long been at the centre of AfT discussions. The WTO Task Force on AfT recommended that ‘additional, predictable, sustainable and effective financing is fundamental for fulfilling the Aid-for-Trade mandate’ (WTO 2006: 1). The flow of funds available to support

Table 7.1 A description of the ICTSD–SAWTEE methodology

Aspects	Elements	Indicators
AfT funds trajectory	Additionality	• AfT in the recent period is greater than AfT in the base period (2002–05) • Non-AfT ODA in the recent period is greater than non-AfT ODA in the base period • Growth rate of non-AfT ODA in the recent period is greater than or equal to the growth rate of non-AfT ODA in the base period
Absorptive capacity	Predictability	• Variations between commitments and disbursements over time • Extent to which AfT programmes/projects have been completed without any constraints
	N/A	• Capacity of partner country's institutions in utilising available AfT resources to achieve the defined purposes of AfT programmes/projects
	Mainstreaming of trade	• Formal and substantive trade mainstreaming: extent to which trade is mainstreamed in national development plans, sectoral policies, line ministries etc. • Percentage of AfT resources allocated to programmes/projects that are considered priorities by the partner country and designed by the partner country
Ownership at country level	Stakeholders Co-ordination	• Level of co-ordination (formal vs. substantive) between ministries and government agencies, as well as other relevant stakeholders (e.g. private sector and civil society) in formulating and implementing trade policies as well as AfT programmes/projects
Donors' responses to countries' trade and development needs	Donors alignment	• Formal and substantive level of alignment at which donor priorities are in line with the partner country's trade and development agenda
	Use of country systems	• Extent to which donors use public financial management and procurement system of the partner country as well as local human resources
		• Number of projects implemented by government or through the creation of a parallel implementation unit

(continued)

Table 7.1 A description of the ICTSD–SAWTEE methodology (continued)

Aspects	Elements	Indicators
Aft impact	Impact at macro level	• Changes observed in a country's <i>export performance</i> at aggregate level and at the sectoral level through Aft measures • Sector-level <i>productivity</i> changes in relation to Aft programmes/projects • Role of Aft in enhancing inter-sectoral and intra-sectoral <i>exports diversification</i> • Effect of Aft in trade policies and regulations as well as in building capacity related to trade amongst government officials (<i>governance</i>) • Aft relationship with establishment of new firms and increases of international traders as well as training/capacity building of private sector stakeholders related to international trade (<i>private sector development</i>) • Allocation of Aft funds towards trade-related <i>infrastructure</i>; reduction in time for the movement of goods and imports/exports procedures • Relevance of the specific programme/project to country's trade and development strategies and priorities • Efficiency in programme/project design and involvement of relevant stakeholders in designing the project • Extent to which programmes/projects are efficiently managed and implemented and involvement of relevant stakeholders in programme/project implementation • Effectiveness of project outputs and outcomes in achieving the expected results • Impact of the programme/project in achieving the expected results
	Impact at project/programme level (micro-impact)	

Source: Adapted from Adhikari (2011)

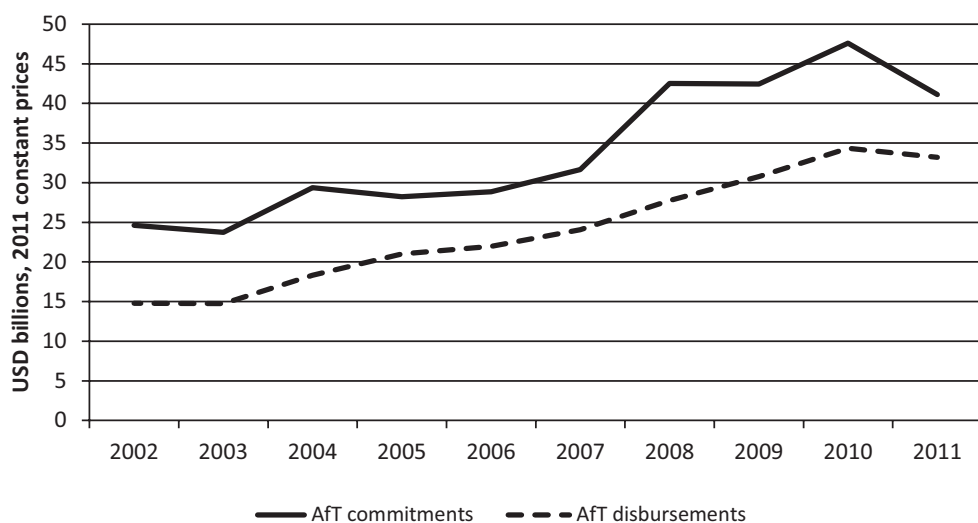
developing countries' trade-related needs seems to suggest that AfT resources have been additional. Total AfT committed resources were up from US\$28 billion in 2005 to US\$41 billion in 2011, representing a 45 per cent increase over this period. Remarkably, commitments have increased faster in recent years – at an average of 7.4 per cent per annum between 2006 and 2011 – than in the base period of 2002–05 when the increase was 5.4 per cent per annum. AfT flows have generally kept pace with committed resources but the wedge between disbursements and commitments has widened since 2007, decreasing only in 2011 when both commitments and disbursements significantly declined as result of the economic crisis (Figure 7.1).

However, additionality means not only that AfT resources have increased, but also that such increase has not diverted resources from aid in other sectors (for instance, social and health) (Adhikari 2011). One way to check for additionality is to compare trends in AfT and non-AfT ODA (i.e. ODA minus AfT). On this count, while AfT flows have increased in recent years, non-AfT ODA has exhibited a fluctuating trend and, in 2011, was almost at the same level as 2005 (about US\$117 billion) (Figure 7.2). Meanwhile, over this period, the share of AfT in total ODA went up from 15.5 per cent to 22 per cent. This could be interpreted to mean that AfT flows were being fed by diverting resources away from ODA in other sectors. If true, this would be a cause for concern for developing countries and could only be justified if spending ODA through AfT is more effective in promoting development.

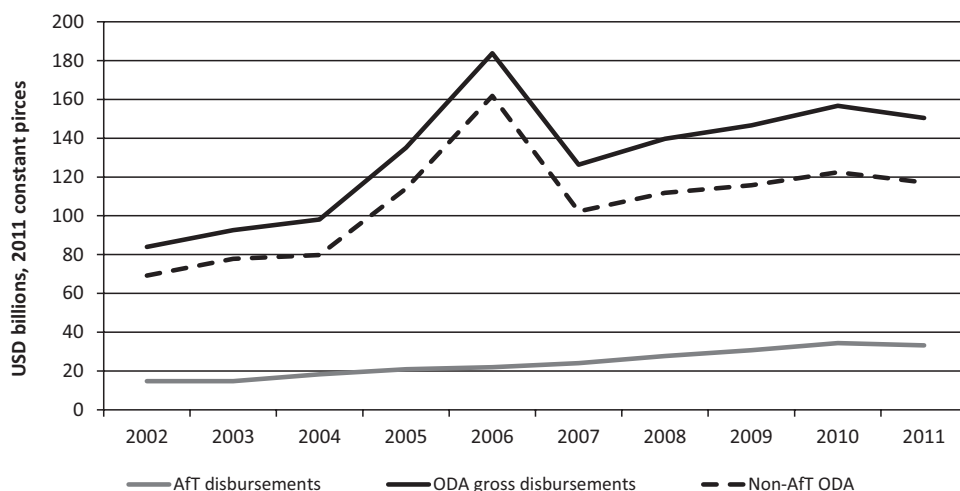
7.3.2 AfT to LDCs

It would be particularly worrisome if the decrease in non-AfT ODA had affected the least developed countries (LDCs), given their known vulnerabilities and structural weaknesses. Fortunately, the data do not bear this out: AfT in LDCs appears to have

Figure 7.1 Global Aid for Trade commitments and disbursements



Source: OECD Creditor Reporting System (CRS) Database, accessed June 2013

Figure 7.2 Global Aid for Trade and non-Aid for Trade ODA flows

Source: OECD CRS Database, and OECD. StatExtracts, accessed June 2013

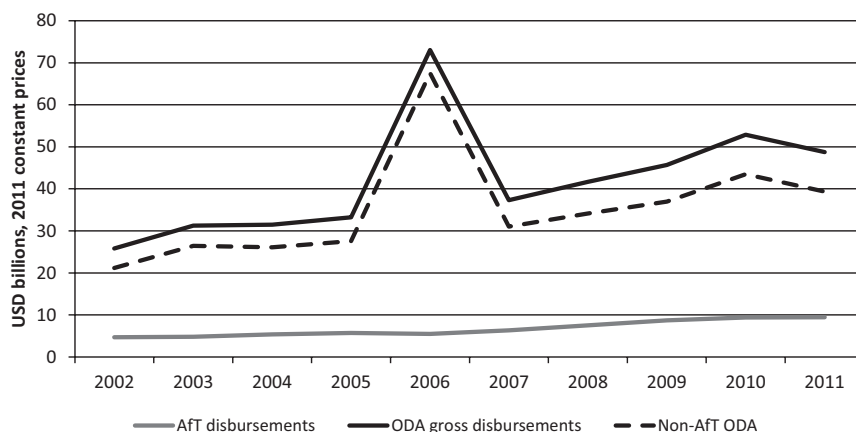
been additional since both AfT and non-AfT ODA have generally increased (Figure 7.3). LDCs' share of AfT has hovered at about 28 per cent in recent years. Of concern is the fact that, in 2011, total ODA flows declined while AfT slightly increased.

A closer inspection of country-specific data shows that AfT flows vary quite significantly among LDCs. Indeed, 20 out of 49 LDCs have attracted 65 per cent of total disbursements. The smallest amounts of funds have been directed to small islands and small LDCs, which by contrast have usually received more AfT per capita than other countries. Moreover, CRS data reveal that some of the poorest LDCs have received very little in per capita terms – typically less than US\$10 over the period 2006–10. Although there is no available benchmark to determine the adequacy of AfT funding, these figures indicate that LDCs have not received a fair share of AfT resources.

7.3.3 Other trends

OECD data reveal that, since 2002, the bulk of AfT resources has been channelled for building economic infrastructure and productive capacity. Among the top five AfT recipient countries, four are in Asia and one in Africa. In 2011, Afghanistan was the largest recipient country and received US\$5.8 billion, followed by the Democratic Republic of Congo (US\$4.2 billion), Pakistan (US\$2.6 billion), Vietnam (US\$2.1 billion), and India (US\$2 billion). Ethiopia, Iraq, Mozambique, Tanzania and Kenya complete the list of the top ten recipient countries. In terms of donors, the United States is the main AfT provider, followed by European Union institutions, Germany, United Kingdom, France, Japan, the Netherlands and Sweden.

A significant trend in recent years in the AfT arena is the growing role of emerging economies. These countries are not DAC members, so there is no systemic data and

Figure 7.3 Aid for Trade and non-Aid for Trade disbursement in LDCs

Source: OECD CRS Database, and OECD. StatExtracts, accessed February 2013

information about their AfT activities. However, various reports have documented their increasing contributions, which nevertheless remain small in comparison with DAC donors (e.g Kragelund 2010). Emerging donors tend to provide development aid in a different way from traditional donors, focusing more on infrastructure and much less on social sectors.

7.4 Insights from country experiences in managing AfT

The effectiveness of AfT in boosting trade-related performance depends crucially on a large number of country-specific factors. This section discusses the experience of eight developing countries with AfT projects/programmes on the ground. Four of them are classified as LDCs: Bangladesh (Said et al. 2011), Cambodia (Siphana et al. 2011), Malawi (Said et al. 2011) and Nepal (Adhikari et al. 2011). Ghana (Danchie et al. 2013), Guatemala (Maul et al. 2012) and the Philippines (Abrenica et al. 2013) are lower middle-income economies, whereas Peru is an upper middle-income economy.

The country experiences indicate that the overall effectiveness and impact of AfT on trade performance has been extremely varied. Not surprisingly, countries that effectively mainstreamed trade in their development strategies, established functional co-ordination mechanisms with both national constituencies and donor agencies, clearly identified their trade-related constraints and used aid to tackle them witnessed a greater and more positive impact through the use of AfT resources.

7.4.1 Utilisation of AfT funds

Trajectory of funds

The positive trend in global AfT disbursements noted in the preceding section is also reflected in the eight country cases. AfT commitments have increased in all countries

since 2006, except the Philippines, where pledges have decreased by 23 per cent in comparison with 2002–05. However, disbursements have increased by 42 per cent in recent years. Disbursements increased in all countries but Bangladesh and Nepal, two of the four LDCs in the sample. This seems to confirm our earlier observation that the disbursement of AfT resources takes place at a slower pace in the world's poorest countries.

In order to determine whether AfT was additional we have to consider not only if AfT resources have increased since the operationalisation of the initiative in 2006, but also if these funds have not diverted resources from other aid sectors (Adhikari 2011). Only in Cambodia and Peru have both AfT and non-AfT resources increased in recent years; therefore we can claim that trade-related development assistance was additional, that is, it did not divert resources from other aid sectors. Instead, in Guatemala and Ghana, while AfT flows increased, non-AfT ODA declined.⁴ Therefore, the additional resources available for supporting trade-related needs in these two countries might have come at the expense of other aid sectors.

Any attempt at assessing additionality of AfT resources is hindered by both the way AfT is defined as well as the monitoring framework of international AfT flows, which is mainly based on donors reporting to the OECD. This issue seems to be particularly relevant in light of the limited understanding of AfT issues in aid-recipient countries. In fact, evidence from the eight countries shows that key stakeholders often have a limited knowledge of what AfT means, brings and entails. This was stressed not only by the private sector and civil society, but in some cases, quite surprisingly, by officials within ministries of trade or finance and other line ministries, as well as by local donor agencies. Indeed, this limited understanding of the AfT issue constitutes a key institutional weakness of AfT despite the rise to prominence of the initiative since its inception. As we discuss later, this negatively affects the local ownership of AfT programmes and projects, and hence the effectiveness of the initiative both at local and global levels.

Predictability is one of the core elements of the Paris Declaration as well as a key recommendation made by the WTO Task Force on AfT. Predictability can be defined as the extent to which donors provide reliable commitments over a period of time and disburse aid in a timely and predictable fashion (Adhikari 2011: 13–14).

Predictability of AfT funds has emerged as a problem in some of the countries, namely Nepal, Bangladesh and Ghana. In these countries, disbursements have not kept up with commitments. Two main factors seem to have negatively affected AfT predictability. First, changes in donor priorities altered the availability of resources in Cambodia, Nepal, Bangladesh and the Philippines. Second, limited local absorptive capacity has often delayed the release of funds in almost every country, particularly in the LDCs, as further discussed below.

Nature of funds

Remarkably, the bulk of AfT resources is disbursed in the form of grants. Nevertheless, in some countries, loans constitute a large share of disbursed funds. Partly, this can be

explained by the prevalence of loans in financially demanding economic infrastructure projects, as in the cases of Guatemala, Ghana, Peru and – surprisingly, given its LDC status – also Bangladesh. On a positive note, overall AfT does not seem to have contributed to increasing the public debt of recipient countries. An exception to this is Ghana: before 2006, the country's public debt ratio was on a significant declining trend, mainly thanks to the Heavily Indebted Poor Countries (HIPC) Initiative. In recent years, however, this trend has reversed dramatically – in part as a result of AfT loans. In 2002, the ratio of public debt to GDP was at its highest, at 93 per cent, declining to about 42 per cent in 2006–07. Since then, the ratio has been on an increasing trend and almost doubled since the AfT initiative started.

Absorptive capacity

The increased funds generated through the AfT initiative are a welcome development, as they make it possible to tackle some of the existing supply-side constraints hindering developing countries' participation in world trade. Nevertheless, if unmatched with adequate absorptive capacities in recipient countries, it could retard an efficient utilisation of funds, which would limit the impact on the ground. Unfortunately, absorptive capacities remain weak in all the countries analysed. The extent of this problem varies considerably from country to country. For instance, in Peru it does not appear to be a major problem within ministries, whereas regional and local governments are notoriously deficient in AfT management capacity.

Weak absorptive capacity was identified as a key constraint in all LDCs, although Cambodia has done slightly better. In fact, capacity building for trade development has been identified as a key priority by the Government of Cambodia, which has established mechanisms for intra-government policy co-ordination and for consultation among key stakeholders, including the private sector and civil society. The case of Nepal is typical of LDCs. In the Himalayan state, a series of factors – clustered into three broad categories – were identified as reasons for low absorptive capacity: (a) human resource-related factors; (b) systemic factors (internal and external); and (c) procedural factors (Table 7.2). Similarly, in Malawi stakeholders complained that project effectiveness was hindered by a lack of effective knowledge transfer in training activities.

However, these problems are not unique to LDCs. Lack of technical expertise for project implementation, often addressed by recourse to foreign experts, was a key problem in Guatemala. In the Philippines, delays in project implementation were caused by the fact that the implementing agency did not always have the personnel required to implement AfT projects.

7.4.2 Ownership at country level: mainstreaming of trade and multi-stakeholder co-ordination

Mainstreaming of trade as a stepping stone for greater effectiveness

Ensuring that developing countries exercise effective ownership over their trade and development policies and co-ordinate their development actions is a critical

Table 7.2 Reason for low Aid for Trade absorptive capacity in Nepal

Cluster I Human resource-related factors	Cluster II Systemic factors	Cluster III Procedural factors
• Dearth of qualified human resources • Low capacity of the government for designing projects and implementing them • Poor human resource planning: government's transfer policy, high staff turnover, rewards and penalties not linked to performance, and weak institutional memory. Staff who give more ideas and work more are given more workload without commensurate increase in incentives/motivation • Low motivation of government employees • Leadership problem at the level of project manager/director	<i>Internal</i> • Lack of project banks • Lack of co-ordination among government agencies and with development partners at the country level • Low priority assigned to trade by government (although, with the launch of NTIS, indications are positive) • Political instability/frequent change in governments and their priorities • Not giving sufficient time to the initial planning phase, resulting in delay in project execution <i>External</i> • Private sector getting limited direct support to implement AFT projects	• Budgetary cycle (mismatch between fiscal year and donor calendar year) • Delay in procurement due to provisions in the Procurement Act – due either to procedural requirements or to government officials trying to play safe • Difficulty in the timely allocation of counterpart funds

Source: Adhikari et al. (2011)

element of AfT effectiveness. This is one of the pillars of the Paris Declaration. Local ownership in the context of AfT primarily lies in the recognition of trade as a driver of economic growth, and ultimately of development. This hinges upon in-country awareness and understanding of the cross-cutting nature of trade, and also the ability to translate this awareness into formal plans and substantive processes (trade mainstreaming) so that the aid-receiving country creates an environment conducive to trade in co-operation with donors, the private sector and other stakeholders. Trade mainstreaming represents a crucial step in negotiations with donors, and it helps set the ground for results-based intervention programming. As a result, a key expected outcome of the AfT initiative is to promote awareness of the development potential of trade, where the Enhanced Integrated Framework for trade-related assistance for LDCs should have played a pivotal role.

Indeed, those countries that have mainstreamed trade in a systematic manner seem to be benefiting the most from AfT. The impact has generally been stronger, resulting in increased export capacities. Although exports are determined by numerous factors, AfT has been successful in creating a strong base for export development while providing new opportunities for export diversification. The cases of Cambodia and, to a certain extent, Bangladesh are winning examples where AfT has contributed to boost exports, respectively in the rice and ready garment sectors, through an improved business climate, gains in competitiveness and increases in flow of FDI. This will be further discussed in the section on impact.

Review of national development plans, strategies and projects reveal somewhat divergent levels of trade mainstreaming among countries. On a positive note, trade has been found to be formally mainstreamed in all countries' development plans, either fully or partially. For instance, trade has gradually become part of either national strategic development policies (e.g. the National Strategic Development Plan 2009–13 of Cambodia) or specific trade-oriented policy papers (e.g. *Plan Estratégico Nacional Exportador* of Peru, and Nepal's Trade Integration Strategy 2010).

While trade has been mainstreamed in national development plans, there is still a lack of clear understanding among key stakeholders of how trade objectives can be realised through specific activities at the programme level. In Malawi, for example, in the last few years the Ministry of Agriculture and Food Security has focused on maize production (subsidy for food security) rather than productivity, export diversification and increased incomes. The objective was first to develop productive capacity and then to find markets at a later stage. As a result, some agriculture projects that did mainstream trade had only a limited impact. Given the current large maize surplus, the government is now realising that trade is important and is starting to move beyond simply focusing on food security. Indeed, since 2010, the government has tried to mainstream trade through the Agriculture Sector Wide Approach. Meanwhile, the main road transport corridors in Malawi are being developed with this trade objective in mind, and the energy sector is also increasingly being driven by trade priorities, both in part financed by AfT resources. At the end of 2012, the new administration adopted a National Export Strategy for the period 2013–18 – a first for the country.

According to the government, this paradigm shift is intended to serve ‘as a critical component to achieve the millennium development goals [...] by providing a framework and focus on how Malawi may build its productive capacity’. The strategy aims to provide ‘a clearly prioritised and realistic roadmap that Malawi needs in order to develop the productive base of the economy’ (Government of Malawi, United Nations Development Programme 2012). These efforts to align the trade policy with overall development strategy and the Millennium Development Goals should be seen as a positive step in achieving sustainable development through trade. As part of these efforts, the government is now trying to mainstream trade in the Ministry of Agriculture and Food Security, as well as in other line ministries, and to work closely with donors to align aid to this strategy. This is crucial to enhance AfT effectiveness, which so far has been limited in Malawi. Indeed, when aid is part of a sector-wide approach and a programmatic strategy to address major supply-side bottlenecks to trade, it is more likely to be effective.

In this respect, the distinction between formal and substantive mainstreaming of trade is highly relevant. As already observed, all countries have formally mainstreamed trade in their development strategies, in the sense that they have formulated some trade-related objectives and made them part of their development efforts. However, what really matters here is the substantive mainstreaming of trade at the policy level, which occurs, for instance, when trade strategies, policies and actions are clearly determined or when line ministries include trade objectives in their domain, in co-ordination with the trade authority.

The eight countries considered in this analysis recognise trade as one of the drivers of development in their strategies, but out of these only Cambodia, Peru, Ghana and the Philippines are pursuing an approach to trade promotion that can be described as ‘active’. Nevertheless, the level of substantive mainstreaming proved to be a weak point in all of them. For instance, lack of mainstreaming of trade in the different ministries affected by the cross-cutting nature of trade is quite common, as further discussed in the next section. Lack of recognition of trade at operational levels, for instance at project and programme levels, was observed in Ghana, Malawi and Bangladesh, whereas in Peru stakeholders complained about the lack of trade mainstreaming at regional or local administrative levels.

Substantive mainstreaming of trade, however, is a matter of in-country policy evolution, as illustrated by the recent positive developments in Malawi (described above). Likewise, in Nepal, the transition towards greater mainstreaming of trade within the national policy structures occurred gradually: whereas the Diagnostic Trade Integration Study (DTIS) in 2003/04 involved the Ministry of Commerce and Supply (MoCS) only, the Nepal Trade Integration Study (NTIS) of 2010 already tangibly involved all relevant ministries responsible for implementation of the NTIS, under the co-ordination of MoCS. Similarly, Cambodia’s efforts towards fuller-scale trade mainstreaming were embodied in the adoption of the Trade Sector Wide Approach. Along the same lines, the government of Guatemala is now redefining its priorities within AfT in order to link it with its trade and competitiveness policies, with a view to better managing aid and enhancing its effectiveness. Nevertheless, at the

moment there are no clearly defined trade objectives set by the government, and the opportunities offered by AfT are not taken into full consideration by the International Trade Policy Framework (*Política Integrada de Comercio Exterior*).

Therefore, even though much room remains for substantive and effective mainstreaming of trade in many developing countries, particularly in the LDCs and small and vulnerable economies (SVEs) such as Guatemala, evidence from the ground reveals that significant efforts are under way. This is certainly a positive outcome generated through the AfT initiative. In fact, as part of these efforts, many countries have been trying to design AfT strategies aligned with their trade and development policies.

Stakeholder co-ordination: in-country dialogue as lever for ownership

Deficiencies in trade mainstreaming are usually manifested in a lack of co-ordination and stakeholder involvement in both the trade-related needs-identification process and the implementation of trade-related programmes such as AfT. In this sense, co-ordination deficiencies can be classified at two levels.

First, government stakeholders, especially line ministries and other agencies, sometimes advance competing interests or agendas. In Malawi, for instance, ministries behave territorially and defensively in competing for resources. For example, the Ministry of Transport, Public Works and Infrastructure, a key institution in implementing AfT infrastructure projects, does not collaborate with the Ministry of Trade. Consequently, the ministry lacks a thorough understanding of trade needs and priorities, especially in the rail and air sectors. Similarly, in Cambodia the reason behind limited co-operation is a lack of understanding of trade as a cross-cutting issue. Guatemala, however, provides an interesting counter-example: whereas intra-government co-ordination in the field of trade is weak, exporter associations are generally active in promoting national-level co-ordination. This, for instance, has contributed to raising trade as a priority in the textile and clothing policy agenda and, to a certain extent, in agriculture.

Second, and more prominently, in-country policy co-ordination is limited by a truly participatory dialogue comprising all relevant stakeholders. For instance, despite the setting up of national and sectoral working groups and public–private dialogues on issues relating to trade, the Malawian government has failed to adequately engage the private sector in the trade policy process. Co-ordination with the private sector continues to be constrained by the poor level of organisation of producers, particularly in agriculture, which is largely dominated by smallholder producers. In Nepal, policy dialogue with the private sector remains only in consultative contours and has had limited impact on the formulation and implementation of trade policies. In Bangladesh, the donor-driven nature of AfT projects precludes effective in-country co-ordination and stakeholder engagement, even though the government often implements AfT projects. Conversely, a high level of stakeholder consultation and input inclusion into the formulation of trade-related policies has been observed in Peru and Ghana. Nevertheless, in the case of the former the consultation process stumbled at the regional and local levels, and in the latter the views of civil society

were systematically not taken into account and are largely ineffective, as inter-ministerial collaboration and stakeholders' involvement is weak at operational level.

The common denominator in this matter lies in the underdeveloped institutional capacities and structures responsible for managing AfT, and more generally trade policy. It therefore seems crucial that the government exercise effective leadership in co-ordinating the efforts in the framework of national policies. Lessons from Cambodia are particularly instructive:

Political will in Cambodia helped create an environment conducive to trade-induced development (and the country's relatively fast accession to the WTO) and facilitate a truly multi-stakeholder trade and development dialogue, eventually leading to increased productivity in the agriculture sector with a spill-over effect on exports.

(ICTSD 2012: 11)

Similarly, in Peru, one of the reasons for the overall effectiveness and impact of AfT is clearly the strong and active role of the Ministry of Commerce in synchronising and co-ordinating all relevant policies with respect to external trade, and in using AfT resources together with locally generated fiscal resources to implement these policies.

7.4.3 Donors' responses to countries' trade and development needs

Donors' alignment

The Paris Declaration requires donors to align their overall development support 'on partners' national development strategies and periodic reviews of progress in implementing these strategies.' The presence of efficient institutional mechanisms provides the ground for donors' alignment with the trade and development priorities of partner countries. Evidence suggests that, when there is a high degree of alignment between donors and the development agenda of the partner country, the benefits of AfT – and more generally of ODA – are likely to be the greatest. Although this appears an obvious observation, the reality on the ground indicates that this principle remains a problematic one.

Peru constitutes a positive example of donors' alignment. Indeed, aid delivery in this country is in harmony with its trade and development priorities. A key element behind this is that Peru has clearly elaborated its trade and development objectives under the leadership of the Ministry of Commerce. Furthermore, it has identified its supply-side constraints and its needs to strengthen its trade competitiveness, thus creating the conditions that are necessary for the alignment of donors' interventions. Ghana and the Philippines have also done so: a review of donors' co-operation programmes suggests that development assistance in the area of trade is aligned to their trade and development priorities. Even in countries where trade mainstreaming is limited and institutional capacities in managing aid projects are relatively weak, such as Bangladesh, Guatemala, Malawi and Nepal, AfT is generally channelled towards projects and programmes in areas that have been identified as national priorities. In

this sense, we can argue that donors align their aid interventions with countries' trade needs, strategies and policies.

Nevertheless, a careful analysis of AfT indicates that donors' use of country systems to implement projects and programmes is generally limited. In fact, donors have the tendency to use their own structures to implement aid projects. Nepal's donor agencies, for instance, seem to implement AfT through the extensive use of parallel implementation units, with donors largely dominating project design and staff recruitment as well as procurement. Indeed, this is a perennial problem in aid delivery, as donors' legitimate interests (efficient use of resources) and effectiveness principles (use of – often weak – country systems) sometimes clash. Lengthy decision-making and limited national capacity were identified as key obstacles to donors' alignment to Nepal's priorities. Similar reasons were found behind the donor-led design and implementation of projects in Bangladesh, the Philippines, Ghana and Guatemala.

Some countries have taken steps to cope with the limited use of country systems, and more generally with the lack of alignment. Malawi, for instance, banned the use of parallel implementation units, but existing country systems remain weak and this has not contributed to solving the problem. Bangladesh enacted the Public Procurement Act in 2008 and, since then, the use of parallel implementation units has declined. A similar procurement act was also issued in Nepal. In the Philippines, donors have been reported to be keen on helping the country upgrade the quality of its systems and better align their intervention with the country's priorities. For example Japan, the largest donor in the country, has recently commissioned a team to evaluate its assistance programme's consistency with Philippine development strategies and priorities. Similarly, the European Union (EU) has recently assessed the contribution of its development programmes to achieving the country's development objectives. The extensive use of the Sector Wide Approach in Cambodia has also contributed to align donors' support to the country's priorities. As a result, the government implements around 70 per cent of projects directly, and not through specific procurement systems.

Donor co-ordination

Donor co-ordination is a key element of harmonisation and, as such, represents another crucial element of AfT effectiveness. When donors co-ordinate their activities they can jointly contribute to achieve larger developmental outcomes, particularly when the recipient country is involved in the co-ordination mechanism. Moreover, it is more likely to avoid duplication of projects and programmes, especially in those situations where there is a proliferation of donor-funded activities. It is important to stress that effective donor co-ordination depends as much on the interaction among donors as on local information on aid activities, and more generally on trade-related issues. Therefore, the role of recipient institutions is central in facilitating co-ordination of aid interventions. Despite many improvements at both aggregate and local levels, experience from the ground almost invariably revealed important weaknesses in donor co-ordination.

The case of Nepal constitutes a typical example. For instance, the International Finance Corporation (IFC), the UK's Department for International Development (DFID) and the United States Agency for International Development (USAID) have been reported to finance similar projects in the area of improving the business climate without co-ordinating their interventions. Many donors are supporting similar trade activities but are not co-ordinating them, potentially reducing the marginal productivity of aid resources and their impacts. This is because of both a lack of information among donors and a lack of government oversight in preventing such duplication of effort.

On the other hand, numerous efforts aimed at co-ordinating AfT activities exist. The Private Sector Development Programme in Ghana, for instance, has recently been bolstered by the establishment of a pooled fund of donors, also serving as a co-ordination mechanism. Similarly, Cambodia's Trade Development Support Programme, established through a multi-donor technical assistance fund, was intended to create synergies in the area of technical assistance. However, this initiative has had limited success due to its slow implementation.

Ghana's Joint Assistance Strategy and Bangladesh's Joint Cooperation Strategy represent attempts at establishing co-ordination and mutual accountability mechanisms. Co-ordination among donors to Malawi has improved significantly, largely thanks to the Ministry of Finance's Division of Labour Matrix, which aims at avoiding duplication of effort by donors and aid fragmentation; the establishment of Sector Working Groups; the Common Approach to Budget Support; and informal donor discussion forums.

The Philippines have also put in place an efficient mechanism that has contributed in increasing both aid alignment as well as co-ordination among donor agencies. The country has established two institutional platforms for discussion among the government and donor agencies, namely the annual ODA portfolio review led by the National Economic and Development Authority and the Philippine Development Forum. These forums of discussion have been essential to identify cross-cutting implementation problems as well as solutions to tackle them. Indeed, in the forums, both government and development partners are expected to agree and commit to actions to address these problems. A recent output of these continuous dialogues was the adoption of the Harmonized Philippine Bidding Document, which aims to resolve recurring procurement issues and inspire donors to co-operate and use the country's procurement system. Nevertheless, problems of co-ordination still remain. For instance, two major forthcoming technical assistance programmes in the area of trade, one financed by the EU and the other by USAID, have strikingly similar objectives and some of the activities overlap.

7.4.4 From implementation to impact

Although AfT could play a role in boosting a country's exports, its effects are entangled in a complex web of factors bearing on trade. Nevertheless, by using a mix of quantitative indicators and anecdotal evidence, it is possible to identify some of the impacts of AfT – especially at the project level – on the ground. Country experiences indicate that the impact of the initiative on trade performance has been

extremely varied. Not surprisingly, and as would be expected from the Paris principles as endorsed by the WTO Task Force, countries that effectively mainstream trade in their development strategies, establish functional co-ordination mechanisms both with national constituencies and donor agencies, clearly identify their trade-related constraints and use aid to tackle them are more likely to generate impact through the use of AfT resources.

A careful analysis of major AfT projects in Peru suggests that the country can be considered a success story. The positive impact and overall effectiveness of AfT can be attributed to the clear prioritisation of trade objectives in development strategies, the identification of supply-side constraints, and the collaboration between the government and donor agencies. Moreover, the involvement of the private sector, particularly in the needs assessment and planning phase, has contributed to the positive performance of AfT. Various projects have contributed to diversifying exports and increasing value added, particularly in agriculture, but also in the textile and clothing sector. Moreover, trade facilitation and infrastructure projects financed through AfT funds have proved beneficial in improving export competitiveness.

Cambodia can be considered another (rather) positive example. Between 2006 and 2009, a total of US\$304 million of AfT funds was allocated to develop economic infrastructure, such as transport and storage, communication, and energy. One of the most prominent projects in this context was the World Bank's Trade Facilitation Competitiveness Project, which, among other projects, installed an Automated System for Customs Data. Indeed, the impact of these investments appears to be taking shape. According to the World Bank's Doing Business Survey, for instance, the number of days for export procedures went from 43 days in 2002 to 22 days in 2010, with a small reduction registered in export procedure costs. A similar effect is noted for import procedures. The reduction in bureaucracy and cost for import/export procedures is likely to have played an important role in the country's trade performance (Siphana et al. 2011).

At sectoral level, the country has focused on, among other things, enhancing the competitiveness of the agricultural sector. The main objective of most, in not all, agriculture-focused AfT interventions is to shift Cambodia's low value added, subsistence agriculture into a commercialised and diversified sector. Therefore, both government policies and AfT investments have focused 'on improving agricultural productivity and diversification towards higher-value products; the market environment for private, agro-based enterprise growth; and strengthening capacity for competitive agriculture commercialisation' (Siphana et al. 2011: 43). Overall, the impact of these efforts is still minimal and stakeholders believe that local institutions have limited implementation capacity that might negatively affect the sustainability of project outcomes. As already discussed above, the absorptive capacity of the government is generally low, and capacity building for trade development has been identified as a priority for future AfT programmes and projects. Despite these problems, AfT projects have been reported to have contributed to generate some modest productivity gains, as suggested by the recent increase in production of and trade in rice, maize, cassava, fish and small livestock (Siphana et al. 2011: 44).

Cambodia was particularly successful in the design and delivery of the Rice Export Policy, which may be credited with the increase in rice yields from 1.8 tons per hectare in 1998 to 2.8 in 2010. As a result, Cambodia is now self-sufficient in rice and produces a 2 million-ton exportable surplus. Indeed, the country has been able to break 'the vicious cycle in which insufficient investment in the agriculture, water, and rural development sectors were attributed to the lack of strategies and policy, and when these were produced, tangible actions fell short due to a lack of implementation capacity' (Siphana et al. 2011: 56). Clearly, these positive results cannot be attributed to AfT projects alone. The government has in fact created policy conditions conducive to investment. However, the key message for the AfT debate is that the right emphasis on a clearly formulated development strategy (Rice Export Policy) has created the necessary conditions for improving aid effectiveness in Cambodia, thanks also to the co-operation between the government and the private sector.

At the project and programme level, some positive outcomes through AfT have been observed in all countries. For example, in Bangladesh, AfT projects in the ready garment sector have been useful to address some critical areas such as capacity building of workers and fulfilment of compliance requirements, which in turn have improved the sector's competitiveness. In the Philippines, technical assistance and capacity-building programmes financed by both the EU and the USA have generated concrete gains in reducing trade barriers, lowering transaction costs, eliminating restrictive rules on business processes and direct investment, and strengthening regulations. A European project on technical assistance on sanitary and phytosanitary measures has resulted in boosting food exports to the EU by almost 15 per cent annually between 2003 and 2008. However, the impact was uneven across products: for example, fisheries exports increased whereas exports of coconut products declined. In Ghana, the Northern Rural Growth Program, with projects financed by a mix of donors, has shown some modest gains. The programme, aimed at addressing some of Ghana's key national development priorities with a focus on improving income through production in country's poorest regions, has benefited from a highly participatory, consultative and demand-driven process, by involving the private sector, civil society, and local and regional authorities. However, for lack of absorptive capacity, the programme has not been effective in achieving the majority of its short-term targets and is not likely to meet its medium- and long-term objectives, particularly because the programme does not have a substantive focus on tackling existing capacity constraints.

In Nepal, the Enhancing Nepal's Trade Related Capacity project (ENTReC), established as a long-running partnership between the United Nations Development Programme and the government, has shown some success in achieving some of its objectives, such as increasing the competitiveness of Nepali exporters, creating a more empowered and engaged private sector and creating a more favourable investment environment. This was possible mainly because the project was designed consistently with the country's trade policy. Nevertheless, a partial lack of ownership due to limited human capacity has prevented some of the project's deliverables from being fully achieved, which has limited its overall impact.

Similarly, the Joint Integrated Technical Assistance Programme in Malawi was successful in achieving a number of planned outcomes – particularly in building awareness about the functioning of the multilateral trading system – thanks to its focus on training and capacity building. Nevertheless, these results have been short-term, as the project has not created those institutional capacities among local stakeholders that could last beyond the project's lifetime.

Overall, the impact of AfT in Malawi 'is close to negligible with respect to [the country's] trade deficit and export growth, largely because of a fragmented approach to aid that does not tackle Malawi's export constraints in a comprehensive manner' (Said et al. 2012: 47). Indeed, a lack of local ownership (manifested mainly among line ministries and the private sector), weak absorptive capacity, and poor alignment and co-ordination have meant that, while overall exports were growing, the relationship with AfT remained weak. In particular, a fundamental disconnect between AfT and the private sector in most areas of economic activity was manifested not only in Malawi but also in Guatemala, Ghana and Bangladesh.

In conclusion, one of the major lessons learned from developments on the ground is that AfT should be viewed not as a separate development effort, but rather in conjunction with the development in other sectors outside trade-related capacity building, including social ones. This is even more urgent in LDCs and SVEs, where human and institutional capacity development is a prerequisite for adequate AfT demand formulation, planning and subsequently the effective management and implementation of AfT projects.

7.5 Conclusion and the way forward

This chapter presented new evidence on AfT effectiveness on the ground compiled from case studies of eight developing countries, including four LDCs. The assessment of the AfT projects is undertaken at the national level but several of the country cases include narratives of specific projects. The methodology used is based on the Paris principles of aid effectiveness, but is innovative in several ways. Besides providing quantitative and qualitative indicators for monitoring various aspects of a project, our approach assumes that the additionality and predictability of aid flows are also a critical component of AfT effectiveness.

Evaluations of development assistance projects and programmes have always proved elusive, and AfT is no exception. Perhaps, in AfT's case, the challenges have been even bigger: data limitations, the absence of clear benchmarks and the high cost of evaluations relative to the size of projects have often placed rigorous evaluations of AfT on the back burner. The country-level studies on which this chapter is based overcome several of these constraints by applying a workable methodology; by collecting primary data to complement secondary sources of information; and by balancing the need for quantitative evidence with the convenience and added value of qualitative data. This, however, comes at a cost. There is no objective way of aggregating the various indicators into a summary statistic that could say whether aid in a given country has, on the whole, been effective or not. We generally refrain from

making such conclusions and prefer to highlight the conditions under which AfT is likely to deliver results.

Table 7.A1 summarises the main findings across countries and selected indicators. Overall, our findings are not radically different from what has emerged from the more general aid effectiveness debate. In short, AfT is likely to be effective when the host country has the appropriate institutions and human resources to utilise aid; when the aid programme enjoys broad local ownership, including political ownership; and when donor objectives are aligned with local priorities. To these, we shall add that, specifically for AfT flows, it is crucial that these be additional and predictable, and not just a diversion from existing ODA resources.

The evidence gathered from in the eight countries has several implications for the AfT initiative. First, AfT projects must address local capacity constraints and institutional weaknesses in their very design, and, more generally, the initiative should tackle problems related to additionality and misalignment. As the donor community calls for AfT to deliver results, it must share responsibility with partner countries to see to it that AfT brings value for money.

In this respect, the growing focus on AfT project evaluation may be counterproductive, as it could divert dwindling resources from more pressing needs. In most of the countries considered in the ICTSD case studies, and especially in the LDCs, the conditions that make AfT effective are often absent. Significantly, most of these conditions are host country-specific (such as lack of absorptive capacity, low degree of trade mainstreaming, lack of stakeholder co-ordination and involvement) and are independent of the way the AfT business is conducted. It might therefore be more efficient for the donor community to devote greater effort to tackling the key determinants of success of AfT – notably, local capacity constraints and supply-side constraints – rather than investing more resources in AfT evaluations.

As donors come under tightening budget constraints, there is a growing need to strengthen recipient countries' ability to effectively manage AfT resources. This may result in not only better use of limited resources but also improved development impacts. Enhancing partners' capacity to benefit from AfT, in turn, requires that effective institutional arrangements be set up at the domestic level for stakeholder participation and interagency co-ordination, supported by appropriate legal frameworks.⁵ As highlighted above, most countries have not yet elaborated a national definition of AfT; nor have they established clear AfT strategies, incorporating results-based management practices, to allocate resources and assess impacts. Supporting them in this endeavour might have more impact than simply trying to improve the design and delivery of individual AfT projects.

This chapter also reveals that there is limited co-ordination among relevant ministries and government agencies on the way AfT programmes are designed and implemented. The private sector is generally poorly involved in the AfT process and in-country donor agencies do not always co-ordinate their activities among themselves and with national stakeholders. All these factors tend to affect local ownership, aid effectiveness and, ultimately, development outcomes regardless of the quality of the AfT projects.

These are the critical areas where greater effort should be directed in the future as the AfT initiative comes under increasing pressure to show results.

Overcoming these constraints is not an impossible task. Taken individually, many of the countries surveyed have tried to address them with different degrees of success. Beyond the eight countries covered in this chapter, there is a growing wealth of experience and creative solutions among recipient countries, particularly those that have been successful at making the most out of limited aid resources. As we move to the next AfT Global Review, identifying best practices in managing AfT, based on experiences so far, and sharing them among recipient countries might be one of the most efficient way to improve the use of AfT resources and ultimately increase development impacts. Such South–South exchange of experiences should become part of a continuous learning process involving not only recipient countries but also traditional and emerging donors.

Annex

Table A7.1 Summary of findings by key indicators of the ICSTD–SAWTEE methodology

	Bangladesh	Cambodia	Ghana	Guatemala	Malawi	Nepal	Peru	Philippines
AfT funds trajectory	No: AfT commitments increased since 2006, but disbursements not.	Yes: AfT funds additional, not resulting in diversion of resources from other ODA sectors	Partial: AfT commitments and disbursements increased, as well as non-AfT ODA disbursements. However, non-AfT ODA commitments decreased	Partial: AfT funds increased on the whole, but non-AfT ODA resources decreased in 2009–2012 compared with 2006–08	Partial: AfT and non-AfT ODA increased, but at a lower rate than in the past	No: non-AfT ODA and AfT commitments increased, but AfT disbursements declined. Nevertheless, no diversion of resources from other ODA sectors	Yes: AfT funds additional, not resulting in diversion of resources from social sectors	No: AfT commitments decreased since 2006, but disbursements increased. The opposite is observed for non-AfT ODA: commitments increased, although at a lower growth rate, whereas disbursements decreased
Additionalty	Non-AfT ODA increased, both for commitments and disbursements, but commitments grew slower than in the past. No diversion of resources resulting from AfT							

(continued)

Table A7.1 Summary of findings by key indicators of the ICSTD–SAWTEE methodology (continued)

	Bangladesh	Cambodia	Ghana	Guatemala	Malawi	Nepal	Peru	Philippines
Predictability	No: great variance in the AFT disbursements/commitments ratio (utilisation rate), which declined in comparison with the baseline period; delays in initiation and implementation of AFT projects	Yes: overall, AFT has been predictable, although the disbursement of funds still needs improvements. Donors admit that changes in their priorities sometimes affect availability of resources	No: decline in the AFT commitments ratio since 2006. AFT funds are generally less predictable than aid to other sectors; this is mostly driven by limited predictability in AFT to economic infrastructure	Partial: in general, AFT disbursements follow donors' commitments, but limited absorptive capacity sometimes delays project implementation and release of funds	Yes: data and stakeholders' views suggest that AFT has generally been fairly predictable	No: the utilisation rate of AFT commitments declined since 2006. Moreover, untimely disbursements of funds. Low predictability is due to both changes in donors' priorities as well as limited absorptive capacity	Yes: disbursements follow commitments, except for occasional administrative hurdles/inconvenience	Yes: disbursements follow commitments. No widening gap has been observed. Local stakeholders confirm that programmes and projects are, in general, implemented in a timely fashion
	Poor absorptive capacity, which negatively affects the utilisation rate of AFT (disbursements/commitments ratio)	Poor absorptive capacity, but trade capacity-building programmes provided to relevant institutions have slightly addressed this problem	Poor absorptive capacity largely due to weak institutional capacity of trade-related Ghanaian institutions	Poor absorptive capacity. Lack of human resources, inadequate economic incentives and changes in policies and strategies cause a high turnover of qualified staff in Guatemalan institutions, which reduces institutional capacity and know-how	Poor absorptive capacity of local stakeholders, resulting in significant delays in project implementation. AFT projects do not address this issue, resulting in limited aid effectiveness. However, some evidence of improvement in certain areas	Poor absorptive capacity, manifested in low utilisation of commitments and delays in disbursements. The utilisation rate of AFT has worsened in recent years, and the gap between the utilisation rate of AFT and non-AFT ODA has widened	Good absorptive capacity. However, limited capacity at regional and local level	Poor absorptive capacity manifested by the fact that implementing agencies often do not have the required personnel, infrastructure and resources to co-finance the implementation of projects. This delays project implementation, or causes the cancellation or reduction in the scope of some activities

(continued)

Table A7.1 Summary of findings by key indicators of the ICSTD–SAWTEE methodology (continued)

	Bangladesh	Cambodia	Ghana	Guatemala	Malawi	Nepal	Peru	Philippines
Ownership at country level	Partial: trade is mainstreamed in national development plans and in some sectoral policies. However, trade is not adequately mainstreamed in line ministries and at project and programme levels	Partial: trade fully mainstreamed at formal level (National Strategic Development Plan 2009–13), but not substantially mainstreamed to all relevant ministries. Awareness of the role of trade needs to be enhanced	Partial: trade is mainstreamed in national development strategies. Sectoral policies prioritise the role of trade; however, in some cases there is a lack of implementation. The understanding of trade issues is limited at project and programme levels	Poor: trade is poorly mainstreamed in current national development strategies, but the government is now starting to prioritise trade	Poor: partial mainstreaming at formal level in the national development plans, but limited understanding and ownership of trade at sectoral and programme level. However, some evidence of recent improvements	Partial: trade mainstreamed at formal level, but not at substantive level. Little co-ordination between the Ministry of Commerce and line ministries to promote trade	Partial: almost fully mainstreamed at national level, but limited mainstreaming at regional and local levels	Poor: trade has been fully mainstreamed into national policies and programmes, but implementation of trade policies sometimes constitutes a problem, as for instance in the reform of customs
Mainstreaming of trade								
Stakeholder co-ordination	Poor: inter-ministerial co-ordination in implementing trade policies and AFT programmes is weak; scope for involvement of non-governmental stakeholders is narrow	Good: stakeholders involved in the formulation of trade policies; Trade SWAp roadmaps developed through stakeholder consultations. Co-ordinating role of the Steering Committee for Trade Development	Poor: ministerial co-ordination and stakeholder co-ordination is high at formal level (National Development Planning Commission; three platforms for cross-ministerial/inter-sectoral collaboration), but it is largely ineffective as	Poor: weak co-ordination at government and inter-ministerial level (competing interests and priorities) although lower-level authorities substitute for this (e.g. AGROEXPORT)	Poor: different ministry priorities results in competition for ODA resources. Limited co-ordination and fragmented approach to aid at local level. Private sector only marginally involved in trade policy dialogue.	Poor: the formulation of the Trade Integration Study and other trade policy documents is inclusive, but private sector's views have limited effects in policy formulation	Partial: the Ministry of Commerce implements and co-ordinates trade strategies and actions, including AFT. Involvement of stakeholders in trade discussions, particularly the business sector. However, participation of regional and	Partial: creation of the Philippine Development Forum as a venue for dialogue among government agencies, donors, business groups, NGOs, members of Congress and academia to co-ordinate aid activities and generate additional commitments.

(continued)

Table A7.1 Summary of findings by key indicators of the ICSTD–SAWTEE methodology (continued)

Bangladesh	Cambodia	Ghana	Guatemala	Malawi	Nepal	Peru	Philippines
		inter-ministerial collaboration and stakeholder involvement is weak at operational level. Moreover, limited involvement of civil society		Despite recent improvement, lack of understanding of Aft, precluding effective utilisation of funds		local stakeholders at policy-making level very limited	However, limited focus on trade issues
Donors' responses to countries' trade and development needs Partial: Aft, and more generally ODA, almost fully aligned with national priorities. Joint Cooperation Strategy between the government and 18 donors intended to further strengthen donors' alignment. However, most projects conceived and formulated by donors, while the government is mainly responsible for implementation	Partial: Aft projects are often not aligned with countries' priorities though the channelling of Aft funds to support Trade-Sector Wide Approach has partially contributed to align donor interventions	Good: donors programmes aligned with Ghana's trade and development agenda and national priorities	Poor: limited Aft alignment is mainly due to lack of countries' priorities in the area of trade. However, each donor defines its intervention with the government through a strategic planning. However, the lack of a broader and long-term view makes Aft largely ineffective	Partial: Aft overall aligned with country's two main priorities: food security and infrastructure. However, lack of long-term approach to local human capacity development, which is a key priority for the country	Partial: Aft is generally going to programmes prioritised by the government at the broad level, although activities sometimes clash at programme/ project level	Good: clear strategy for trade capacity building and leadership of Ministry of Commerce crucial in pairing country's and donors' priorities	Good: donors generally align their programmes with country's priorities
Donor alignment with countries' priorities							

(continued)

Table A7.1 Summary of findings by key indicators of the ICSTD–SAWTEE methodology (continued)

	Bangladesh	Cambodia	Ghana	Guatemala	Malawi	Nepal	Peru	Philippines
Use of country systems	Poor: limited use of country systems, but reduction in the use of parallel project implementation units since 2005	Partial: limited use of country systems, but many projects implemented through direct budget support to government bodies; generally, though, donors feel that government structures lack credibility and accountability	Poor: the large majority of AFT (and ODA) is provided through non-budget support and implemented through the creation of parallel implementation units, despite recent improvements in national systems	Poor: donors tend to use their own implementation units, especially for AFT projects, mainly because implementation capacities are weak in local institutions	Poor: limited use of country systems. Extensive use of parallel implementation units, but recent limitations on their use	Poor: donors tend to use their own implementation systems. Local systems are often regarded as inefficient and bureaucratic	Poor: donors prefer not to use national systems of procurement as they are considered rigid and not efficient enough	Poor: limited use of county systems while implementing projects. Some donors even require that implementation agency set up a parallel implementation unit independent from existing organisations
Donors co-ordination	Poor overall, but some progress in improving co-ordination of aid activities through local consultative groups, which have fostered dialogue between the government and donors. This aims to promote interaction and transparency on donor's activities. However, donors prefer to co-ordinate their interventions	Poor, but various interventions to avoid duplication of aids and create synergy to co-ordinate trade-related technical assistance programmes (e.g. Trade Development Support Programme)	Good level of co-ordination, facilitated by effective mechanisms such as the Multi-Donor Budget Support. However, co-ordination appears less strong for AFT activities that for non-AFT ODA. Co-ordination between local donor offices and their headquarters is limited on trade-related issues	Poor: mechanisms for donors co-ordination exist (e.g. the group of the 13 largest donors, the 'G13') and have improved in recent years but co-ordination of AFT activities is limited. The lack of co-ordination is mainly due to internal factors such as the lack of an AFT strategy, limited mainstreaming of trade, and weak capacities	Good: donor co-ordination has significantly improved in recent years, largely thanks to the Ministry of Finance's division of Labour Matrix, the establishment of sector working groups, the adoption of the common approach to budget support and informal donor discussion forums. However, limited	Poor: duplication of projects and funding exists, but donors are trying to reduce these inefficiencies, particularly after the launch of Nepal Trade Integration Study.	Good: donors have put in place both formal and informal co-ordination mechanisms. Overall, donor co-ordination improved in recent years. However, some cases of duplication of activities highlight that co-ordination among donors and with the government needs to improve	Good: establishment of institutional mechanisms to facilitate donors co-ordination and government–donor co-ordination

(continued)

Table A7.1 Summary of findings by key indicators of the ICSTD–SAWTEE methodology (continued)

	Bangladesh	Cambodia	Ghana	Guatemala	Malawi	Nepal	Peru	Philippines
	among themselves because these structures are considered inefficient			of institutions dealing with trade	co-ordination for trade policy and regulation activities			
AfT impact	Statistically insignificant relationship between AfT and export performance	Reduction in bureaucracy and cost for import/export procedures, which have enhanced trade performance, but difficult to clearly isolate the impacts of AfT. Modest impact in increasing production and diversifying exports, mainly in agriculture	Despite the recent increase in exports, Ghana's exports are still highly concentrated and low-value added. Some degree of diversification towards non-traditional exports. However, this modest performance cannot be attributed to AfT	Modest gains at project/programme level: diversification of products; increased competitiveness in the textile and clothing sector and for some small and medium enterprises. However, the lack of an integrated approach to trade (and AfT) has limited the overall impact of aid, which has not been channelled in addressing some of the key supply-side bottlenecks	AfT impact is close to negligible in terms of trade deficit and export growth because of fragmented approach to aid not channelled to key export constraints	AfT is positively associated with export growth. Modest impact of AfT is visible in the upgrading of infrastructure, building of core network roads, export growth and diversification (for example ginger and cardamom)	AfT impact is 'marginal' in relation to the overall positive macroeconomic and export development of recent years, resulting primarily from sound national policies. Positive impact at project level resulting, for instance, in diversification towards non-traditional agriculture exports and private sector development	Poor export performance of the country in terms of export growth and diversification, which has negatively affected AfT impact. In general, AfT has had a modest impact on Philippine trade mainly because it has poorly addressed the country's key supply-side constraints (weak institutional capacity, poor infrastructure etc.)
Impact at macro level								

(continued)

Notes

- 1 South Asia Watch on Trade, Economics and Environment is a non-governmental organisation (NGO) based in Kathmandu, Nepal.
- 2 Recommendations of the Task Force on Aid for Trade, Fifth draft, 24 July 2006, p. 7.
- 3 See also Basnett et al. (2012).
- 4 In the case of Ghana, non-AfT ODA commitments decreased in recent years if compared with the 2002–05 period, whereas non-AfT ODA disbursements increased.
- 5 In this context, the OECD's ongoing work on Managing Aid for Trade and Development Results is worth mentioning. This programme has generated case studies for Colombia, Ghana, Rwanda, Vietnam and the Solomon Islands.

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PART II. SELECTED CURRENT ISSUES IN AID FOR TRADE

Chapter 8

Regional Aid for Trade Effectiveness and Corridors

Bruce Byiers and Dan Lui

8.1 Introduction

After emerging at the WTO (World Trade Organization) Hong Kong Ministerial Meeting in 2005, the Aid for Trade (AfT) initiative is now a mainstreamed *credo* of the international trading system. There is now broad acceptance of the need to assist developing countries to build their capacity to benefit from trade. Moreover, there is evidence to suggest that the AfT initiative has succeeded in mobilising resources for trade-related activities while also improving the quality of aid in terms of the ownership and design of programmes and policies (OECD/WTO 2009).

At the same time, it has been difficult to gauge the effectiveness of AfT because of the broad, cross-cutting nature of the initiative. Overall, AfT accounts for more than one-third of all official development assistance (ODA) delivered by traditional donors, covering a wide range of areas from network infrastructure and sector-level programmes (for example in agriculture, tourism or microfinance) to support for regional integration and enacting policy reforms. Projects vary widely in size, and are delivered and implemented through a large range of aid modalities, all of which makes it difficult to explain and assess AfT as a coherent category of aid

Against this backdrop, the ‘regional dimension’ of AfT has been relatively overlooked in assessments so far. While donors have traditionally focused their development co-operation at country level, assistance for regional trade-related projects has gained in significance in recent years, not least because of the desire in sub-Saharan African countries to pursue a deeper level of regional integration as a step towards integrating into the global economy.

In this regard, a ‘corridor approach’ has emerged as a key policy approach to link countries and create regional supply chains, both for developing country governments and for donors. This approach emphasises tackling regional barriers to trade in an integrated and coherent manner, complementing liberalisation commitments with a combination of physical and ‘soft’ infrastructure investments as well as addressing productive capacity constraints in sectors such as agriculture, in part through encouraging large-scale investments by the international private sector.

This study looks at the opportunities and challenges of improving the effectiveness of AfT through a regional approach. The study is based on (i) an analysis of available AfT data, (ii) discussion of regional approaches and challenges to co-ordinating and implementing AfT projects in institutional terms and (iii) closer examination of the opportunities offered by a corridor approach to overcome some of these challenges. In doing so, the study attempts to employ the framework and key concepts of the 'aid effectiveness' agenda, while also focusing on the specific problems of improving regional AfT to overcome long-standing difficulties around the implementation of regional agendas.

The descriptive analysis presented in this paper suggests the following broad conclusions. While AfT at the regional level appears well suited to improving AfT effectiveness, the practicalities of regional co-ordination, prioritisation and implementation suggest that major challenges still remain. A corridor approach appears to be one way of narrowing the focus and bringing stakeholders together around a concrete agenda with clearly identifiable constraints, potentially offering a means to maximise AfT effectiveness while promoting regional goals and aspirations. The increasing involvement of 'new' development partners such as the international private sector also appears important for AfT, as does private sector finance, given the current climate, in which the importance of aid is declining although the distribution of benefits from such approaches must be monitored.

The remainder of the study is organised as follows. Section 8.2 gives an overview of regional AfT flows using the OECD database. Section 8.3 looks at the opportunities and challenges for making regional AfT more effective, focusing particularly on the regional economic communities (RECs) and the challenges in drawing up and applying regional AfT strategies. Section 8.4 discusses the corridor approach as a mechanism for increasing AfT effectiveness, focusing specifically on sub-Saharan Africa.

8.2 Regional Aid for Trade in sub-Saharan Africa: an overview

Within Africa, the rationale for regional approaches to trade appears to be obvious: for small economies the pooling of resources and opportunities through the creation of effective regional markets may be decisive in stimulating production capacities and trade and investment flows (Mackie et al. 2010). Integration in Africa remains at an early stage, however: intra-African trade still represents only 10 per cent of total African trade (AU 2011).

In response, several regional blocs in sub-Saharan Africa have dismantled internal tariffs either partially or completely. Furthermore, three overlapping regions in Eastern and Southern Africa have decided to create a 'Tripartite Free Trade Area' that will cover half the continent. Most recently, at the continental level in Africa, the African Union (AU) adopted a dedicated *Action Plan for Boosting Intra-Africa Trade* that include a continent-wide free trade by the 'indicative date' of 2017.

Regional AfT naturally plays an important role in supporting such liberalisation initiatives, while also assisting countries to enact associated policy reforms.

8.2.1 Regional Aid for Trade flows

The evidence on regional AfT effectiveness is limited to a number of qualitative assessments and anecdotal surveys, with few quantitative analyses. The main data source is the OECD's Creditor Reporting System (CRS). This provides data on regional AfT from 2002 to 2010. Although available only at the aggregate level and subject to methodological and definitional concerns around its reporting (see Box 8.1), it nonetheless indicates the trends, sources and distribution of regional AfT.

Aid for Trade has grown steadily since the initiative began, with total disbursements growing from US\$20 billion in 2006 to US\$32 billion in 2010.¹ Regional disbursements have been growing faster than total AfT, with regional AfT allocations growing across all regions in absolute terms, as illustrated in Figure 8.1, and as a share of overall AfT allocations. Accordingly, total AfT delivered at the regional level increased from an annual average of around US\$300 million during 2002–05 to around US\$1.6 billion per year in the 2008–10 period, equivalent to a rise from 1.9 per cent to 5.9 per cent of overall allocations.

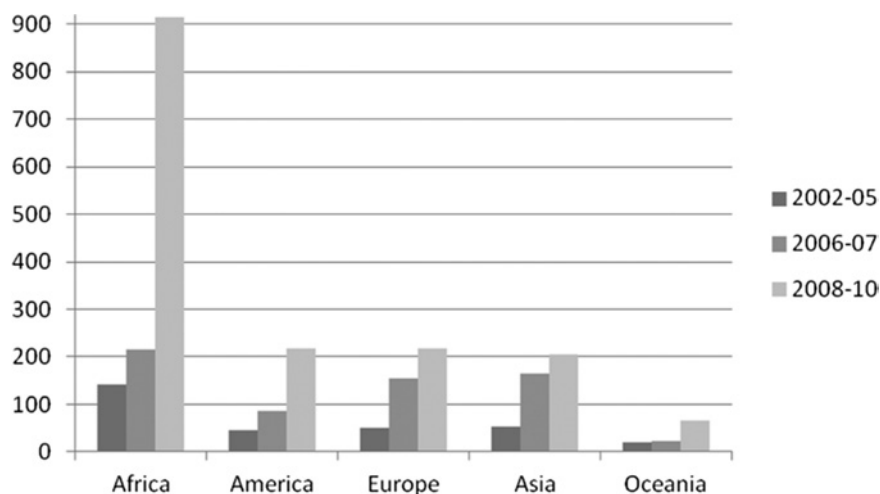
Box 8.1 Defining regional Aid for Trade in the data and in practice

While AfT is defined by the WTO to cover a range of trade-related interventions, at the regional level there is an added complication of how to distinguish regional AfT from national programmes. ILEAP (2007) defines AfT as being regional 'where either implementation is taking place involving more than one country, or where it is being coordinated at the regional level'.

However, it is likely that many 'regional' projects are in fact implemented through national governments. The OECD's CRS system relies on self-reporting by donors, creating the possibility of discrepancies if some donors report all cross-border projects as regional AfT (including when this aid is programmed and channelled through partner countries) while others adopt a different definition.

Further problems arise when individual projects contribute to regional goals, without necessarily being part of any co-ordinated regional effort. Such 'spillover effects' could be very significant; for example, it is not hard to see how an national AfT project to upgrade Mombasa port could have beneficial impacts for all of East Africa.

Figures for regional AfT are at present highly aggregated, with breakdowns only between North and sub-Saharan Africa, rather than for individual sub-regions. Further, although AfT has grown, some part of this increase may relate to efforts to better identify, monitor and report on their AfT contributions (OECD/WTO 2011; ILEAP 2007). Furthermore, the CRS covers mainly traditional donors, which limits the coverage of important providers of AfT such as the Gulf countries, China and India.

Figure 8.1 Regional Aid for Trade at continental level

Source: OECD CRS

While regional AfT flows have increased, the extent to which projects are delivered regionally still varies widely by continent, as shown in Table 8.1. The proportion of AfT attributed to the regional level ranges from less than 2 per cent in Asia to 19.1 per cent in Oceania, potentially reflecting a lack of physical donor presence and government capacity to administer national-level projects in that region's small island states.

For sub-Saharan Africa in particular, total AfT disbursed at the regional level increased roughly threefold, from around US\$215 million in the baseline period of 2002–05 to approximately US\$690 million in 2010, growing as a share of total AfT from 4.9 per cent to 8.4 per cent (Figure 8.2).

The OECD data allow a breakdown of the sector distribution of regional AfT. As Figure 8.3 shows, the sub-category of Trade Policy and Regulations (TPR) is heavily overrepresented in regional allocations compared with overall AfT. Whereas TPR accounts for only a small proportion of AfT provided to sub-Saharan Africa (3.3 per cent in 2008–10), it accounts for almost a quarter of all regional AfT. As Figure 8.3 demonstrates, in the most recent three years for which data are available, more than half of all aid provided by donors for the area of TPR bypassed national administrations to be delivered at the regional level.

Agriculture also features strongly in sub-Saharan Africa in terms of regional AfT, as highlighted in Table 8.2. This reflects the high level of AfT support to agriculture more generally but also recent initiatives to boost investment in the sector through coherent regional approaches. Other sectors are less well represented in regional AfT allocations, including the largest AfT sub-category of Transport and Storage.

In overall terms, the distribution of regional AfT is likely to reflect the reality of how aid is delivered and projects are implemented. TPR projects may be better suited to regional delivery, since they often address 'generic' needs such as legislation or training or

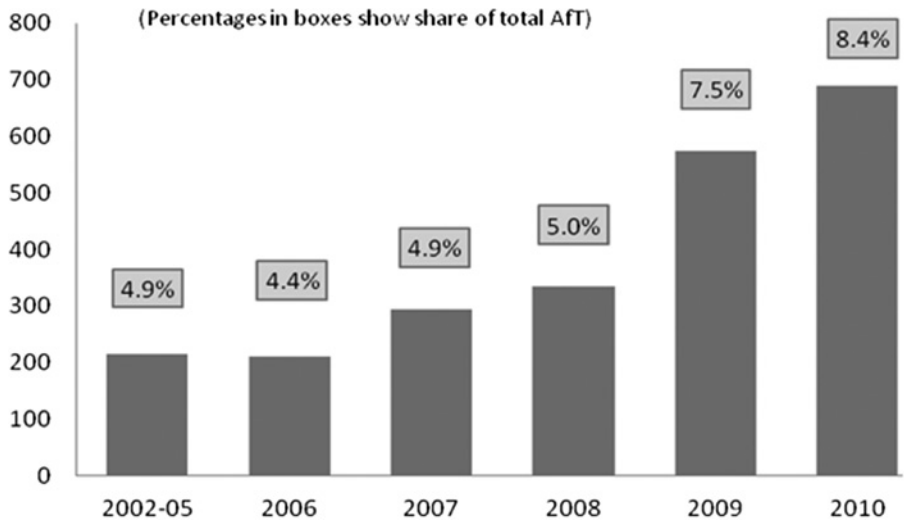
Table 8.1 Total and regional Aid for Trade in selected sub-regions^a

	2002–05 (average)			2006–07 (average)			2008–10 (average)		
	<i>Total Aft</i>	<i>Regional Aft</i>	<i>Share (%)</i>	<i>Total Aft</i>	<i>Regional Aft</i>	<i>Share (%)</i>	<i>Total Aft</i>	<i>Regional Aft</i>	<i>Share (%)</i>
Africa, north of Sahara	882.0	20.8	2.4	1,273.2	79.2	6.2	1,928.8	61.3	3.2
Africa, south of Sahara	4,408.6	215.8	4.9	5,403.9	252.7	4.7	7,549.4	532.9	7.1
Europe	768.6	50.0	6.5	1,170.2	154.6	13.2	1,853.5	217.2	11.7
North and Central America	470.6	39.7	8.4	607.7	72.3	11.9	1,170.7	107.2	9.2
South America	550.8	16.1	2.9	776.2	53.7	6.9	1,119.3	49.3	4.4
Far East Asia	3,077.4	18.5	0.6	4,152.3	59.4	1.4	4,342.2	16.9	0.4
Middle East	1,398.4	14.0	1.0	2,599.6	40.0	1.5	1,290.9	12.3	1.0
South and Central Asia	3,360.3	31.0	0.9	3,667.1	9.6	0.3	5,934.5	5.3	0.1
Oceania	217.1	19.6	9.0	230.4	21.2	9.2	342.6	65.4	19.1

^aThere are some discrepancies in the OECD's regional Aft figures. In particular, figures given for breakdowns of sub-regions such as North-of-Sahara and sub-Saharan Africa bear very little relation to totals for the continent as a whole. The discrepancies seem likely to relate to overlapping sub-regions and double-counting: in some years regional Aft provided to the two sub-regions even exceed the continental-level total.

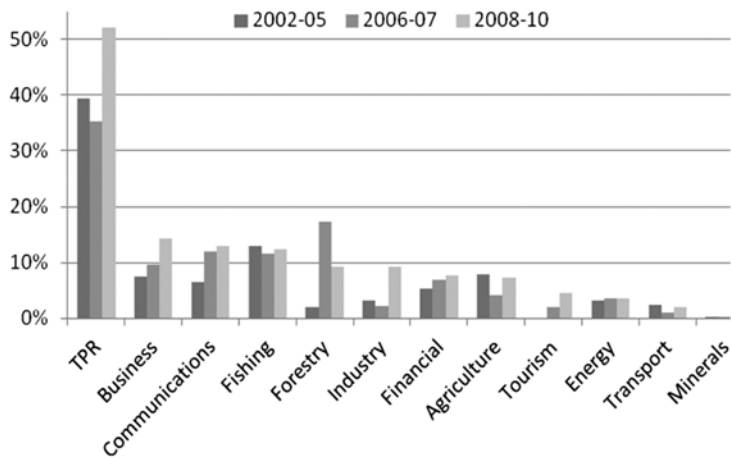
Source: OECD CRS.

Figure 8.2 Regional Aid for Trade to sub-Saharan Africa, US\$m



Source: OECD CRS

Figure 8.3 Proportion of sector Aid for Trade delivered in sub-Saharan Africa at regional level



Source: OECD CRS

participation in trade negotiations. By contrast, large infrastructure projects are specific, and carried out at the national level where the legal contractual framework exists.

OECD data also provide information on the development partners supporting regional AfT. Here, one tentative finding from a stylised grouping of donors indicates a preference amongst small to medium-sized donors towards regional AfT: those having a total sub-Saharan AfT allocation of between US\$10 million and US\$150 million

Table 8.2 Total and regional Aid for Trade to sub-Saharan Africa by broad Aid for Trade sub-sector, US\$ million

OECD broad Aft category	2002–05 (avg)					2006–07 (avg)					2008–10 (avg)				
	Total Aft	% of total Aft	Reg'l Aft	% of reg'l Aft	Total Aft	% of total Aft	Reg'l Aft	% of reg'l Aft	Total Aft	% of total Aft	Reg'l Aft	% of reg'l Aft	Total Aft	% of total Aft	Reg'l Aft
II.1. Transport	1,589.6	36.1	37.9	17.6	1,966.4	36.4	21.2	8.4	2,355.9	31.2	48.0	9.0			
II.2.	89.7	2.0	5.8	2.7	91.7	1.7	10.9	4.3	112.0	1.5	14.5	2.7			
Communications															
II.3. Energy	455.6	10.3	14.8	6.9	631.3	11.7	22.8	9.0	1,145.2	15.2	41.5	7.8			
II.4. Financial	327.1	7.4	17.8	8.2	346.1	6.4	24.0	9.5	646.6	8.6	49.3	9.3			
Services															
II.5. Business	170.7	3.9	12.7	5.9	268.9	5.0	26.0	10.3	343.1	4.5	49.2	9.2			
III.1.a. Agriculture	1,070.7	24.3	84.6	39.2	1,417.0	26.2	60.2	23.8	2,060.5	27.3	150.5	28.2			
III.1.b. Forestry	98.9	2.2	1.9	0.9	106.8	2.0	18.5	7.3	129.0	1.7	12.0	2.2			
III.1.c. Fishing	100.0	2.3	12.9	6.0	86.7	1.6	10.1	4.0	102.4	1.4	12.7	2.4			
III.2.a. Industry	256.3	5.8	8.2	3.8	227.9	4.2	5.0	2.0	267.1	3.5	24.7	4.6			
III.2.b. Mineral	191.6	4.3	0.4	0.2	95.9	1.8	0.0	0.0	125.4	1.7	0.2	0.0			
III.3.a. Trade Policy	47.6	1.1	18.8	8.7	152.6	2.8	53.8	21.3	248.9	3.3	129.6	24.3			
III.3.b. Tourism	11.0	0.2	0.0	0.0	12.5	0.2	0.2	0.1	13.4	0.2	0.6	0.1			
Total	4,408.6	100.0	215.8	100.0	5,403.9	100.0	252.7	100.0	7,549.4	100.0	532.9	100.0			

Figures in roman numerals refer to OECD broad Aft sector codes within the database

Source: OECD CRS

provide around twice as much on average through regional institutions as larger donors. This may be important for AfT effectiveness, by indicating donor willingness to co-ordinate support within broader AfT programmes.

Overall figures show that the largest AfT donors to sub-Saharan Africa in recent years are the EU, the African Development Bank (AfDB), Japan and the United States, followed by individual larger EU countries.² Apart from AfDB, the regional integration assistance strategies of many multilateral institutions also emphasise the growing importance of regional projects, even as most aid continues to be predominantly programmed and channelled through partner countries.

Beyond the Development Assistance Committee (DAC) donors, a prominent role is now clearly being played in some sectors by non-traditional emerging countries. The OECD (2011) notes that China 'has outpaced the World Bank as the leading funder of Africa's infrastructure', committing some US\$9 billion in 2010. Arab countries also spent US\$3.3 billion, mostly directed to Arabic-speaking African countries.³

8.2.2 Evaluation to date of regional Aid for Trade and its effectiveness

At present, specific analyses of regional AfT are scarce. Apart from the CRS statistics, the other main sources of information on the effectiveness of regional AfT include:

- WTO/OECD self-assessment questionnaires on AfT conducted by the OECD as part of the Global AfT Review process;
- policy documents of donors and regional economic communities; and
- micro-level evaluations conducted so far on regional programmes and projects.

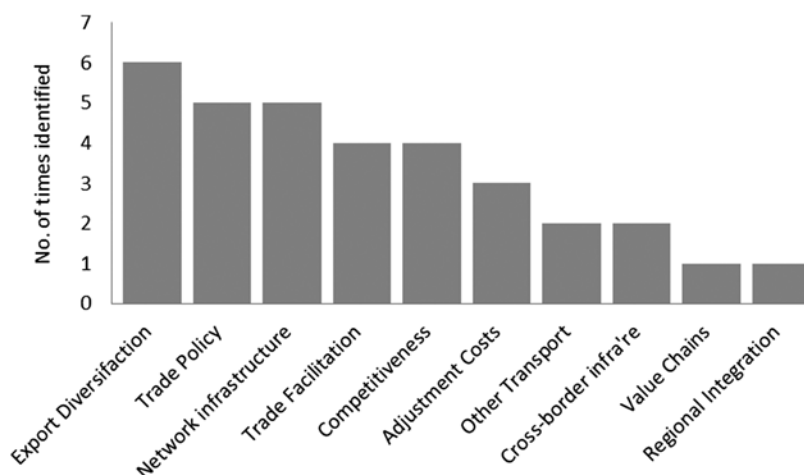
Below, we examine the self-assessment questionnaires before summarising the broader evidence on the effectiveness of regional AfT.

Evidence from WTO/OECD self-assessment questionnaires

Basnett et al. (2012) note that survey data collected from donors and recipients on AfT by the OECD have their limitations, as questions tend to be highly subjective. They nonetheless indicate the perceptions of stakeholders, including RECs, on regional AfT trends. Based on these questionnaires, the third Global AfT Review (OECD/WTO 2011) found that demand for regional integration programmes has been rising steeply in recent years, with many bilateral and multilateral donors reportedly altering their strategies to better address the regional dimension. Interestingly, however, there are signs that regional integration is not the highest AfT priority at the national level, as demonstrated in an analysis of Southern African Development Community (SADC) responses (Figure 8.4).

Broader evidence on whether regional AfT works

Although the OECD questionnaires can give an impression of whether countries perceive any benefit from regional AfT, they do not address whether regional AfT actually succeeds in meeting its objectives, namely:

Figure 8.4 National Aid for Trade priorities identified by SADC member states

Source: Authors' calculations from individual WTO/OECD country questionnaires

- whether regional AfT has any impact on actual trade outcomes; and
- whether regional AfT and regional approaches offer a more effective way of providing assistance, vis-à-vis national-level approaches.

There have been few attempts so far to measure the overall impact of regional AfT on trade outcomes in quantitative terms, partly because of data issues mentioned above.

Evaluation work and case studies of support programmes and specific projects may offer insights into whether regional AfT contributes to better trade outcomes. Here it is possible to distinguish between meso-level evaluations carried out by donors on their support to regional integration, or on their overall AfT programmes, and micro-level assessments on specific AfT projects. However, most evaluations do not in fact link to broader long-term goals such as the impact on trade or poverty reduction, instead focusing on programme or project objectives (or more commonly only on process issues). Nevertheless, the limited evidence available from donor programme evaluations on the impact of their support regional AfT (and other) programmes is mixed.

- ADE (2004) studies the trade-related assistance delivered by the EC, finding that private sector support programmes had a positive impact on expanding beneficiaries' export capacities; however, Saana (2012) points out that it was not possible to quantify these effects.
- A major recent evaluation of US assistance for regional projects highlights the contribution of the US Trade Hubs programme to the facilitation of exports from sub-Saharan Africa, with the hubs facilitating exports over their project lifetime worth US\$12.3 million in West Africa, US\$28 million in East Africa and US\$47 million in Southern Africa (USAID 2010).

- An evaluation conducted by the European Court of Auditors (ECA) in 2009 was critical of the trade-related assistance provided from 2003 to 2008. Auditors found that ‘project effectiveness was difficult to assess, but in most cases limited’: of 18 individual projects evaluated, the court was unable to assess five for lack of information, caused by objectives being too vague or inadequate collection of information. Of the remainder, six were assessed as having proven ‘unsatisfactory’.

In terms of micro-level evaluations, the OECD in particular has made notable attempts to collate evidence from this source. The 2011 OECD *Aid for Trade at a Glance* report compiled a collection of around 300 case studies to showcase ‘success stories’ covering the range of AfT support areas. A very modest number of these submissions assessed specific regional projects in sub-Saharan Africa, ranging from improving agricultural standards in the East African Community, through revamping railways in Southern Africa, to export promotion in West Africa. Although these studies highlighted generally positive experiences, Saana Consulting (2012) notes that most of the case stories again ‘focused on process, and sometimes outputs, rather than actual outcomes and impact’.

Nonetheless there are notable examples of regional AfT projects that have been based around achieving concrete results. One widely cited example has been the North–South Corridor (NSC), which was based on a robust evaluation of regional barriers to trade and prioritising key bottlenecks, further discussed below. One early NSC project established a one-stop border post at Chirundu that was cited as having cut average truck-processing times from three days to three hours, saving an estimated US\$600,000 over a year in efficiency cost gains (TradeMark Southern Africa undated). This suggests both that regional AfT projects can in fact have a significant impact, and that it is possible to design AfT projects to achieve clear results.

A recent evaluation by the African Development Bank (AfDB 2012) of its ‘multi-country AfT operations’ provides three case studies of cross-border infrastructure investments that have achieved a positive, quantified impact:

- the Arusha–Namanga–Athi River Road Project responded to the needs of both Kenya and Tanzania and was estimated to reduce vehicle operating costs by about 20–30 per cent;
- the Manantali Energy Project laid down the foundations for establishing a sub-regional energy market in the Economic Community of West African States (ECOWAS) and produces energy at a cost around one-third lower than other sources; and
- the Sasol Natural Gas Project involving South Africa and Mozambique led to greater than expected levels of gas exports while also fulfilling its corporate social responsibilities with more than 150 projects for clinics, schools, sink boreholes for drinking water and other facilities implemented, accounting for US\$11.5 million compared with US\$6 million planned.

Within meso-level donor programme evaluations there appears to be a high level of consensus on the circumstances in which regional aid (including AfT) works best.

A synthesis of ECA (2009), World Bank (2007, 2009) and AfDB (2012) reveals the following factors as being key:

- *Strong country commitment and ownership*, which most reviews see as a prerequisite to achieving project goals, as well as greater alignment between their own regional and country programmes.
- *Scope matched to national and regional capacities*, including the need for capacities in regional planning and co-ordination, accountability arrangements and national-level implementation.
- *Delineation and co-ordination of responsibilities*, and most notably supporting and building linking between activities at the regional and national levels. The ECA (2010), for example, makes the recommendation that ‘the EC [European Commission] should increase its efforts to help regional organisations in: (i) improving co-ordination between themselves and between them and their member states, and (ii) establishing monitoring systems to support implementation of programmes’.
- *Accountable governance arrangements*, also including formulating project objectives that are SMART (specific, measurable, achievable, relevant and subject to a realistic time-frame). The ECA (2010) emphasises the need to build internal capacity within the EC to manage regional projects, while the World Bank (2009) also highlights the need to strengthen management oversight of regional projects.
- *Conducive policy environment for sustainability*: here, for example, the World Bank (2007) highlights inadequate attention in its programmes to putting in place the appropriate policies to ensure that regional programmes are sustainable.

At the micro level, most studies tend to examine overall project success without addressing measures to improve the effectiveness of AfT. However, the ODI (2009) suggests that the success of the 2003–08 the Common Market for Eastern and Southern Africa (COMESA) Regional Trade Facilitation Programme (RTFP) was due to a ‘demand-driven, pragmatic approach’, with high ownership from national governments and strong synergies between project interventions, that seeks the simultaneous removal of infrastructure and regulatory bottlenecks at regional level. At the same time the RTFP evaluation encourages greater linkage to poverty reduction. Finally, Makhan (2011) in particular makes a notable contribution by highlighting the challenges in co-ordinating EU donor support to COMESA, and advocating *inter alia* the revision of donor procedures and operating modes, ‘with a view to more flexibly allow for harmonisation and alignment at the implementation levels, and facilitate joint financing, for instance [...] to build bridges between the different instruments and mechanisms at play’.

In spite of these findings, the general evidence base for assessing regional AfT remains weak. One conclusion to draw is that there should be a more systematic attempt to collect information on regional AfT to see how lessons can be better mainstreamed within the design of future AfT projects and evaluation systems.

8.3 Improving the effectiveness of regional Aid for Trade: challenges and opportunities

As flows of AfT being channelled through regional institutions have increased markedly in recent years and there is some evidence of positive impacts, it is important that such resources be used effectively to achieve the increases in trade flows that ultimately help to raise incomes and reduce poverty.

Although greater ‘regionalisation’ of aid offers opportunities for improvements in donor co-ordination and for more efficient and streamlined aid programmes, regional-level approaches arguably add a new set of problems to question of how to assess and improve the effectiveness of AfT.

8.3.1 The policy context for regional AfT effectiveness: principles and policy responses

Applying aid effectiveness principles to regional Aid for Trade

Efforts to improve the effectiveness of regional AfT can draw upon the underlying principles and rationale of the AfT initiative, as well as the international dialogue on how to improve aid effectiveness as a whole. As Lui, Byiers and van Seters (2012) highlight, the ‘Aid for Trade’ and ‘Aid Effectiveness’ agendas are closely aligned, partly because they emerged at the same time and were both concerned with improving the quality and not just the quantity of aid.⁴

In seeking to apply aid effectiveness principles to regional AfT, it is important to recognise that the additional layer of complexity at the regional level adds a new set of problems to the question of how to assess and improve effectiveness though the need to ensure effective input and ownership among member states that may differ widely in terms of characteristics and needs.

Here, for example, *alignment* is not only about how well donors align their programmes to regional priorities, but also about how well national and regional policies align. *Mutual accountability* is subject to a similar extension of the principle: effectiveness is no longer dependent only on strong and equal accountability relationships between donors and regional organisations, but also on a robust set of accountability relations between the RECs and their member states. A similar argument follows for *ownership*: regional ownership requires not only the REC to approve a project, but also involvement by member states (and beyond them regional civil society organisations). The concepts of donor *coherence* and *co-ordination* also take on a special meaning at the regional level given that relatively few donors may currently work directly with RECs and other regional implementing authorities, and where new aid instruments and modalities may also be required alongside existing ones.

One of the key questions for regional AfT concerns *subsidiarity* and the appropriate level at which to implement regional projects. As well as questions over mandate and authority, this in turn depends partly on the *capacity* of regional agencies to implement complex projects: in recent years and despite the opportunities for more efficient aid,

most stakeholders would agree that regional programmes have not yielded the best results in terms of implementation.

Regional AfT strategies in sub-Saharan Africa

Sub-Saharan African stakeholders have responded to the growing emphasis on regional integration and regional AfT by developing ‘regional AfT strategies’. To some extent these have been developed to mirror the AfT strategies of donor countries – such as the EU’s 2007 AfT Strategy – but also to define AfT funding priorities while attempting to overcome the challenges laid out above. In most cases, however, the documents have evolved beyond the issue of mobilising additional AfT resources to address a wider set of policy questions and challenges around how best to deliver AfT at the regional level, especially in terms of fostering greater ownership and encouraging coherent and co-ordinated approaches. Examples include the COMESA, UEMOA (West African Economic and Monetary Union) and ECOWAS AfT strategies, and SADC is also understood to be in the process of designing an AfT strategy.

Lui and van Seters (2012) highlight, for example, that, in contrast to the broad scope of AfT, the COMESA strategy is focused on two specific, cross-cutting regional problems not being addressed elsewhere: the high cost of doing business across borders, and trade adjustment as a result of regional liberalisation. For both of these areas the strategy advocates clear approaches: investing in more strategic ‘corridor’ approaches to solving high business costs, and a donor-funded fiscal compensation programme to deal with adjustment costs. Implementation of the strategy is helped by investment in capacity within the COMESA Secretariat in the form of a regional AfT unit.

However, despite some specific successes, it has proven more difficult to apply broader aid effectiveness principles at the regional than at the national level in Africa. Programme implementation has raised additional practical challenges due to capacity constraints and co-ordination and coherence issues that threaten the effectiveness of working through the regional level.

8.3.2 Key challenges to improving regional Aid for Trade

Although potential gains to AfT effectiveness are available through a regionally co-ordinated, coherent, and articulated vision of how to use AfT, there are also challenges relating to the mobilisation of resources as well as the design, delivery and implementation of regional AfT.

Resource mobilisation and new sources of development finance

Whereas AfT has grown in recent years, a major concern is whether existing AfT flows will be maintained into the future. OECD/WTO (2011) concludes that, against the backdrop of the financial crisis, ‘maintaining AfT flows will be difficult’, even though development challenges for Africa continue to be considerable and financing gaps remain substantial. Although AfT for African infrastructure has grown in recent years to around US\$10 billion per year, this is still only a fraction of the estimated US\$93 billion needed on an annual basis. Of additional concern for regional AfT

flows is the potential for forthcoming cuts in EC support to regional institutions. This is important given that instability and unpredictability of resources is cited as one reason why RECs had a limited capacity to play a leading role in successful regional co-operation and integration (Dalleau and van Hove 2012).

At the same time, the most recent discussions on the future of development assistance have emphasised new forms of financing beyond aid. The recent Busan Declaration emphasises, *inter alia*, taxation and domestic resource mobilisation, private finance and public–private partnerships. The latter appear particularly suited for regional infrastructure projects and again have increasingly been sought for trade and development corridors, where there are already strong linkages to private sector interests (Lui et al. 2012).

Regional vision and prioritisation

Despite progress in developing regional AfT strategies in sub-Saharan Africa, the extent to which regional AfT can be an effective tool for boosting trade and investment ultimately depends on its alignment with a genuine common vision for integration in each region. This is difficult to achieve in regions comprising countries of very different size, geography, population and level of economic development. This diversity presents challenges to the design, prioritisation and implementation of regional AfT, given the involvement of multiple actors, each with their specific set of incentives and interests and, frequently, overlapping regional configurations.

Regional AfT strategies can, in principle, help to overcome some of these problems by advocating for stronger coherence and agreed prioritisation of key cross-border projects. Nevertheless, such strategies must add value to existing regional policy frameworks and programmes, raising the issue of how to achieve ‘horizontal coherence’ across all the different frameworks. Regional AfT approaches – including the trade corridor approach highlighted in Section 8.4 – can therefore play a potentially catalytic role in ‘unlocking’ such problems.

Finally it should be noted that the political economy of regional aid (and regional integration more generally) is seldom explored in conventional evaluations and assessments that tend to treat regional organisations as quasi-independent, interest-neutral, fully legitimate and accountable actors. The World Bank (2007), however, does note that regional projects ‘affect political relations between countries’ and the ‘effectiveness of programmes has depended on [...] reconciliation of countries’ differing interests’.

Ownership, alignment and donor co-ordination

Despite commitments to increase ownership of aid programmes by recipient countries and increased harmonisation of donor activities, this has proven difficult.

In terms of ownership, the broad fact that the AfT agenda emphasises aid resources suggests that primacy is given to inputs rather than development outcomes. As noted above, one motivation for the development of AfT strategies in sub-Saharan Africa has been as a response to those of donors, raising suspicions that AfT is essentially

a donor-led agenda. To underline this, some countries have reportedly changed their AfT priorities to match donors' interest.⁵ The issue of national ownership of regional AfT is also complicated by the need for consultation, acceptance and oversight by member states. In the area of donor co-ordination, joint programming and delivery of support by donors continues to be limited, despite a few achievements such as the EU–Africa Infrastructure Trust Fund.⁶ Development partners are often better structured and equipped to deal with national partners than regional ones. Whereas RECs can receive grants, financial instruments do not always allow loans to RECs or groups of countries.⁷ Moreover, where development partners feel pressure to disburse, the perception that supporting regional projects is slower because of complicated procedures can be a disincentive (Mackie et al. 2010). With regard to different regional AfT modalities, general budget support can enhance donor alignment, yet this is still an unusual practice at the regional level (Mackie et al. 2010). Direct budgetary contributions from bilateral donors to RECs have also proven to be unpredictable (AU-UNECA 2006).

In terms of agreeing regional AfT priorities with donors, successful examples of joint programming at the national level suggest that regional AfT strategies need to be brought to the fore in discussions. For their part, donors emphasise that they can only respond to coherent requests coming from regions themselves. This also implies the need for improved forums for co-ordinating regional aid, such as the multi-partner dialogues that are more common at national level. Finally, the increasing importance of China, India, Brazil and other 'emerging players' is also likely to alter donor–recipient relations given the interest in supporting and investing in AfT areas such as infrastructure, creating new policy management challenges alongside opportunities for developing countries.

8.3.3 Implementation issues around regional AfT

Regional economic communities often find it difficult to drive regional initiatives, in part because of weak institutional and technical capacity, but also because they lack sufficient political legitimacy and mandate to do so. Regional groupings in sub-Saharan Africa differ widely in terms of original mandate and scope of operations, and their consequent legitimacy and ability to act as implementing agencies or authorities.

Whereas COMESA is focused on the goal of establishing a single market in Eastern and Southern Africa, the foundations of SADC are as a political grouping, and ECOWAS has a stronger focus and mandate than other organisations in the area of maintaining peace and security. As noted above, regional integration (along with aid itself) has important political-economic dimensions that are important for stakeholders to understand and respect in deciding how AfT can be effective in supporting integration initiatives.

In terms of technical capacity to implement regional AfT, recent experience suggests that the establishment of specialised regional agencies may in some instances be useful to improve implementation. One illustration is given by the recognition from SADC, COMESA and the East African Community (EAC) that there is a lack of

capacity to conduct many of the technical functions necessary to implement the North–South Corridor (NSC) initiative and prepare projects sufficiently to bring them to a ‘bankable’ stage. This led to the establishment, with support from DFID, of TradeMark Southern Africa (TMSA) as a technical support unit for the tripartite process. Although the work of TMSA is highly valued by the region, it clearly has only a limited lifespan and so may need to be replaced with a more sustainable solution.

8.4 The corridor approach and regional AfT effectiveness

Many of the challenges to effective regional AfT might potentially be resolved through a more focused approach addressing bottlenecks between countries with cross-border interests. Aid for Trade effectiveness may therefore be improved through a corridor approach that helps to prioritise concrete, implementable activities to promote trade and exchange across borders and promote national, regional and international value-chains.

8.4.1 Corridors overview

With 16 landlocked countries, the corridor approach has been adopted with considerable enthusiasm in sub-Saharan Africa. This is related to African geography, colonial remnants and resource extraction, but is also because regional trade is low, transport costs are high, and private sector employment predominantly consists of informal enterprises and smallholder farmers. By holistically addressing these issues, a corridor approach potentially offers an effective means of using AfT to boost private sector performance and exchange, particularly along historically important trade routes.⁸

The corridor approach essentially aims at providing co-ordinated investments in ‘hard’ and ‘soft’ infrastructures. This is based on the premise that investments in roads and other ‘hard infrastructures’ are less effective if not combined with investments to improve border procedures and behind the border constraints.

Investments in soft infrastructures include initiatives such as the construction of ‘One-Stop Border Posts’ at key trade crossings. These have been recognised as an important step in cutting time spent by trucks and the associated costs. National single window technology has also been advanced as a technological solution to streamlining the import and export clearance process, which can often involved multiple agencies at the border, each with their individual bureaucratic requirements. At the same time there is widespread recognition now that investments in cross-border co-operation and technological systems cannot succeed without accompanying efforts in the area of policy reform to streamline import and export procedures in the first place.

Increasingly, corridor approaches are looking beyond merely facilitating trade, towards more ambitious ‘spatial development initiatives’. The corridor from Maputo port into South Africa has been designated a ‘Development Corridor’; others specifically focus on linking agricultural producers with markets. Examples here include the Beira Agricultural Growth Corridor (BAGC) in Mozambique and the Southern Agricultural Growth Corridor of Tanzania (SAGCOT).

These recent corridor initiatives are being driven to an important extent by the international private sector and commercial interests. Although critics fear this undermines development concerns, commercial interests may also provide the additional momentum required to see such initiatives through, thus also boosting the potential effectiveness of any regional AfT component. Nonetheless, the continuing link between corridors and moving mineral extraction products to the sea raises the challenge of ensuring that such corridors can genuinely work with small-scale producers. This underlines the need for balance between commercial interest and ensuring development impact in applying AfT to such initiatives.

This section considers the role of regional AfT support to corridors in general, with more in-depth discussion of the NSC, the SAGCOT and the Maputo Development Corridor (MDC).

8.4.2 Corridors in policy

Given developing country and AfT donor attention to improving physical infrastructure, trade development and productive capacity, corridors based on historical trade linkages represent an attractive approach.

By providing a concrete output for stakeholders to support, the corridor approach also serves as a marketing device for national leaders to promote. This is most evident in the Beira and SAGCOT corridors, where ‘investment blueprints’ were promoted at events such as the World Economic Forum by the presidents of Mozambique and Tanzania, while the NSC has also received high-level support and promotion by Presidents Zuma and Museveni of South Africa and Uganda, respectively. The suitability of the corridor approach as a marketing tool for investment may also explain the proliferation of corridors in sub-Saharan Africa.

There are 21 major corridor projects either in the pipeline or ongoing in Africa, with 16 at least currently under active work.⁹ Figure 8.5 shows the principal corridors in Southern and Eastern Africa, to which can be added the Lamu Port and New Transport Corridor Development to Southern Sudan and Ethiopia (LAPSSSET)¹⁰ as well as the Mtwara Development Corridor, ‘a spatial development initiative (SDI) comprising southern Tanzania, northern Mozambique, northern and central Malawi, and eastern and northern Zambia’.¹¹ Figure 8.6 similarly traces the major corridors connecting the West African region.

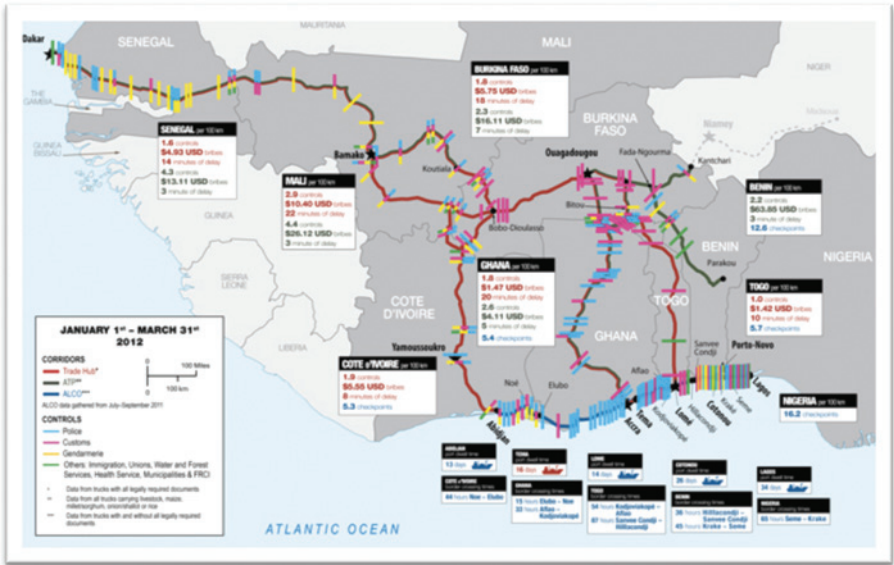
One of the key features of the corridor approach is the linkage it instils between regional trade policy, investments in infrastructure, supporting AfT and private sector participation. The NSC, which seeks to reduce cross-border trade costs and waiting times along the major trading routes in the Eastern and Southern Africa region, emerged as a key regional AfT ‘pilot programme’ from the COMESA–EAC–SADC Tripartite process. Based on a two-pronged approach, the NSC seeks to achieve both physical infrastructure improvements in roads, railways and energy supply as well as streamlining and harmonisation of the regulatory environment through trade facilitation measures at the various borders.

Figure 8.5 Major corridors in Southern and Eastern Africa



Source: TradeMark Southern Africa, available at: www.trademarksa.org/our_work/corridors_infrastructure/multi_modal_corridors# (accessed 29 November 2012)

Figure 8.6 Major corridors in West Africa (with road controls)



Source: USAID-UEMOA (2012: 2).

The SAGCOT Corridor Initiative is seen as a ‘showcase for public–private partnership in agricultural growth’ as well as regional trade, corresponding to the stretch of the NSC from Dar-es-Salaam to Zambia and the Democratic Republic of Congo (DRC) (G8 2012). Launched at the World Economic Forum (WEF) in May 2010 in Dar-es-Salaam, SAGCOT aims to be an international public–private partnership focusing along major transport routes to Zambia to catalyse ‘large volumes of responsible private investment [...] to deliver rapid and sustainable agricultural growth, with major benefits for food security, poverty reduction and reduced vulnerability to climate change’ (SAGCOT 2011). The goals of SAGCOT are considerably more ambitious than those of facilitating trade, with US\$2.1 billion of potential investments planned to be brought in over a 20-year period, public sector grants and loans of US\$1.3 billion and a forecast increase in land under profitable production of 350,000 hectares.

More than the NSC, the SAGCOT involves partnership with major international companies such as Yara, Monsanto, DuPont and Unilever, with the aim of ensuring ‘equitable and sustainable partnerships with smallholder producers’ (SAGCOT 2011). The SAGCOT investment blueprint promotes production clusters along the corridor through public financing of a catalytic fund of US\$50 million for startup agribusinesses incorporating smallholders; ‘patient capital’ to finance the cost of ‘last mile infrastructures’ such as farm roads and irrigation connections; and loan guarantees and currency risk instruments to leverage capital from the banking sector.¹² These clusters are intended to involve a nucleus farm and outgrower schemes, (cold) storage facilities, infrastructure access, inputs and finance as well as access to research.

In addition to its ambitious objectives, the SAGCOT initiative sits at the intersection of an array of policy initiatives. These include Grow Africa and the G8 New Alliance, the Tanzania CAADP Compact and the Tanzania Agricultural Food Security Investment Plan (TAFSIP). On paper it is also underpinned by the Agricultural Sector Development Programme (ASDP) and Agricultural Strategic Plan (ASP), both aimed at increasing agricultural productivity and profitability, generating employment in rural areas and ensuring national and household food security (United Republic of Tanzania undated: 2). It follows and builds on the Kilimo Kwanza, or ‘agriculture first’ programme.

Thus, the corridor approach represents a far more outcome-oriented and private sector-driven approach to trade policy and regional AfT. It also highlights the catalytic role it can play, not just in financing initiatives but also in helping to translate the many overlapping policies relating to trade and productive capacity into a more coherent and concrete plan.

8.4.3 Corridors in practice

At this point it appears that the corridor approach helped not only in serving as a regional focal strategy but also in pressuring for some genuine prioritisation among related regional needs, and in catalysing additional resources.

Although still a work in progress, the NSC approach is widely considered to be a successful pilot AfT initiative deserving replication. As noted above, efforts to mobilise

resources met with some success, with a 2009 High Level Conference generating some US\$1.2 billion in pledges from multilateral and bilateral donors. A Tripartite Trust Account to leverage funds from commercial and quasi-commercial sources was established in 2010 by the Development Bank of Southern Africa (DBSA), which also serves as the fund's management, while DFID has so far granted €67 million.¹³

In terms of results, the NSC project has reduced transport costs and time-consuming bottlenecks, while 8,599 km of NSC roads have been refurbished or are planned to be renewed within the foreseeable future. The quality and conditions of the routes along the NSC are now surveyed and presented online for interested stakeholders while a Non-Trade Barriers Reporting, Monitoring and Elimination Mechanism has been digitised and is now available online. Further, as a part of the NSC the first sub-Saharan One-Stop-Border Post (OSBP) was established in Chirundu in 2009 and, despite some major initial challenges, the OSBP is considered to have substantially reduced transit time and is now replicated elsewhere along the NSC route.

Challenges nevertheless remain in implementation, particularly because the NSC is regional whereas many decisions and actions related to the NSC are taken at the national level, an issue raised in the discussion above. Stakeholders highlight challenges of co-ordination, information sharing and incompatible procedures. Gaps in the technical capacities in member states and REC Secretariats also lead to delays in project design and implementation.

Other corridor successes include the Maputo Development Corridor, where the Witbank to Maputo road was upgraded as a 30-year concession and the first public-private partnership in Southern Africa (Soderbaum and Taylor 2007). A cited benefit of the Maputo Corridor is the Mozal smelter plant, for which roads, ports, power generation, telecommunications, water supply and drainage systems were built or upgraded with a mixture of African and European public and private finance (Office of the Premier 2008). According to some estimates the MDC attracted US\$5 billion of private funding between 1996 and 2005 (Kuhlman et al. 2011). A range of border improvements have also taken place with investments to improve border processing times for freight traffic through separating freight and passenger channels, extended border opening times and initiation of the process towards a 'one-stop border post' (Bowland and Otto 2012). Private sector operators are generally upbeat about the improvements in using the Maputo corridor although critics suggest that poorer households and small businesses and farmers have benefited little.

SAGCOT is at an earlier stage so understandably has less successes to offer. Although it is clear that this kind of multi-stakeholder partnership is time-consuming to set up, there are nonetheless criticisms of the limited investments in commercial agriculture that can be attributed to SAGCOT activities and the little actual investment of the SAGCOT commercial partners beyond Yara's investment in its fertiliser terminal, while the business environment remains challenging (UNDP 2012). This is not to mention concerns around access to land. However, given that Yara reportedly needs to sell 200,000 tonnes per year of fertiliser through the port to make it profitable, thus relying on markets in Zimbabwe, Malawi and Zambia, its own vulnerability to movement along the corridor and also its broader

development also suggest that in practice the commercial motive is likely to keep the initiative moving.

Project preparation as a key ongoing challenge

Amongst the remaining challenges, the difficulty in preparing projects to reach the 'bankable' stage at which funds can be committed represents a major hurdle. This is understandable given that bringing a project to a bankable stage has been estimated to represent a 10 per cent sunk cost even before construction begins. Leigland and Roberts (2007) have highlighted the different steps that need to be taken to bring an infrastructure project to bankable stage in Table 8.3.

This suggests that a priority for AfT might be project preparation and then financing projects, potentially through regional project preparation units. The creation of the SADC project preparation unit offers one such example. This is only one of a recent proliferation of project preparation units and similar organisations, such as the DBSA, the African Development Bank, TMSA and the World Bank's Public-Private Infrastructure Advisory Facility (PPIAF) in Nairobi. However, such units also face continued challenges in terms of lack of capacity on both a human and a financial level and assume some form of process of priority setting and project selection, at least at the cross-border level.

Modalities for donor corridor support

According to the JICA Corridor Project Dataset, financiers of corridor project elements include the World Bank, the African Development Bank, Japan International Cooperation Agency (JICA), the EU, KfW, Kuwait, national governments, Danida and the Arab Bank for Economic Development in Africa (BADEA).

One key donor mechanism has been the EU Africa Infrastructure Trust Fund, established in 2007 to facilitate support for infrastructure projects with a cross-border or regional impact in sub-Saharan Africa. Approved grants can support interventions in the energy, transport, water and telecommunications sectors through four mechanisms: interest rate subsidies; technical assistance/feasibility studies; one-off grants for social or environmental components of projects; and grants covering early-stage premiums on risk mitigation insurance. The fund is managed and supported technically by the European Investment Bank (EIB) and encourages co-ordination, co-financing and 'blending' between European grant providers such as the EC and EU member states, and the EIB and other EU development finance institutions such as AFD, KfW and LuxDevelopment.

Aside from the hardware aspects of corridor construction, donors have also grouped together to support agencies set up to help provide technical assistance for the implementation of regional programmes. The TMSA and TradeMark East Africa (TMEA) programmes focus on three main components, namely infrastructure development, trade policy capacity development and trade facilitation within Eastern Africa, Southern Africa and the East African Community (EAC) respectively. Other donors have subsequently added their support to the initiative including Sweden,

Table 8.3 Phases in infrastructure project development

Phase	Actions
1. Enabling environment	• Designing enabling legislation • Designing regulatory approaches • Reforming project-relevant institutions • Reforming policy • Building capacity to support project • Building consensus around project
2. Project definition	• Identifying desired outputs • Determining priority of project relative to others • Identifying project champions • Preparing action plans (including terms of reference)
3. Project feasibility	• Conducting pre-feasibility studies • Performing financial modelling • Conducting economic, social, technical and environmental studies
4. Project structuring	• Assessing public and private options • Structuring project finance • Designing legal entities
5. Transaction support	• Designing and conducting bid process and drafting contracts
6. Post-signing support	• Negotiating financial and legal terms • Finalising post-signing financial arrangements • Conducting scheduled tariff reviews • Renegotiating or refinancing project

Source: Leigland and Roberts (2007)

Denmark, Belgium and the Netherlands. Some contributions come in at the regional level (headquarters) and others at country level (field offices), illustrating the co-ordinating role that this initiative can play, while a Partnership Fund has been set up to fund capacity-building activities.

Similar initiatives are under way with USAID supporting the aforementioned regional Trade Hubs in West Africa (WATH) and Southern Africa (SATH) with the goals of increasing international competitiveness, intra-regional trade and food security. As well as targeted interventions to promote specific private sector value chains, a major focus of SATH's work is to reduce the time and costs of transporting goods across borders through tools such as co-ordinated border management, customs connectivity and national single windows along key regional transport corridors.

Although generally seen as a success, support through this type of project management unit is criticised for the way it creates parallel structures outside the regional organisation and thus goes against some of the principles of the Paris Declaration, notably ownership and alignment.¹⁴ At the same time, their effectiveness in moving forward initiatives relating to the NSC and other corridors has been lauded, suggesting this as a useful model.

In the case of SAGCOT, although support is received from a number of initiatives such as TMSA and SATH, the co-ordinating institution is the SAGCOT centre. The SAGCOT Centre is intended to ‘coordinate investment and action by a range of players to address a range of opportunities and needs at once – thus kick-starting environmentally sustainable and socially beneficial commercial agricultural development in the Corridor’ (Jenkins 2012). This is an important role with a range of functions. Although the initiative is to some extent still in its early stages, after a year of functioning the centre had neither the staff nor the budget to carry out the designated tasks. The centre receives few dedicated government resources and donors are apparently reluctant to fund it, partly because of the implicit availability of private sector funds for this.

Rather than seeking direct implementation support, therefore, the SAGCOT investment blueprint encourages donor support and contributions to a catalytic ‘patient capital fund’. At present, the only ‘money on the table’ is US\$50 million for the fund, contributed by the World Bank, DFID and USAID. Although these three main donors are willing to support the effort, the institutional design of the catalytic fund had been overlooked by the SAGCOT initiators, leaving this as a key task being undertaken at present. Indeed, some suggest that focusing on the fund distracts from the core work of stimulating investment from SAGCOT signatories and potential investors. Some US\$20 billion of investment is envisaged in the SAGCOT blueprint, while apart from Yara’s port investment none of the international investors have yet to come forward with any new investments.

Interestingly, donors supporting agricultural development in Tanzania are also conscious that spatial development initiatives such as this also raise issues of prioritisation and the dangers of ‘orphan’ areas. One donor representative even suggested that his agency was focusing their attention *away* from the key target areas of the SAGCOT plan. This again raises issues of co-ordination and a potential need for this to take place at the national level.

Corridors and the domestic private sector

In terms of improving the effectiveness of regional AfT, the current consensus is that a focus on corridors provides a useful, targeted and co-ordinated approach for donors, the private sector, regional and government actors to combine forces in the prioritisation and design of approaches. At the same time, it is important to look beyond the policy rhetoric, to realities on the ground. At least one recent in-depth analysis of the Maputo Development Corridor and the SAGCOT raises questions about the degree to which corridors contribute to the broader objectives of AfT, in terms of promoting productive capacities as well as regional integration (Byiers and Rampa forthcoming).

One concern is the role that national businesses play in the corridor approach. Key industry segments in SAGCOT include agro-dealers, food processors, supermarkets, support service institutions and financing companies (UNDP 2012). National businesses are certainly expected to benefit from corridors; not just from supporting

investments, but also from improved infrastructures, border procedures, deeper markets and greater access to credit. Yet different operators are also engaged to different degrees in ongoing policy processes, face different constraints and are likely to benefit in different ways. For example, large multinational players such as South Africa-based Shoprite – which control whole value chains and are present across regions – have a vested interest in the corridor approach and can drive change. At the same time they are said by some to be forming cartels, effectively blocking smaller operators.

Despite a rhetorical emphasis on the ‘key role’ for the domestic private sector, an overall sense is that despite having more to offer than international companies they are not being included in ongoing initiatives. Many existing companies operating in the SAGCOT area and working with smallholders were not aware of the SAGCOT initiative, while civil society was similarly uninformed (see, for example, UNDP 2012). This lack of deeper engagement may have negative impacts in terms of the sustainability of the growth corridors initiative. One common argument is that domestic operators are in the sector for the ‘long haul’, in contrast to the footloose nature of international investment, experienced on numerous occasions in the past.

Perhaps more fundamentally, for any of the corridor initiatives to fully function, the underlying business environment remains key. In Tanzania, electricity supply is cited by 73 per cent of interviewed firms as their biggest obstacle to doing business (World Bank 2006), while the biggest obstacles in Mozambique include access to finance and informal competition, although electricity is also a constraint (World Bank 2007). This highlights the basic constraints that firms face at ground level in achieving the broad ambitions sought in corridor initiatives.

There are clearly limits on the role corridors can play in improving the existing business environment. The SAGCOT investment blueprint states that a conducive environment in areas ranging from ‘land legislation, agricultural taxes and tariffs, import and export restrictions’ to ‘access to utility services’ is ‘fundamental to SAGCOT’s future success’ (SAGCOT 2011). A key question remains the degree to which corridor initiatives rely on these supporting reforms, and the degree to which it can drive them.

8.5 Conclusions

This chapter analyses and discusses AfT effectiveness and the appropriateness of a regional setting to achieve this.

Given the enormous scope covered by AfT interventions and the types of instruments employed, measuring regional AfT effectiveness in any rigorous way is not easy. Although this is similar to the problems faced at a national level, this chapter looks at AfT flows, institutional issues and challenges to implementing effective AfT programmes at the regional level, and focuses on a corridors as an approach to overcoming some of these challenges.

8.5.1 AfT flows

According to the available data and subject to numerous caveats, regional AfT flows have been increasing over recent years, particularly in Africa. A major caveat is that many projects that are regional in nature are nonetheless financed through national mechanisms. Whereas increased flows to regions can be interpreted as a positive development, given the potential for regional strategies to maximise opportunities for regional and international trade, financial flows themselves clearly do not imply that this is being used effectively.

8.5.2 Institutions

At the level of regional institutions, the AfT initiative has led to an institutional focus on preparing regional strategies. Although these potentially offer benefits by providing a co-ordinated, coherent regional prioritisation of needs, the fact that they are based on aid inputs ultimately makes the exercise donor driven, while ideally donors would be willing and able to align their financing with existing regional strategies. Putting this aside, regional institutions face a range of challenges in implementing their strategies, relating to financial and human capacity, but also the mandate to take projects forward at the regional level. Thus it is not clear that, in practice, regional AfT manages to ensure 'effective' aid delivery to the trade and productive sectors.

8.5.3 Corridors as a tool for more effective AfT?

Corridors provide a narrower focus for AfT in terms of geographical areas within countries, smaller sub-groups within regions, and concrete hard and soft infrastructure needs. This promotes greater co-ordination and sequencing, as well as bringing constraints to light that can then be the target of additional project efforts.

Whereas corridors began as being about roads and border crossings, the concept has developed with the inclusion of large multinational private sector actors, in this way becoming regional spatial development initiatives. The increasing engagement with the private sector for corridors offers opportunities for greater effectiveness through the commercial motivation, knowledge and ideas that private sector operations bring, while in some cases a commercial approach may be the defining factor in making AfT sustainable, and therefore more effective in that sense.

Nonetheless, this approach still needs to be better understood in terms of ensuring that low-income households and local producers benefit. There is a need to find a balance between private interests and development priorities.

Overall, while AfT at the regional level appears well suited to improving AfT effectiveness on paper, the corridor approach seems to represent a useful way of focusing efforts to overcome some of the problems associated with broader regional programmes. Further, in the context of the declining importance of aid, an approach that works with the private sector not only for increasing financial resources but also in aligning interests appears to be a useful approach to maximising the effectiveness of AfT as a catalyst for broader public and private investment.

Notes

- 1 All data are for disbursements in constant 2010 US\$.
- 2 Data for 2009 appear to have been influenced by a large increase in AfT reported by AfDB, which is understood to have changed its AfT reporting at the time. Similar increases in regional AfT were not repeated in 2010.
- 3 These figures are not directly comparable with AfT commitments by traditional donors, as they include a variety of non-concessional instruments. They are also unlikely to be 'regional' as defined above, even if projects may contribute to regional trade. Consequently, more identifiable forms of regional assistance – including support channelled through RECs – are still likely to be dominated by EU donors. Nevertheless, the figures at least indicate the importance of newer partners such as China.
- 4 One key point to make, however, about aid effectiveness principles is that for the most part they are still focused on improving the quality of aid *inputs*, rather than *outcomes* such as increasing regional trade. Thus, some of the crucial implementation challenges may not necessarily be addressed *per se* by the aid effectiveness agenda.
- 5 OECD/WTO (2011: 32), notes, for instance, that Kenya prioritised infrastructure in its demands for AfT 'because OECD countries want to give more aid to infrastructure'.
- 6 For a case study of EU AfT to COMESA in this regard, see Makhan (2011).
- 7 For example, until 2009, the World Bank was not able to supply RECs with grants. RECs could not borrow from the International Development Association, as they had no revenue-raising power and were therefore seen as too risky for lending. Member States were usually not willing to borrow for a regional rather than a national programme. Introduction of recent instruments may help address this situation.
- 8 Although the focus here is on sub-Saharan Africa, the approach is not limited to that region. Other major corridors link Bangladesh and India (the Dhaka–Chittagong–Northwest transport corridor) and the Mekong Delta region in South East Asia.
- 9 These figures come from the JICA Corridor Project Information Dataset: <http://corridormap.jica.go.jp/Corridor-Project-Information-Data-Set.pdf>
- 10 www.vision2030.go.ke/index.php/pillars/project/macro_enablers/181
- 11 www.aurecongroup.com/Projects/Transport/Mtwara-Development-Corridor-Project
- 12 'Patient capital' is defined as long-term, low-cost subordinated capital provided by donors and invested in the early stages of private sector agricultural ventures (SAGCOT 2011).
- 13 This section draws on TradeMark Southern Africa (2011a,b), COMESA, EAC, SADC, (2009), ODI (2009) and Lui and van Seters (2011).
- 14 TMEA mirrors the EAC and member states' structures and tries to reinforce them, and the agency recently signed a Memorandum of Understanding (MoU) with the EAC Secretariat. At present, however, the initiative remains a parallel organisation, and stakeholders acknowledge that strengthening the EAC Secretariat is a long-term process.

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Chapter 9

Regional Aid for Trade and Aid Effectiveness: Examples from East and West Africa

Liz Turner and Anna Fink

9.1 Introduction

This chapter provides an introductory review of regional Aid for Trade (AfT) and the extent to which aid effectiveness principles are applied through the use of case studies. The focus is on projects and programmes supporting regional economic integration, since many of these are regional and multi-country in nature. Geographically, the area of study is East and West Africa. The main aid effectiveness principles explored are ownership, alignment and harmonisation. The chapter does not attempt to conduct a comprehensive assessment but rather lays the groundwork for future work in this area.

The chapter begins with an introduction to regional AfT and aid effectiveness and looks at the engagement of developing countries and development partners. Sections 9.3 and 9.4 explore the main implementers of regional economic integration programmes including regional organisations such as regional economic communities, partner states and development partners. The challenges and opportunities faced in delivering such programmes according to aid effectiveness principles are also assessed. Section 9.5 highlights some of the key findings and conclusions while Section 9.6 provides areas for further investigation. This chapter aims to contribute to the debate around AfT and aid effectiveness, for instance at the World Trade Organization (WTO) and Organisation for Economic Co-operation and Development (OECD) AfT global reviews¹ and the high-level forums on aid effectiveness.²

9.2 Regional Aid for Trade and aid effectiveness in Africa

9.2.1 The AfT initiative

The AfT initiative has its origins in the WTO negotiations and fears over adjustment costs associated with multilateral trade liberalisation, particularly those arising from preference erosion (Turner 2008). The initiative gained prominence during the WTO Ministerial Meeting held in Hong Kong in December 2005, which also established an AfT Task Force.³ The final Ministerial Declaration stresses the importance of AfT in assisting developing countries, especially least developed countries (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 expand their trade’ (WTO 2005).

The AfT Task Force provided recommendations on how to operationalise the initiative and provided recommendations on the mandate, rationale, objectives,

scope and challenges. The Task Force recommended that: ‘The scope of Aid for Trade should be defined in a way that is both broad enough to reflect the diverse trade needs identified by countries, and clear enough to establish a border between Aid for Trade and other development assistance of which it is a part. Projects and programmes should be considered as Aid for Trade if these activities have been identified as trade-related development priorities in the recipient country’s national development strategies.’⁴

The six main categories identified by the Task Force as AfT are included in Box 9.1.

9.2.2 AfT and aid effectiveness

Since the 2005 Hong Kong Ministerial Meeting, the WTO has been working in partnership with the OECD to develop a monitoring framework for AfT guided by both the ‘Paris Declaration’ and the ‘Accra Agenda for Action’ on aid effectiveness. Monitoring is undertaken at several levels – both quantitative and qualitative – including monitoring of AfT flows using the OECD Creditor Reporting System (CRS) database for the categories that are most closely related to the WTO AfT Task Force definition. Qualitative information is obtained through questionnaires in which respondents (development partners, partner countries and regional

Box 9.1 Aid for Trade categories

- a. **Trade policy and regulations** including training of trade officials, analysis of proposals and positions and their impact, support for national stakeholders to articulate commercial interest and identify trade-offs, dispute issues, institutional and technical support to facilitate implementation of trade agreements and to adapt to and comply with rules and standards
- b. **Trade development** including investment promotion, analysis and institutional support for trade in services, business support services and institutions, public–private sector networking, e-commerce, trade finance, trade promotion, market analysis and development
- c. **Trade-related infrastructure** including physical infrastructure
- d. **Building productive capacity**
- e. **Trade-related adjustment** including supporting developing countries to put in place accompanying measures that assist them to benefit from liberalised trade
- f. **Other trade-related needs:** reporting on categories (c), (d) (e) and (f) should be reported as AfT when these activities have been explicitly identified as trade-related priorities in the recipient country’s national development strategies

The first two (a) and (b) may be considered as ‘narrow’ AfT and the others ‘broad’ AfT.

economic communities) provide self-assessments submitted ahead of the AfT global reviews. In addition, case stories were prepared for the 2011 AfT Global Review, which aimed to demonstrate the impact of AfT. These provide useful examples of what is working (or not), why it is working (or not) and what improvements are needed. Three global reviews have so far taken place in which the information and analysis of the monitoring information is presented (2007, 2009 and 2011).⁵ The 2013 global review will also include the results of questionnaires submitted by the private sector.

Results from previous reviews suggest that the AfT initiative has been successful in mobilising resources and raising awareness of the positive role trade can play in development. Many of the case stories give examples of how aid effectiveness principles (Paris and Accra) have been applied (e.g. increased ownership) and a number demonstrate tangible results (e.g. reduction in transport times). However, given the greater focus on the impact of aid in the current international development climate, it is increasingly important to move beyond questions of whether or not principles of aid effectiveness have been applied and to give greater consideration to what development interventions actually achieve in terms of impact on the ground (what we refer to here as ‘development effectiveness’). This is an area for further analysis.

9.2.3 Regional AfT

Regional AfT encompasses the different categories of AfT highlighted in Box 9.1. The main difference is that it is regional and multi-country in nature. In many cases it is hard to draw a distinction between regional and national AfT. Some sectors favour regional approaches more than others (e.g. infrastructure).⁶ For instance, support for the development of the Port of Mombasa, which is a central element in the regional transport corridors, will have implications for countries along the corridor and not only Kenya. In other words, an AfT intervention in one country may have positive externalities for other countries. Examples of narrow regional AfT (see Box 9.1) include support to the institutional capacity development of regional organisations supporting regional economic integration (e.g. the East African Community (EAC) and Economic Community of West African States (ECOWAS)). Broad regional AfT includes support to economic infrastructure programmes.

There is no strong consensus amongst development partners on what constitutes regional AfT. They often take various different approaches in terms of their financial, staffing and strategic planning procedures. The 2009 AfT Global Review incorporated a preliminary consideration of ‘the regional dimension’ of AfT, which took the approach that regional AfT included multi-country programmes or national programmes with a regional scope (WTO/OECD 2009). The definition of ‘multi-country’ AfT is echoed in other arenas. An International Lawyers and Economists Against Poverty (ILEAP) advisory brief on regional AfT defined regional AfT as ‘Aid for Trade co-ordinated and/or implemented at a level involving more than one country’ (te Velde 2010). Examples of regional AfT are also presented in Box 9.2 based on the principle of subsidiarity (i.e. ‘where activities should not be carried out

Box 9.2 Examples of regional Aid for Trade

- Regional trade policy-making in free trade areas
- Support for border authorities
- Support for developing common standards and certification authorities
- Intra- and inter-regional infrastructure projects (roads, energy, communications)
- Regional investment funds
- Activities with substantial economies of scale

Source: Voionmaa and Brüntrup (2009)

regionally unless they are more effective than actions taken at the national level' (Voionmaa and Brüntrup 2009).

For the purpose of this chapter we will consider regional AfT to be aid delivered through either a regional organisation or a regional implementation mechanism with an explicit regional objective. We will focus on regional AfT through the lens of regional economic integration.

9.2.4 The growing importance of regional AfT

The regional dimension of AfT is becoming an increasingly important element of development partner support, growing faster than overall AfT.⁷ According to the 2009 AfT Global Review, 80 per cent of development partners consider the regional dimension to be an 'essential' or 'important' element of their AfT strategies.

A major driver is the escalation of regional (and bilateral) trading arrangements over the last two decades, with many agreements being negotiated or already agreed and in the process of being implemented. According to the WTO, the number of recorded regional trade agreements in force has risen from 230 in 2008 to 489 in March 2011. Although regional economic co-operation may deliver significant benefits, in many developing countries supply-side constraints limit the ability to take advantage of regional trading opportunities. Addressing supply-side constraints at the regional level – related to standards, infrastructure building productive capacity more generally – is seen as fundamental for developing countries to overcome the challenges posed by small internal markets and high transport costs. Hence, there is an important case to be made for AfT, especially at the regional level, to unblock the bottlenecks to production and trade.

The 2009 AfT Global Review noted that 'almost three-quarters of donors report increased demand for region-wide Aid for Trade [and] more than half report that their regional Aid for Trade has increased by over 15 per cent since 2005' (p. 88). In Africa, for example, regional AfT tends to be directed towards cross-border infrastructure (e.g. transport corridors), trade facilitation and capacity to meet quality standards (WTO/OECD 2009).

The percentage share of the African Development Bank's (AfDB) African Development Fund (ADF-12) assigned to regional integration is growing. In addition, a recent review of the World Bank's Regional Integration Assistance Strategy (RIAS) noted that its regional lending programme has grown by 75 per cent between 2008 and 2011 with approximately 78 per cent of the lending focused on reducing the 'missing links' in regional infrastructure networks (World Bank 2011). It should be noted that, following the mid-term review of the RIAS, the World Bank is now able to extend grants to regional organisations, which was not previously feasible.

A number of development partners and multilateral agencies have developed strategies to guide their interventions on regional economic integration and are escalating their support in this area. For example, the AfDB produced an overarching strategy on regional integration in 2009 and during 2011 launched the first set of sub-regional strategies on regional integration for Southern, Central, East and West Africa (2011–15). Similarly, the World Bank published its RIAS in 2008 structured around three pillars (regional infrastructure, institutional co-operation for economic integration, and co-ordination interventions to provide regional public goods). Bilateral development partners – such as the UK Department for International Development (DFID), the United States Agency for International Development (USAID) and Danida – are also very active in this area. The UK government's White Paper on trade highlighted the importance of AfT and particularly support to regional integration and trade in Africa. The UK was instrumental in the design of TradeMark East Africa and TradeMark Southern Africa and provides considerable funding to these programmes, which support regional integration in the respective regions. Denmark recently launched its first regional integration programme in East Africa. The USAID has been active in this area for a number of years and also has sub-regional strategies (Central, East, Southern and West Africa) focused on regional integration.

9.2.5 Development partner engagement in regional AfT and aid effectiveness

While commitments for regional AfT have been increasing, there is equally a growing recognition that levels of development partner co-ordination, harmonisation and alignment at the regional level are insufficient and not in keeping with commitments made under the Paris Declaration or Accra Agenda for Action.

WTO and OECD monitoring of regional AfT

Following the 2005 Hong Ministerial Conference, the AfT Task Force recommended that a regional AfT Committee be established. This recommendation was not carried out; however, the regional perspective has increasingly been integrated into AfT monitoring processes. The 2009 AfT Global Review included dedicated questions on regional AfT in partner country and development partner questionnaires. The 2011 AfT Global Review went a step further and included specific questionnaires for regional organisations as well as the opportunity to submit case stories for regional initiatives. However, current monitoring of regional AfT by the OECD CRS database looks at 'multi-country' programmes which may – or may not – have a truly 'regional' impact.

The findings of the 2011 AfT Global Review enriched the understanding of the effectiveness of AfT at the regional level particularly through the case studies and qualitative data from regional organisations.

Joining Up Africa: beginning of a consensus

In March 2010, DFID convened a meeting of regional organisations, African heads of state and key development partners, in order to address the issue of the effectiveness of regional AfT directly. The objective of the conference was to support the resolutions of the African Union on the importance of economic integration in Africa and to embed the Paris Declaration and Accra Agenda at a regional level.

The major outcomes of this conference were commitments to accelerate the implementation of regional trade, transport and energy infrastructure programmes, ensure private sector engagement and improve the effectiveness of support for regional integration. This included the development of a full set of proposals for ownership, alignment, harmonisation, results management and mutual accountability based on examples of best practice from Africa for the Fourth High Level Forum on Aid Effectiveness (HLF-4) in Seoul in November 2011. The commitments and responsibilities agreed are included in Box 9.3. The Infrastructure Consortium for Africa (ICA) was named as one of the lead organisations for monitoring progress on these commitments.

9.3 Regional organisations and implementation of regional programmes

Regional organisations and their partner states are the main managers and implementers of regional AfT. Development partner support to regional organisations may include, for example, financial contributions to the organisation (through a contribution

Box 9.3 Commitments of the Joining Up Africa conference

Ownership

African Union (AU)/regional organisations commit to:

- promote coherent regional development strategies based on broad consultative processes, including parliaments and citizens;
- promote prioritised results-oriented medium-term operational programmes consistent with overall resource availability;
- enhance political leadership and accountability mechanisms;
- take the lead in establishing dialogue with development partners on their regional strategies and encourage them to work as a group to support the strategies and programmes.

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Development partners commit to:

- respect the AU/regional organisation leadership
- work together to scale up and harmonise support to build AU/regional organisation capacity.

Alignment

AU/regional organisations commit to:

- intensify efforts to mobilise domestic resources within the region and to create an enabling environment for public and private investments.

Development partners commit to:

- develop joint strategies with the region or regularly consult the region if they choose to develop their own regional strategies;
- co-ordinate their interventions with beneficiaries at the national, regional and pan-African level and across regions;
- aim to do programming jointly with each other in support of the strategies and programmes.

Harmonisation

AU/regional organisations commit to:

- demonstrate proactive leadership to encourage development partners to work together and harmonise their procedures.

Development partners commit to:

- strengthen their own capacity to address co-ordination and harmonisation and strive to develop and use harmonised systems;
- provide reliable indicative commitments of support over multi-year frameworks and disburse support in a timely and predictable fashion according to agreed schedules.

Managing for results

AU/regional organisations commit to:

- establish results-oriented reporting and assessment frameworks that monitor progress against key targets.

Development partners commit to:

- link programming and resources to results.

(continued)

(continued)

Mutual accountability

AU/regional organisations commit to:

- strengthen the role of national governments in regional development strategies and engage with a broad range of development partners.

Development partners commit to:

- provide timely, transparent and comprehensive information on aid flows to enable regional organisations to present comprehensive budget reports.

AU/regional organisations/development partners commit to:

- hold mutual assessment reviews.

agreement/budget support) and technical assistance and capacity building (e.g. training on trade negotiations).

Given the central role that regional organisations play in delivering and co-ordinating regional AfT, it is valuable to understand the major challenges and opportunities faced in terms of applying aid effectiveness principles. An introductory analysis of the institutional structures and implementation mechanisms established by regional organisations and their member states demonstrates many of the challenges faced in working according to aid effectiveness principles. These challenges have multiple and important implications for the delivery of regional AfT.

During the Joining Up Africa conference in 2010, the African Union and regional organisations agreed to exercise effective leadership over their regional integration policies and programmes and take the lead in ensuring alignment and harmonisation of development partners to regional level programmes. The following chapter reviews the capacity and progress made by the EAC and ECOWAS in meeting these responsibilities and highlights some of the major challenges they have encountered.

9.3.1 East African Community

Background and regional integration agenda

The EAC was re-established in 1999 and currently comprises Kenya, Uganda, Tanzania, Rwanda and Burundi.⁸ The mandate of the EAC is guided by the EAC Treaty and its objective is to spearhead East African economic, social and political integration. The EAC Development Strategy 2011/12–2015/16 outlines the broad strategic goals of the EAC as well as the specific targets to be achieved during the period. The EAC has established an ambitious agenda, but has achieved impressive results. In 2005 the EAC Customs Union Protocol came into force and the Common Market Protocol (which allows for the free movement of goods, services, labour and capital) came into effect in 2010. The Community has also already begun preparing for monetary union, and the ultimate goal is political federation.

The progress achieved so far establishes the EAC as one of the most rapidly integrating regional organisations in Africa and signals a significant achievement. Nevertheless, significant challenges remain in terms of implementation of regional protocols and legislation at the national level. The EAC Secretary General has identified as priorities for his term the realisation of a single customs territory; making the Common Market work; and achieving a monetary union; as well as infrastructure development and industrialisation.⁹ The signing of the Common Market Protocol in 2009 and its commencement since July 2010 has increased demands on the EAC and partner states to finalise elements of the Customs Union such as the application of the Common External Tariff (CET), removal of internal tariffs and a significant reduction in non-tariff barriers (NTBs) to trade.

Since 2008 the EAC has also been part of the COMESA (Common Market for Eastern and Southern Africa)–EAC–SADC (Southern African Development Community) Tripartite. The Tripartite was established in order to try to overcome the challenge of overlapping memberships in regional organisations faced by many partner states. The aim of the Tripartite is to harmonise trade rules, catalyse major regional integration investments (such as the North–South Corridor) and create a free trade area (FTA) covering the three regions.

Major EAC-led regional AfT programmes

The EAC works in partnership with development partners on a large number of regional economic integration programmes in East Africa. The European Commission (EC) provides financial support to the EAC (directed through COMESA) for the Regional Integration Support Programme, which is a €50 million programme covering capacity building for the EAC itself as well as support for trade negotiations, trade facilitation and trade development in the region. The EAC also works with the AfDB and World Bank on large infrastructure projects such as the East Africa Road Network Programme and the East Africa Submarine Cable System. DFID and the Swedish International Development Cooperation Agency (SIDA) have also partnered with the World Bank and EAC to implement the EAC Financial Sector Development Project and the EAC Investment Climate project.

The EAC also manages direct contributions from development partners through the EAC Partnership Fund. The Partnership Fund is a multi-donor basket fund, which totalled US\$6.3 million in 2009/10. The main objective of the fund is to support the capacity building of the EAC. The EAC is also in the process of developing its own Development Fund, which will be used to address infrastructural development issues, fiscal imbalances and investment promotion to support the deepening and acceleration of EAC integration.

Challenges faced by the EAC

During the Joining Up Africa conference, the African Union and regional organisations agreed to exercise effective leadership over their regional integration policies and programmes and take the lead in ensuring alignment and harmonisation of development partners in regional level programmes. The EAC is taking decisive

action in order to fulfil this requirement but the current organisational structure of the EAC, in particular the role and mandate of the EAC Secretariat, poses a significant challenge in ensuring ownership of regional AfT initiatives at both the regional and the national level.

The major organs of the EAC include the Secretariat, East Africa Legislative Assembly, East Africa Court of Justice, Council of Ministers, the Summit and co-ordination and sectoral committees. Co-ordination of regional integration at the national level is performed by Ministries for the EAC (MEACs), which have been established in each of the partner states since 2007. Except for the Summit, the Council is the highest decision-making authority of the EAC. The Council is composed of ministers from the partner states' MEACs as well as other relevant ministers such as those for trade and finance or foreign affairs. The Council is responsible for making policy decisions and regulations and issuing directives to partner states' governments. The Secretariat is the executive organ of the community and is responsible for proposing initiatives to the council, preparing protocols and agreements and monitoring their implementation.

Currently, the EAC Secretariat has no legal mandate to enforce the implementation of regional legislation at the national level and, although decisions made by the Council are binding on partner states (as per the EAC Treaty), there is no operational or enforcement mechanism to ensure that they are obeyed. Currently integration of regional level legislation at the national level is done according to the 'good will' of the national governments.

The example of the implementation of the SQMT Act (see Box 9.4) demonstrates the multiple challenges faced in the implementation of regional-level initiatives. The EAC Secretariat does not have the mandate, or the internal resources, to play a strong co-ordinating and oversight role in integrating regionally agreed standards at the national level. Partner states remain the main implementers so success of the initiative depends on strong political buy-in and ownership at the national level.

Without strong lines of accountability between the regional and the national level, national interests in enacting regional-level programmes (which may have relatively higher gains to their neighbours) can be undermined. Even when political buy-in is achieved (as in the Rwandan case) additional challenges exist created by low levels of technical capacity and access to financial resources.

In recognition of the need to progress implementation of regional level commitments, the Secretariat has recently conducted an institutional review, which recommends the evolution of the Secretariat into a Commission in order to increase its ability to ensure implementation at the national level along with an increase in the powers of the Courts of Justice and EAC Legislative Assembly.

Although the evolution of the Secretariat into a Commission may go some way to strengthen mutual accountability between the regional and national level, national sovereignty considerations of partner states means that responsibility for implementation will remain fundamentally at the national level. Consequently, improving accountability – and strengthening aid effectiveness – will depend not

Box 9.4 Institutional barriers to realisation of the Common Market: the example of standards

To demonstrate the complexities and challenges of the current institutional set up in the EAC we can look at the example of the harmonisation of regional product standards, which is a vital element of the EAC Common Market. Standards policy in the EAC is regulated by Chapter 13 Article 81 of the EAC Treaty, which provides for co-operation amongst partner states in Standardisation, Quality Assurance and Metrology (SQMT). It is further supported by the 2006 SQMT Act and a Standards Protocol, which is currently being promulgated. The SQMT Act provided for the establishment of National Standards Bodies (NSBs) in each of the partner states and representatives from the NSBs sit on an East Africa Standards Committee (EASC), which aims to provide a mechanism for the co-ordination and harmonisation of the partner state's National Quality Infrastructures (NQIs). There are approximately 5,500 standards in the EAC, 1,400 of which have been harmonised at the regional level. Partner states have begun the process of passing these standards into national law but progress is varied across the partner states and in some cases national standards are being used in parallel to regional ones (PTB 2010).

Once the standards have been passed into law, there is the additional challenge of implementation at the national level by the relevant bodies. Different partner states will encounter different levels of difficulty in achieving this based on the current level of development of their NQIs. Rwanda has taken a particularly pro-active stance in evolving its NQI to the new regional requirements and has recently developed a new National Quality Policy, which will require significant institutional restructuring of the current standards bodies but which will bring it into line with regional and international requirements. Even with this kind of high-level national buy-in, Rwanda will also require significant support for upgrading laboratory and testing equipment and training staff on the new procedures.

In order for improvements made to NQIs by individual partner states to translate into the desired reduction of NTBs and increase in trade, it is equally vital that partner states reciprocate, particularly in terms of recognition of certification and procedures at the borders. In some cases, it may be in the interest of one partner state to slow down or hinder the harmonisation of a standard in order to protect certain trading interests. The current mechanism for co-ordination between the regional NSBs is the EASC. This Committee is, however, a forum for information sharing and the development of policy, and does not have a mechanism for resolving complaints between partner states or for enforcing compliance.

A recent strategy paper on the implementation of the EAC SQMT Act (PTB 2010: 5) noted that: 'What is also sorely needed is a proper review mechanism to

(continued)

(continued)

track the implementation of the EAC SQMT Act obligations, and the reporting of the progress at the EASC and the EAC Secretariat to ensure that Partners that fail to meet their obligations are appropriately supported or ultimately sanctioned. The current situation is anything but healthy – there is a lot of talk, but very little action.’

only on strengthening the mandate and capacity of the regional organisation but also on the political buy-in (ownership) and capacity of the partner state.

9.3.2 Economic Community of West African States

Background and regional integration agenda

ECOWAS comprises 15 West African countries and was established in 1975 by the Treaty of Lagos. The objective of ECOWAS is to provide a forum and framework for sustainable economic development and poverty reduction and support political stability and the promotion of regional peace through dialogue and conflict resolution.

The highest policy-making authority of ECOWAS is the Conference of Heads of States of Government, followed by the Council of Ministers, which comprises the ministers responsible for ECOWAS affairs in the partner states. Unlike the EAC, there are no specific ministries for ECOWAS integration within partner states. Ministers therefore typically come from the ministries of finance or foreign affairs.

The main implementation body for decisions made by the Conference of Heads of State and the Council is the ECOWAS Commission, which is headed by a president, a vice president and seven commissioners across the focus areas of agriculture, human development, infrastructure, macro-economic policy, political affairs, and trade and customs. Other bodies of ECOWAS include the Parliament, the Court of Justice and specialised technical institutions and committees.

Since establishment, ECOWAS has created and is in the process of consolidating an FTA and aims to establish a customs union, a common market and eventually monetary union. ECOWAS has established its Vision 2020 and Regional Strategic Plan for 2011–14. The Regional Strategic Plan provides a coherent medium-term plan for the implementation of regional programmes by ECOWAS institutions and its stakeholders in direct support of its Vision 2020. The West African Economic and Monetary Union (UEMOA) and ECOWAS are also the first regional organisations to establish a joint Regional Poverty Reduction Strategy for West African development with support from the World Bank and International Monetary Fund (IMF).

Major ECOWAS-led regional AfT programmes

The ECOWAS Commission plays an important role in the development, management and implementation of many regional-level programmes. The Commission is in the process of developing a Community Development Program (CDP). The CDP aims to

formulate a coherent programme of action to take forward Vision 2020 and will serve as a platform for co-operation amongst the various departments of the Commission for promoting sub-regional development. The West Africa Economic Partnership Agreement (EPA) development programme (referred to as PAPED or EPADP) supported by the EC is another programme under development. Other programmes include the ECOWAS Agricultural Policy (ECOWAP), which provides the official framework for agricultural development in the region, and the Regional Road Transport and Trade Facilitation Program, which is supported by the various transport and infrastructure programmes funded by the World Bank and EC. The World Bank, USAID, AfDB, European Investment Bank (EIB) and European Union (EU) are also working with the ECOWAS Commission to develop a regional power market through the West Africa Power Pool. The ECOWAS Commission also implements its Capacity Building Plan with support from a multi-donor Capacity Building Pool Fund.

Challenges faced by ECOWAS

ECOWAS has, however, suffered from similar challenges to those of the EAC in terms of implementation at national level and also suffers from the challenge of overlapping memberships (with UEMOA) and the integration of historically divergent institutional structures between anglophone and francophone countries.

In 1990, ECOWAS began the ECOWAS Trade Liberalisation Scheme (ETLS), which embodies the essential features of the ECOWAS FTA, including the free movement of transport, goods and persons within ECOWAS. This was intended to be achieved over a period of 15 years, but 21 years after the ETLS was launched the level of implementation in partner states remained relatively low. In 2010, USAID conducted a gap analysis of the implementation of the ETLS in each of the ECOWAS partner states. Consultations conducted by the study revealed the continuing existence of NTBs such as non-reciprocity of standards/certification; the use of quantity and quota restrictions; duty being charged on duty-free goods; vehicle inspections not being conducted according to procedure; and so on.

In 2007, the ECOWAS Secretariat became a Commission and as a result its mandate and scope of activities increased. Compared with the EAC Secretariat, the ECOWAS Commission has a greater role in generating and driving policy. Whereas ECOWAS has existed since 1975, its mandate and scope of activities have increased dramatically, particularly since 2007. The performance of ECOWAS in recent years has, however, highlighted major management and recruitment concerns undermining its ability to effectively exercise these strengthened powers (ACBF 2008: 273).

In addition to weak capacity and oversight by ECOWAS, significant challenges to the implementation of the ETLS are located at the national level. The USAID gap analysis revealed that the reasons for weak implementation include:

- gap between legislation and implementation – many ETLS protocols are codified in legislation, but there is a lack of enforcement and consistency in application at the borders;

- lack of awareness – private sector traders indicated they had limited detailed information on ETLS protocols; and
- incentives for informal trade – border procedures are complex and duplicative, and involve a significant level of harassment, which encourages informal methods of trade.

Arguably, the foundation of many of these challenges is weak ownership and buy-in to the process of regional integration by the public and private sector, possibly due to self-interest or lack of awareness. The study also highlighted that for the ETLS to be realised it would also require neighbouring countries to reciprocate. As with the example of the EAC, without strong enforcement and co-ordination mechanisms, incentives for reciprocity between partner states is considerably weakened.

9.3.3 Lessons learnt for aid effectiveness

Comparison of the challenges faced by ECOWAS and EAC in the implementation of regional integration provides several revealing commonalities, which have important implications for the design of effective aid programmes. Partly because of national sovereignty concerns, the institutional structures of ECOWAS (until relatively recently) and the EAC have not provided these regional organisations with the legal mandate to act as an enforcer of regional acts and legislation. In addition, both regional organisations suffer from inadequate human and financial resources, weakening their ability to fulfil their mandate of monitoring and co-ordinating regional integration.

Responsibility for implementation remains at the national level, where a lack of political will, engagement and/or lack of capacity often results in delayed and incomplete implementation. Levels of national ownership of regional integration are relatively low and arguably present the greatest challenge to the realisation of regional programmes of development. The implication is that, for effective delivery of aid, engagement at both the regional and national levels are required simultaneously. Bolstering the capacity of regional organisations and national ministries is potentially the most effective mechanism for ensuring mutual accountability and development impact.

9.4 Development partner support for regional Aid for Trade

9.4.1 Regional AfT and aid effectiveness in East Africa

In East Africa, development assistance to support regional economic integration is mainly provided through the support of large multilateral organisations (such as the AfDB, World Bank and EC) and bilateral development partners (DFID, Danida, German Development Cooperation [GIZ], Japan International Cooperation Agency (JICA) and USAID). Other bilateral development partners (e.g. Finland, Belgium, Norway, Sweden, the Netherlands and France) are scaling up their support in this area. The focus of development partners' regional-level initiatives is particularly on the areas of infrastructure and trade facilitation in line with the EAC priorities laid out in the current and previous EAC Development Strategies.

Support by development partners to regional initiatives in East Africa, particularly trade and economic development, is particularly high. A study by USAID in 2009 found that more than 125 projects were being implemented by development partners on trade and transit on the Northern and Central Transport Corridors in East Africa alone in the period 2002–14 with a total value of more than US\$4 billion (Walker et al. 2009). The EC and the AfDB provide direct budget support to regional organisations but other development partners tend to support regional integration through multiple mechanisms such as contributions to multilateral organisations and involvement in joint development partners programmes and on a direct project basis with regional institutions or national governments.

Challenges and opportunities faced by development partners in supporting aid effectiveness

A study conducted in 2010 for DFID on the feasibility of greater joint agency working found that, although development partners understood the importance of greater co-ordination in the delivery of regional aid (and were keen to reduce costs through more effective practices), efforts were undermined by internal institutional structures which meant that offices responsible for East African integration are geographically dispersed and many development partners lacked dedicated funding and personnel for the implementation of regional programmes (Wood et al. 2010).

The World Bank and the AfDB have regional programmes and dedicated funding, which they manage from Addis Ababa and their respective headquarters in Washington and Tunisia. USAID works through the East Africa Trade Hub (COMPETE), which is based in Nairobi. Sweden and Canada both have small 'regional' programmes managed out of their Nairobi offices but funding is limited and funds for what would be defined as regional projects often come out of other national programme budgets.

In addition, the definitions of regional coverage by different agencies are not harmonised. For example, Canada's official East and Southern Africa regional programme does not include Rwanda and Burundi. The AfDB has recently produced an East Africa Strategy which covers 12 countries, whereas work by DFID covers East and Southern Africa combined.

The EC manages its East African regional support through Brussels and Dar es Salaam and charges the EC delegation in Dar es Salaam with the responsibility for implementation and monitoring (but does not provide the guidelines or resources to do so).¹⁰ The EC's regional indicative programmes (RIP) for East Africa covers four separate regional organisations: COMESA, EAC, Indian Ocean Commission and the Intergovernmental Authority on Development. In 2002, it established the Inter-Regional Coordinating Committee (IRCC) in order to provide a mechanism to co-ordinate the RIP between the different regional organisations and help overcome some of the challenges caused by overlapping memberships of partner states.

In 2008 it was decided that there was a need for an increase in the role and scope of the IRCC. It became clear that there was a need for a mechanism to ensure the

effectiveness of EC support to regional organisations and to establish a regional-level monitoring and evaluation mechanism which had previously been lacking.¹¹ A Task Force has now been put in place to achieve this objective and it is hoped that will go some way to achieve greater aid effectiveness of regional AfT by the EC in East Africa.

Other development partners have also established some notable examples of joint working and co-ordination support. Direct support to the EAC, particularly in the area of capacity building, has been co-ordination by development partners through the EAC Partnership Fund. The Partnership Fund was responsible for instigating the Capacity Development Action Plan, which is a multi-donor initiative to provide capacity building to the EAC particularly in the areas of human resources and financial management.¹²

One programme of support to regional integration which is playing an increasing role in co-co-ordinating and harmonising development partners support in East Africa is TradeMark East Africa (TMEA), which is discussed below.

TradeMark East Africa: lessons for aid effectiveness

TMEA is a multi-donor platform for delivering large-scale, strategic support to the EAC's regional integration process. It was established in late 2009 by a group of development partners led by DFID, Denmark, Canada, Belgium and the Netherlands. The overall objective of TMEA is to increase growth and poverty reduction in East Africa and supports interventions in the following areas: reducing costs on transport corridors; supporting EAC institutions to guide regional integration; supporting partner states to increase implementation of regional integration; and engaging the private sector and civil society.

TMEA has an innovative institutional structure, which provides harmonised development partner support to regional and national level initiatives for regional integration (especially economic). TMEA has country programmes (and offices) as well as overarching regional programmes (principally managed out of Arusha and Nairobi). The regional and county programmes support the main focus areas of TMEA.

TMEA was designed through an extensive consultation process. The country and regional programmes reinforce each other to form one cohesive programme of delivery, which falls within one overall results framework, to ensure that *the whole is greater than the sum of its parts*. However, the programmes remain flexible (and demand-driven) within the framework through the creation of annual business plans and consultations at the National Oversight Committees (NOCs). The NOCs are composed of representatives from the national government, private sector, relevant development partners and civil society and have a largely advisory role but can re-allocate a proportion of the national programme budget to reflect changing priorities.

Because of TMEA's structure it has both a vertical (country) and horizontal (regional) funding stream, making it able to accept funds earmarked by country- or regional-level

activities. This structure has proved a major attraction for bringing in funds from a number of development partners who may not have dedicated funding for specific regional-level programmes or who have strong national priorities within the region. This has led to greater development partner collaboration (e.g. joint development partner reviews) and harmonisation and reduces duplication of efforts.

The programme is implemented through five country programme offices, one in each of the EAC partner states (plus an office in South Sudan), and an office in Arusha serving the EAC, and headquartered in Nairobi. In this respect, the structure therefore mirrors and reinforces the structure of the EAC with a central EAC Secretariat and MEACs in each of the partner states.

The scope of activities conducted by TMEA requires a substantial organisational infrastructure for delivery and accordingly TMEA has not escaped criticism from some quarters for establishing an additional delivery institution not channelled directly through the EAC. Although the establishment of a new institution is not in line with the letter of the Paris Declaration, a case can be made to argue that TMEA reinforces the institutional structure of the EAC and provides an implementation mechanism for regionally and nationally integrated working not currently operationalised by the EAC itself.

In addition, TMEA's country programmes focuses on building up national capacity for regional integration. This has focused significantly on building up the capacity of the MEACs in each partner state, including the development of strategic plans, national integration strategies and building mechanisms for cross-government co-ordination. This is a crucial area of support for ensuring aid effectiveness at the regional level, particularly given that the MEACs were not previously receiving support from any other development partner.

TMEA is a relatively new institution and it may be too early to assess its effectiveness. Nevertheless, it provides a good example of a programme that is managed outside a regional organisation but manages to support mutual accountability between the regional and national levels.

9.4.2 Regional AfT and aid effectiveness in West Africa

West Africa has experienced a rapid increase in AfT in recent years. The majority of regional AfT is provided by the EC, World Bank and AfDB, as well as bilateral partners such as USAID, France, Germany, Canada and the UK.

Challenges and opportunities faced by development partners in supporting aid effectiveness

Evaluations of AfT support to the ECOWAS Commission and the region suggest there is a strong need for greater harmonisation and co-ordination. A review by GIZ of regional AfT found that many development partners were not aware that they could use the external relations department at ECOWAS to co-ordinate their activities. There is a bimonthly mechanism for bringing together ECOWAS and development partners but AfT is considered a cross-cutting issue and therefore is not explicitly

addressed.¹³ Also, until fairly recently, regional co-operation has been focused on peace and security rather than on trade.

Attempts at capacity building of ECOWAS have not been considered very successful and development partners have raised concerns about ECOWAS's absorptive capacity (Voionmaa and Brüntrup 2009). ECOWAS has strong high-level leadership but has struggled to recruit sufficient middle management staff and its capacity to oversee and administer programmes (particularly socio economic programmes) has proven to be a limiting factor in the ability of development partners to provide assistance (Wood 2009). The development of the ECOWAS Regional Strategic Plan 2011–15 has gone some way to providing greater direction to development partners on regional priorities. Importantly, ECOWAS is also in the process of developing an AfT Strategy for ECOWAS focusing on regional AfT.

Development partners have also struggled to co-ordinate and harmonise support. One of the challenges to greater co-ordination amongst partners is that they manage their portfolios from different geographical locations. USAID manages its work from Ghana, the World Bank from Washington and Ghana, the AfDB from Tunis and the EC from Nigeria and Brussels. Despite this, development partners have tried to address the problems of co-ordination and increasing numbers of mechanisms and joint programmes are coming on stream.

EPA development programme: lessons for aid effectiveness

EC regional support in West Africa

The EC is the single largest contributor of AfT at a regional level in West Africa with a doubling of funds for regional programmes in the 10th European Development Fund (EDF), the vast majority of which is committed to regional economic integration.¹⁴ In line with the EU's commitments on the delivery of aid, such as the EU Code of Conduct on Complementarity and Division of Labour, and in line with the Paris Declaration and Accra Agenda, EC support at the regional level is provided through RIPs, which are mostly funded through contribution agreements to qualifying regional organisations.

RIPs are developed in conjunction with the relevant regional organisations. For example, the West Africa RIP covers both ECOWAS and UEMOA. Although the process of the development of the regional programmes is aligned with regional organisations' priorities, some concerns have been raised about the integration of regional programmes with national programmes within each of the partner states.

A 2009 report by the European Court of Auditors on the effectiveness of EDF support at the regional level in West and East Africa identified a number of challenges faced by the regional programmes, including a lack of national-level co-ordination and communication of regional-level priorities. National-level delegations are not given sufficient mandate or guidance on how to integrate regional programmes at the national level and reporting on regional programmes is often done by individual country programmes (often only the one in the country where the regional organisation is based, e.g. the Nigerian EC Delegation in Abuja for ECOWAS) with

no mechanism to collate and aggregate these at the regional level. The reporting that does occur is also often focused on finances rather than results. The outcome of this is that co-ordination of regional work by national delegation is weak and impact evaluation of the regional programme is undermined.

As explored earlier, as a result of capacity constraints (amongst others), ECOWAS is currently not providing strong leadership between regional-level programmes and the implementation of the programmes at the national level. Arguably, much of the delivery of the EDF to West Africa thus far has not provided sufficient support to overcome this gap and has even replicated it to some extent through the gap in its own internal co-ordination structure.

EPA development programme

PAPED is a major programme of EC support to West Africa which has been hailed as having the potential to act as a multi-donor platform for regional-level economic support. PAPED is rooted within the EPA negotiations. Its focus is on support for West African integration into the global economy and the stimulation of growth and sustainable development. Accordingly, the programme embodies goals with much broader relevance and has ensured that it is in line with regional and national poverty strategies as well as the ECOWAS CDP and UEMOA Regional Economic Programme.

The process of the development of PAPED has had strong regional ownership. The programme was designed through a participatory process, which included regional and national governments, private sector and civil society and was led by the ECOWAS and UEMOA commissions. This process has given PAPED high-level political endorsement across the region.

PAPED is based on five axes, which have been aligned (retrospectively) with AfT categories at the multilateral level. Thus, PAPED has established itself as a useful framework for EU and non-EU development partners to engage in a more effective and coherent approach to addressing trade-related needs in the region in general.

The process of design of PAPED, which has strong national buy-in and ownership of the regional programme and which aims to have national-level implementation, bodes well for overcoming the current disconnect in ECOWAS (and indeed current EC support) between the regional and national levels. Nevertheless, given the current stage of its development it is still too early to tell and PAPED will need to overcome significant challenges if it is to deliver on its promises.

9.5 Key findings and conclusions

9.5.1 Key findings

- a. There is no clearly established definition of 'regional AfT'. Whereas much of the work considered to be 'regional AfT' by development partners falls within the category of support to regional economic integration, the boundaries of

regional AfT have not been universally established. Lack of a common definition of regional AfT is particularly challenging in respect of establishing a common ground from which to establish mechanisms for monitoring and evaluation, across countries and across development partners, of the effectiveness of regional AfT.

- b. Aid for Trade at the regional level is an area of increasing importance. Developing countries and development partners have shown an increasing interest in regional AfT and regional economic integration. The number of regional trade agreements has risen markedly. The importance of regional economic integration is reflected in many development partner and multilateral agency strategies.
- c. The effectiveness of regional AfT is a growing area of focus. The increasing integration of the regional element into the AfT Global Review process reflect increasing interest and focus of development partners on the issue of effectiveness at the regional level.
- d. Regional organisations are major co-ordinators and implementers of regional AfT but they face significant challenges in working according to aid effectiveness principles. The regional organisations reviewed in this chapter, namely the EAC and ECOWAS, have struggled with the implementation of regional-level commitments and initiatives at the national level. Ownership of regional-level programmes has not been established successfully at the national level, and accountability mechanisms between the regional organisation and partner states are weak. Reasons for this include the weak capacity and mandate of regional organisations for monitoring and co-ordination of regional-level commitments, and a lack of political will or capacity for implementation at the national level.
- e. Development partners' support for regional AfT is not currently in line with aid effectiveness principles but there is a growing number of mechanisms to ensure alignment with regional organisations and harmonise their development support. Development partners in both East and West Africa struggle with the common challenges of lack of dedicated staff and funding for regional-level initiatives; differing classifications of countries included in regions; and dispersion of locations of country offices dealing with the regional level. Nevertheless, there is a growing number of strategies and mechanisms which support greater alignment and harmonisation.

9.5.2 Conclusions

Preliminary conclusions based on the findings above are included below. It is important to note that these conclusions should be tested systematically in future work in this area.

- a. Support to regional AfT needs to occur at the regional and national levels simultaneously. Given the disconnect in national-level ownership and mutual accountability mechanisms identified between regional organisations and their partner states, development partners should ensure that support both builds capacity

at the regional and national levels simultaneously and supports the establishment of mutual accountability mechanisms between regional organisations and their partner states.

- b. Development partners should provide greater focus on internal co-ordination between regional- and national-level programmes. One of the potential challenges to development partners providing the required level of integrated regional- and national-level support is likely to be the difficulties faced in aligning their own internal institutional structures. Development partners could give greater attention to working through mechanisms which provide this kind of alignment as a first step to providing greater co-ordination support to regional AfT.
- c. Ownership needs to be established at the national level for regional programmes. National governments remain the main implementers of regional-level initiatives. Conducting participatory processes which include national-level actors (public sector, private sector and civil society) is important for ensuring national-level ownership and ultimately implementation.
- d. Different approaches can support aid effectiveness. The case studies of TMEA and the EC's PAPED demonstrate two different approaches to building national-level ownership and the implementation of regional programmes. Given the current challenges faced by regional organisations, direct budget support to regional organisations should not be seen as the only approach to supporting effective regional AfT. Given current capacity challenges of regional organisations, providing support which effectively addresses the disconnect between regional organisations and their partner states should be the priority.

9.5.3 Areas for further investigation

The findings and conclusions outlined in the previous section are based on a preliminary investigation of the workings of regional AfT in East and West Africa. Many regional AfT initiatives are relatively young and assessments of their development impact have often not yet been conducted. Accordingly, the chapter provides many more questions than answers to the issue of effectiveness of regional AfT. There are a potential number of areas for further analysis, for instance:

- further exploration of the extent to which aid effectiveness principles are applied;
- exploring whether or not applying aid effectiveness principles leads to positive development impact;
- identifying best practice: who are applying these principles well and what lessons can we draw for future regional AfT initiatives?

Answering these questions is by no means straightforward. An important next step in furthering the aid effectiveness of regional AfT will be a systematic engagement by development partners in how they define and view the boundaries of it. Establishing a common definition for regional AfT amongst development partners will be a useful step in facilitating comparison across regional AfT projects and programmes.

Notes

- 1 www.wto.org/english/tratop_e/devel_e/a4t_e/aid4trade_e.htm
- 2 www.oecd.org/dac/effectiveness
- 3 www.wto.org/english/tratop_e/devel_e/a4t_e/implementing_par57_e.htm
- 4 <http://docsonline.wto.org/imrd/directdoc.asp?DDFDocuments/t/WT/AFT/1.doc>
- 5 www.oecd.org/dac/aft/monitoringaidfortradellogicalframework.htm
- 6 www.businessfightspoverty.org/profiles/blogs/aid-for-trade-and-trans-national-constraints-to-development
- 7 www.oecd.org/trade/aft/aid-for-tradestatisticalqueries.htm
- 8 Rwanda and Burundi joined the EAC in 2007.
- 9 www.eac.int/sg/
- 10 European Court of Auditors (2009).
- 11 The 2009 European Court of Auditors report noted that monitoring and evaluation at the regional level by the IRCC was too focused on finances and not on impact.
- 12 The CDAP is now being managed by TradeMark East Africa.
- 13 An ECOWAS Interdepartmental Working Group on Trade was created in 2009, which could improve coherence between trade-related activities and strategies as well as co-operation with development partners.
- 14 The total allocation to the West Africa regional programme under the 10th EDF (2008–13) is €597 million, of which €418 million is for regional economic integration.

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Chapter 10

Aid for Trade and Value Chains in Small and Vulnerable Economies and Least Developed Countries

Collin Zhuawu

10.1 Introduction

In recent times participation in global value chains (GVCs) is considered essential by most developing countries including small and vulnerable economies (SVEs) and least developed countries (LDCs). GVCs are seen as important routes to markets for export products and services, offering new opportunities to firms, particularly in expanding their business opportunities across borders. This is important, especially given that reaching international markets can be very difficult for firms located in SVEs and LDCs. There is a need to recognise a number of challenges which SVEs and LDCs have to face in terms of policy reforms aimed at increased and meaningful participation in GVCs.

SVEs and LDCs have a number of characteristics that make it difficult for them to harness the power of trade to be an engine for economic growth and poverty reduction. Furthermore, because of their smallness and remoteness, SVE display certain unique characteristics which pose some challenges to both trade growth and economic development, as already discussed in the previous chapters. The challenges remain prominent obstacles for the integration of these countries in global markets.¹ One way of overcoming the challenges for increased and meaningful participation in global trade could involve the utilisation of Aid for Trade (AfT), particularly in achieving productive capacity and private sector development

An examination of this area is important, as it allows the chance to assess the opportunities, if any, to move from basic activities to higher value added activities of supply chains. Building on the existing literature, this chapter seeks to assess the role of AfT in integrating SVEs and LDCs in GVCs. It starts by giving an analytical perspective on GVCs in terms of increased value added trade and policy implications, followed by an assessment of empirical evidence of the involvement of SVEs and LDCs in GVCs. The study will draw examples from Commonwealth SVEs and LDCs.² The chapter also examines the link between AfT and productive capacities in SVEs and LDCs, highlighting some of the lessons learnt from the study.

10.1.1 Value chains and supply chains: analytical perspectives

According to the Organisation for Economic Co-operation and Development (OECD 2012), much of today's world trade and production is increasingly structured around GVCs. This is because of globalisation of production, which means compartmentalising

the production of goods from raw material to finished product, with each process carried out wherever necessary skills and raw materials exist at competitive costs (OECD 2007a). This comes as a result of companies increasingly seeking to be efficient and reduce costs, as they have to face competition in the domestic and international markets, coupled with their desire to enter emerging markets, which offer a number of opportunities including tapping foreign knowledge (*ibid.*). But what are these GVCs and how do they differ from commodity chains and supply chains?

The concept of GVCs originates from the literature on global commodity chains but now includes a wider variety of products, some of which do not have commodity features (Gibbon and Ponte 2005; Gereffi and Joonkoo 2012). However, in its usage, the concept can take two different meanings. First, when industries are related to an input–output structure, the downstream industry forms the market for upstream firms and upstream firms are drawn to locations where there are relatively many downstream firms (OECD 2007b). This has the advantage of saving on transport costs and benefiting from a large variety of different inputs. Nevertheless, individual firms or countries have to understand and address internal and external constraints and take steps towards the generation of value added (Gibbon and Ponte 2005). Second is the political economy point of view, involving all activities that are necessary to produce a product from conception to its end use. This puts the issue of governance at the centre of the GVCs thereby demonstrating the exercise of corporate power to shape the deterioration of profits and risk (Gereffi and Joonkoo 2012).

Both senses affect the way value chains are understood because they focus on the production system, which involves activities that influence the process of value addition and are of ‘intermediate, network type’ (Altenburg 2007). In both circumstances, most suppliers are controlled by decisions of the lead firm on the value chain (Kraemer et al. 2011). Thus the value chain concept helps our understanding of the ‘dynamics of value creation at different stages of the value chain’ as well as the role of barriers to entry and innovation rents (Altenburg 2007). In essence, value chains are mechanisms that allow

producers, processors and traders – separated by time and space – to gradually add value to products and services as they pass from one link in the chain to the next until reaching the final consumer (domestic or global).

(UNIDO 2011a: x)

The common example given of GVCs is that of China, which, because of its trade liberalisation, has facilitated increased participation in the production networks with its trading partners. As a result, China has had an influx of investment from its trading partners due to its specialisation in labour-intensive activities as well as increased processing of products for export back to its trading partners (OECD 2007b). This fragmentation of production has led to the ‘international production sharing and vertical integration of production’ characterised by ‘global production networks’ (*ibid.*: 5). As a result, finished products are a culmination of activities across multiple sectors, industries and countries from raw material to manufacturing, including services used along the chain (UNCTAD 2013). For example, Table 10.1 shows that the production

Table 10.1 Major components and cost drivers for the Apple iPhone 3G

Country	Manufacturers	Components	Costs (US\$)
Japan	Toshiba	Flash memory	24.00
		Display module	19.25
		Touch screen	16.00
Korea	Samsung	Application processor	14.46
Germany	Infineon	SDRAM-mobile DDR	8.50
		Baseband	13.00
		Camera module	9.55
		RF transceiver	2.80
		GSP receiver	2.25
Germany	Dialog Semiconductors	Power IC RF function	1.25
		Power IC application processor function	1.30
United States	Broadcom	Bluetooth/FM/WLAN	5.95
United States	Numonyx	Memory MCP	3.65
United States	Cirrus Logic	Audio codec	1.15
Japan	Murata	FEM	1.35
Cost of rest of materials			48.00
Total cost of materials			172.46
Manufacturing costs			6.50
Grand total			178.96

Source: Xing and Detert (2010)

of Apple iPhone 3G involves nine companies from different geographical locations, each manufacturing different parts and components, with the final assembly done in China (Xing and Detert 2010). Such developments have changed the structure of industries not only within developed countries and emerging economies but in developing countries, SVEs and LDCs, as a number of firms in these countries strive to participate in GVCs. This has given rise to activities such as outsourcing and offshoring, particularly of intermediate goods. It has also led to the relocation of activities overseas and at times to closure of production in the home country (OECD 2007b).

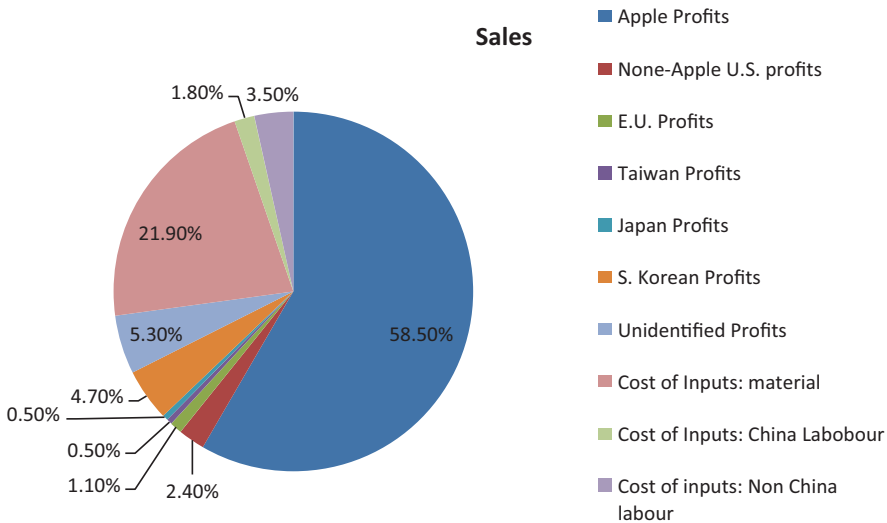
In most instances the terms ‘value chains’ and ‘supply chains’ have been used interchangeably, although the two terms may at times express different foci. This is because the notions are overlapping, with no consensus about their specific contents (Altenburg 2007). However, this chapter makes a slight differentiation between the two in that supply chains involve the alignment of firm activities that bring products or services to the market irrespective of the activity processing or not processing for value addition. Supply chains provide criteria for firms to decide what should be outsourced from which locations and suppliers irrespective whether or not the activity adds value (ibid.). Thus, supply chains enable firms to form alliances that make it possible for them to penetrate global markets. It allows different firms to perform different tasks towards the end product, ranging from the production of raw materials through the production of components to the assembling of the final product (OECD 2007a). For instance, on looking at the distribution of value in the Apple iPad and iPhone, Kraemer et al. show that China, besides playing a role in supply chains and being the country of assembly,

gets a small share of the profits and its benefits come in the form of wages paid for assembling the final product (see Figure 10.1). This, they note, is because Apple keeps most of its product designs, marketing, product management and other functions in the United States (Kraemer et al. 2011). This implies that Chinese companies are not involved in high value added production but are in the supply chain by virtue of assembling the final products.

The Chinese example shows us the need to answer some policy questions. For instance, there can be changing patterns of production and specialisation in different countries, with some countries specialising in certain manufacturing products and tasks which allow them to join in the value chains without adding significant value. In essence, this means joining supply chains without being concerned about the extent of value addition. This has led to concerns that the GVCs narrative is intended to support the case of developed countries to bypass the World Trade Organization (WTO) Doha Round through imposing an ‘ill-advised liberalisation agenda’ on poorer countries (Draper and Lawrence 2013). Indeed, Ismail (2013) argues that the narrative is deeply flawed, as it attempts to reintroduce the idea of self-regulating markets and revive the Washington Consensus. However, firms and countries experience different restructuring depending on different considerations, with high- to medium-technology industries becoming more internationalised than less technology-intensive industries. Given this, it is important that we examine SVEs and LDCs separately in order to have an understanding of their experiences.

Most SVEs and LDCs are found at the raw material production level of supply chains or value chains, which might not be ideal for the growth and development of these countries. Yet some of these countries have the potential to add value and produce value added components in the value chains. However, enabling firms from SVEs and LDCs

Figure 10.1 Distribution of value for iPhone 2010



Source: Kraemer et al. (2011)

to enter GVCs as producers of value added components depends on how the challenges faced by businesses in these countries are confronted. Some of the challenges include lack of production capacities, high costs of inputs, poor market information, limited markets, high costs of technology, low volumes of purchase, lack of business skills and shortcomings in product design and development. The list continues with dependence on specialised imported raw materials, lack of effective enterprise networking, poor-quality products, limited capacity for value added, low levels of productive capacity, poor management skills, high transport costs and the inability to identify potential markets. Mkandawire (2009), on examining the strengthening of supply chains for small and medium-sized enterprises, identifies institutional constraints, as government departments do not collaborate on supporting value chains. Indeed, it is the competitiveness of SVEs and LDCs in both the regional and global markets that has a bearing on the ability of their firms to enter the value chains, contributing to the development of these economies. The biggest challenge, therefore, is for these countries to move from the bottom of the value chains (raw material) to stages of value added processing so that they can continue to prosper in competitive global markets.

This chapter suggest four scenarios for doing this. The first is for firms already operating within value streams, involving many firms in a supply chain, to move up the ladder through assuming a role that allows value added production of components. However, moving up is a big challenge, as it requires firms to be competitive. The second is for firms to integrating into the existing multinational corporations' (MNCs) value chains, building capabilities and competitiveness in specific tasks as part of a broader diversification strategy away from exporting raw materials (Draper and Lawrence 2013). The drawback with this approach is that the MNCs decide on firms and companies to integrate and their role in the GVCs, as in the case of Lesotho below. The third involves firms which are not part of value systems joining the supply chains or networks and moving up the value chain as in the first scenario. This is because at times there is a lack of market transparency, which hampers the formation of business linkages, and in some cases large firms, especially foreign firms, might not be aware of potential local suppliers. The fourth scenario involves firms breaking into the value systems thorough innovation, largely technological innovation. The big problem with this scenario is that SVEs and LDCs lack technological innovation and are thus unable to get into GVCs, as in the case of Belize below. Since most firms in SVEs and LDCs are already operating in the supply chains by virtue of providing raw materials, the first scenario provides a better approach for integrating these firms in GVCs by moving from raw material production to value added processing, which can be done through 'supply chain learning' (Bessant et al. 2003).

At the same time these paths bring with them a number of challenges in terms of policy implications which have to be taken into consideration as the states seek to integrate in GVCs. While GVCs have increasingly become a dominant aspect of world trade, the growing fragmentation of production across borders entail further opening up of countries to trade and investment through the removal of tariff and non-tariff barriers, including other restrictive measures. Accordingly, SVEs and LDCs have to be cognisant of the likely trade policy implications brought about by global value chains. For example:

- a. Value chains may magnify the costs of tariff protection by the potential impact of tariff accumulation, especially when intermediates are traded across borders multiple times (OECD/WTO 2012; UNCTAD 2013). This has also the effect of stifling demand for the finished product, affecting production and investment across all stages of a value chain. Thus, the larger the share of foreign input in production, the higher the relative cost faced by exporters in the markets exported to. This means that those economies which use many intermediate imports in their production for export have a higher cost of production (OECD/WTO 2012).
- b. At the same time, protection measures on the importation of intermediate inputs increases a country's production costs and reduce its competitiveness in export markets.⁴ Protection also impacts on the position of a country in regional and global value chains (OECD/WTO 2012).

Since goods cross borders many times, first as inputs and last as final products, there is a need for increased trade facilitation through fast and efficient customs procedures to smooth the operations of supply chains. As a result there have been trade policy reforms (including in SVEs and LDCs), among other reforms that have facilitated the fragmentation of production processes across the world according to the comparative advantage of location (OECD 2012). There is, therefore, the need to link production stages and cross-border facilitation. The findings of studies undertaken by the Commonwealth Secretariat to assess the effectiveness of AfT in SVEs and countries in sub-Saharan Africa show that, whereas aid had a more significant effect in terms of trade facilitation through cost reduction, it had no major effect on exports (Laurent and Razzaque 2011). This is interesting, as it might also imply less impact on value added processing for export.

10.2 Empirical evidence on the participation of SVEs and LDCs in GVCs

The growth in value chains has affected international trade by allowing outsourcing of intermediate and final production, leading to increased trade through exports and imports. It has also led to increased intra-industry trade, especially in the OECD (OECD 2007b). According to the United Nations Conference on Trade and Development (UNCTAD 2013), value chains shaped by MNCs account for about 80 per cent of global trade. Thus, global investment and trade have become 'inextricably intertwined' through increased international production networks, with firms investing in productive sectors globally and trading inputs and finished products in cross-border value chains (*ibid.*). However, while MNCs contribute the bulk of value chains, there is still room for small firms, particularly from SVEs and LDCs, to participate gainfully in GVCs. For example, they can do this through integrating into the existing MNCs' value chains, building capabilities and competitiveness in specific tasks as part of a broader diversification strategy away from resource exports (Draper and Lawrence 2013). Staritz and Morris (2013) support the view that firms survive and thrive because of their insertion into particular chains. However, no matter how benign value chains might appear, there is always need to closely examine the

best possible way of benefiting from GVCs. In their study on capturing value in the production of the Nokia N95 smartphone, Ali-Yrkko et al. (2011) show that, despite Europe playing a small role in supplying the physical components, it took the lion’s share of the value added, 51 per cent (see Table 10.2).

However, the participation of SVEs and LDCs in GVCs remains relevant in view of multilateral trade liberalisation opening up markets and other opportunities in a growing number of countries, raising the urge in most states to formulate trade policy that facilitates the participation of their firms in GVCs.⁵ The reliance by SVEs and LDCs on commodities exports means that they are not left out of GVCs, but that they have to do more in value added exports if they are to benefit meaningfully from GVCs. This is important, as these countries, by virtue of being suppliers of raw materials, have always been part of global value chains, but at the bottom level. Given this, it is expected that the allocation of resources towards higher value added activities will allow an increase in productivity, boosting real income and wealth in a country (OECD 2007b). Indeed, UNCTAD (2013) notes that value added trade plays an important role in economic growth, with such trade contributing on average 28 per cent to developing countries’ gross domestic product (GDP) compared with 18 per cent for developed countries. However, the exact value added trade contribution by SVEs and LDCs is not clear from these figures, yet it is important that we get an accurate measure if we are to fully understand their supply side to international trade and identify their sources of competitiveness. This is so because competitiveness in value chains requires access to competitive inputs (OECD/WTO 2012). However, the problem faced concerns the lack of data disaggregated into domestic value added components and imported components, data necessary for the measuring of the benefits and importance of trade in value added to SVEs and LDCs’ economies.⁶

Because of lack of disaggregated data on who contributes what in terms of value added in the products that cross borders, particularly for non-OECD countries (Ali-Yrkko et al. 2011; OECD/WTO 2012; UNCTAD 2013), this chapter relies on drawing from some case studies. The use of case studies allows us to draw comparisons and contrasts between countries.⁷ Monnereau and (Bert) Helmsing (2011), in their study on Belize, Jamaica and Nicaragua, found lobster chains to be similar in the three countries in terms of both their functional features and the type of chain actors. They

Table 10.2 The geography of valued added in the production of the Nokia N95 in Finland and China (% value each place adds)

	Finland	Other EU-27 countries	Asia	North America	Rest of the world
Assembly in Finland, final sale in Germany	41	27	13	14	5
Assembly in China, final sale in the USA	39	12	16	28	5
Both assembly locations, all markets	38	16	18	17	11

Source: Ali-Yrkko et al. (2011)

also found that the conditions for exporters were similar and largely determined by US public food safety standards. On the other hand the International Trade Centre (ITC 2012) reports that small Ugandan farmers are benefiting from better access to both domestic and international markets and through participation in value chains. This, it notes, has been done through developing market linkages, improving farmers' knowledge and skills in the market and in certification and verification, and through encouraging more farmers to participate in 'high-end nodes' of value chains (*ibid.*: 1). Such examples are necessary, as they help unpack the story.

Furthermore, in this chapter, two examples from Lesotho and Belize (Boxes 10.1 and 10.2) can be used to show the benefits of participating in value chains and at the same time expose the constraints faced by these countries in enhancing their participation in GVCs. The two examples are similar in that they demonstrate the importance of value chains to the two economies and their growth potential. They differ in that, whereas Lesotho's apparel chains are due to foreign companies, Belize's timber sector activities have emerged from local sources and have remained domestic, largely because of lack of technological innovation. Both countries face constraints (similar and different) in achieving the productive capacity development that is essential for building production and supply networks; this affects their potential to participate in GVCs and benefit from global markets.

The situation of these countries is worsened by other factors owing to their characteristics which influence the share of domestic value added in production for export. For instance, small sizes mean small economies, and being less developed means a poor economy with less diversification and increased importation of inputs, particularly intermediates. In the case of Belize, for example, producers have not been able to join GVCs partly because they have not been able to benefit much from the small Belize market, which is satisfied by imports and local value added from old technology. On the other hand, less domestic value added in small open economies can contribute significantly to GDP in relation to the size of the economy, as in the case of Lesotho, which has experienced increased export earnings and employment creations from cut–make–trim. This makes the movement up the supply chains, from raw material production to value added processing, important for these countries if they are to be meaningfully integrated in GVCs. In one of its studies, UNIDO (2011b) found substantial potential for extending the production of cashew nuts in Tanzania on existing farms, engaging in new plantations for improved varieties as well as increasing domestic value added processing for export (currently only 40 per cent of the cashew nuts produced in Tanzania are processed there). The study also found potential for diversifying processing by diversifying the product range as well as the use of by-products, providing jobs to low-skilled labourers and women.⁸

However, the need to ensure that size or low levels of development do not constrain the participation of these countries in GVCs remains apparent. For SVEs and LDCs to continue to grow from raw material producers to value added exports, there is a need for the countries to find innovative ways of processing to add value and make the 'most of their exports' (Humphrey 2003: 1). Because most SVEs and LDCs are already part of supply chains, moving up the supply chain through value added processing activities allows

Box 10.1 Lesotho: apparel industry

The apparel industry in Lesotho is integrated in the apparel GVCs through foreign direct investment (FDI) and has developed into the largest sub-Saharan Africa apparel exporter to the USA under the Growth and Opportunity Act (AGOA). Recently the industry has started exporting within the region, particularly to South Africa, taking advantage of duty-free market access to South Africa, as provided under the Southern African Customs Union (SACU), and low production costs, including labour costs, in Lesotho. Basically the two export markets are supplied by two different types of firms: affiliates of Taiwanese transnational producers and South African companies, which are inserted in distinct value chains. The Taiwanese producers are US buyer-governed value chains and the South African producers are South African retailer-governed value chains. As such, the value chains differ in terms of ownership, targeted markets, products, governance structures, firms' setup and motivation, and challenges as perceived by the owners. However, both chains have had an impact on the productive capacities and private sector development in Lesotho, with benefits to the economy in general.

- Thanks to value chains linked to Taiwanese transnational producers, Lesotho has become sub-Saharan Africa's largest exporter of apparel to the US market, with a 2004 share of 26 per cent, exports having increased from US\$111 million in 1999 to \$456 million in 2004. The increase in exports was matched by an increase in employment from 9,840 in 1999 to 53,087 in 2004.
- Between 2006 and 2011, exports of apparel to South Africa increased from ZAR17 million to ZAR445 million and employment increased by 5.5 per cent between 2008 and 2009 for South African firms.
- To date the apparel sector contributes 18 per cent of gross domestic product (GDP), about 70 per cent of total manufacturing, 60 per cent of exports, 50 per cent of the formally employed workforce and 80 per cent of Lesotho's manufacturing workforce. Despite the number of employment in the apparel industry declining from 53,087 in 2004 to 39,197 in 2011, the industry remains important for employment creation and poverty reduction in a country with half of the population living below the poverty line.^a
- There has been export market diversification, with most producers supplying the South African market not having previously exported to the United States.

However, a close look at the Lesotho case reveals a number of shortcomings where FDI is involved in building value chains in a foreign country.

- The Taiwanese affiliates in Lesotho have their head offices in Taiwan, where decision-making on higher-value functions, product development and design, logistics, merchandising etc. takes place. Lesotho firms are only

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involved in cut–make–trim (CMT) operations, and head office has little desire to transfer more than manufacturing activities to Lesotho. Only a few Taiwanese companies are involved in more capital-intensive finishing operations. As a result, besides not providing Lesotho with the performance of a high value added function, the future of the industry is also uncertain, especially in the event of operating costs beginning to rise.

- The above Taiwanese scenario is also true of South African manufacturers, except that some plants in Lesotho are given more decision-making powers. Accordingly, they have relocated some of their broader production-related function to Lesotho. Moreover, South African firms do not act globally and do not have substitute companies elsewhere. However, all this is an attempt to move away from the high-cost production environment in South Africa. The question remains what will happen when costs begin to rise in Lesotho.
- Taiwanese firms see wages in Lesotho as higher than overseas. This is a challenge to Lesotho if Taiwanese are to remain in the country.
- South African firms identify the lack of finance, transport, logistics and customs-related costs and deficiencies in the support sector as challenges.
- Both types of industries see low levels of productivity as limiting their export growth. The challenge therefore remains the establishment of production facilities in Lesotho.
- Only a few firms have undertaken major process innovations; firms are mostly involved in ongoing investment in machinery.
- There are no supply chain linkages between foreign firms and local firms, largely because there are no local firms in formal manufacturing. At the same time there has not been any stimulation of local entrepreneurship through backwards linkages or knowledge spillovers.
- Skills transfer from Taiwanese firms has been limited to basic production, with limited effort to advance local skills. Instead such skills are imported. South African firms, besides taking the development of local skills seriously, also import a number of skills because of local conditions.

^a The decline in employment is related to the decline in exports due to a number of factors but largely because of the phase-out of the Multi-Fibre Agreement (MFA).

Source: Staritz and Morris (2013)

diversification in the export sector to enhance effective and meaningful participation in GVCs. If this is the case, the designing of sector-level strategy for participating in GVCs requires collaboration between government and the private sector, which has the knowledge of markets within supply chains (Humphrey 2003). This is important because

Box 10.2 Belize: timber production value chain and the potential for joining GVCs

Timber is declining in importance in terms of export earnings, but timber producers in Belize have started to process timber for trade at the national level and for household use after realising the economic potential in timber activities within the silvopastoral system. The value chain map shows that communities are involved in logging, primary transformation, intermediate and secondary transformation. During primary transformation, most of the wood is meant for domestic use, mainly for home repairs and houses for newly married couples. Most of the sold timber goes to the construction sector, with 1 per cent going to the furniture industry. The intermediate level is involved in activities from sale at the farm gate to the final users. Carpentry work is done at the secondary level (only in one community), producing furniture and wooden houses. Furniture is made according to specification received, allowing different kinds of furniture and designs. At this level, there are value added products that have a potential in the market. However, the products do not receive any marketing because the producers do not see much opportunity in these businesses. Besides small communal producers, there are a few large companies throughout the country, processing less than half of the total timber production. Nevertheless, all the timber harvested is processed into sawn lumber (value added).

Benefits include the following:

- The livelihoods of the people in three different small communities have been improved by income generation, benefiting individuals and the communities involved at large. For example, in Springfield, part of the income earned is used to support community activities and solve common problems. However, the income from the businesses is still regarded as insignificant.
- It provides affordable houses especially in view of the rising demand for housing. Because of the demand for housing, the building sector is expanding, causing a spillover to other sectors such as finance and banking, giving affordable loans for residential projects.
- There is a big popular furniture shop which is very successful in the national market and is very much in demand by the tourist sector. However, the quality of cuts from the traditional small producers prevents them from benefiting from this national market, let alone the export market. Nevertheless, they supply certain types of wood, such as quam, which are preferred by home owners and low-income customers.

However, there are constraints and opportunities in the chains.

Constraints

- The communities still use old traditional technology and the traditional method of trading is at the farm gate, which means they sell their products

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at low prices. Old technology (no electricity, exclusive use of animals for transport and mill sawing) means relatively poor-quality products, compared with other producers who use modern technology. Machinery is outdated and not in good condition, which contributes to low quality. This affects the competitiveness of their value chain.

- The three communities studied have minimal interaction with external players, limiting the chances to upgrade quality and the expansion of lumber production. Minimal interaction also inhibits outsourcing of services or creating alliances or linkages with other producers in the chain outside the communities.
- Processing capacity is low and there is a lack of technical standards to improve productivity.
- There is also lack of technical support to improve their performance and product quality.
- There is no awareness of the market potential in Belize by the traditional producers.
- The traditional producers do not know their products' market value and competitors' rates.

Opportunities

- The timber market in Belize is very small compared with the rest of Central America and yet producers in Belize have not been able to capture a portion of the Central American market. Some businesses have been importing raw material from as far as the United States to supply local demand. Efforts should be made to tap this market and encourage the participations of traditional producers. This might entail joining US value chain streams but the problem is that there is no automatic technological transfer inside these chains (Ismail 2013).
- Traditional producers can take advantage of national demand of timber by introducing new timber species.
- Many residents have skills and good artisan abilities, are very creative and can be encouraged to have more options in the furniture market.
- Networking and communicative skills are already in existence and operative but there is potential for improvement.

Source: Vidal (2012)

it will not only allow participation in GVCs but create positive results for the economy through generating more value added through producing intermediates for export. It is therefore essential that SVEs and LDCs identify those value added export sectors that bring considerable benefits to these countries through participation in GVCs. However,

the participation in GVCs must be mainstreamed in the development policies of these countries to allow effective integration which can significantly benefit their economies. For example, in their study of lobster value chains in Belize, Jamaica and Nicaragua, Monnereau and (Bert) Helmsing (2011) argue that the three countries are weak in terms of their embedding and autonomy but Belize has taken a pro-development approach through organising small-scale fishers into co-operatives and thus enabling them to participate better in terms of export chains.

Benefits can also be realised in the services sector, as the advancement in information and communication technology has had a pronounced effect on the sourcing of services from abroad. For instance, services in the knowledge sector, such as data entry or research and consultancy, can be carried out over the internet and by tele- and video-conferencing (OECD 2007a,b). It is also important to note that GVCs also bring about an extensive use of services; 46 per cent of inputs to exports come from service-sector activities (UNCTAD 2013). This is because manufacturing for export makes use of services in production. According to UNCTAD, more than 60 per cent of global FDI stock is in services activities, 26 per cent in manufacturing and 7 per cent in the primary sector (*ibid.*). This has also brought with it the issues of exporting jobs abroad, which might be seen in negative terms in the outsourcing country. However, it is expected that in the long run the effect on employment would be in terms of the type of jobs available rather than the number (UNCTAD 2013). Moreover, the number of jobs lost to offshore production may be large in absolute terms, but relatively small compared with overall job creation and loss in the labour market (*ibid.*). On the other hand, the OECD (2012) argues that, although there is concern about job losses, the jobs created in the export industry are a result of foreign inputs. For example, the creation of employment in Lesotho in the apparel export sector between 1999 and 2004 was due to the importation of inputs into the apparel industry (see Box 10.1).

10.3 Aid for Trade and the integration of LDCs and SVEs in global trade

If we are to go by the evidence shown above on the importance of value chains to SVEs and LDCs, there is every reason to think positively about the importance of effective and meaningful participation by SVEs and LDCs in GVCs. Yet SVEs and LDCs do not have the capacity. As argued above, one way of enabling SVEs and LDCs to benefit from trade liberalisation requires those activities which encourage higher value added processing, which can be partly enabled by and utilise AfT. Targeting the productive and private sector development category is an important starting point because of the need for SVEs and LDCs to diversify their export base and stop reliance on export earnings from a single commodity or a narrow range of products for growth and economic development. According to OECD/WTO (2011), LDCs on average depend on three products for more than 70 per cent of their export earnings, leaving them highly vulnerable to adverse price changes and falls in demand. Again, they do not have the production capacity to take advantage of improved market access opportunities. Given this, AfT has to be operationalised effectively in mainstreaming

trade in national developments strategies, part of which involves addressing supply constraints to take advantage of improved export markets. This becomes critical especially in view of the diversification of export markets for LDCs (*ibid.*).

Lamy (2012: 2) notes that AfT can be used to help businesses in poorer countries to help 'unlock' the economic potential of value chains. This can be done through diversification and specialising in areas where they have 'competitive advantage or niche potential'. Rugwabiza (2011: 1) points to the importance of 'galvanising' private sectors in poorer countries along value chains and broadening the suppliers' networks through investing in capacity and competitiveness of producers, traders and institutions. AfT can be utilised to help countries retain or create new opportunities for value added processing through evaluating performance gaps and identifying where value could be added at each link in the chain as well as realising the needs or requirements of business in terms of upgrading their activities. For example, it can be used to help increase the efficiency and effectiveness of internal processing by businesses, produce new products or improve old products to be competitive, increase value added by changing the mix of activities at the firm level, and move to a new value chain (Humphrey 2003). It can also be used to enable chains as tools for trade development at the national level through increasing efficiencies in the existing national components of value chains, extending the national value chain and building new value chains (*ibid.*). According to Humphrey (2003), increasing efficiencies in the existing value chains involves helping strategy makers determine the type of trade support services to be provided to different institutions to help increase the overall export performance of export sectors.

On the other hand, extending the national value chain will help identify opportunities for capturing greater value by extending parts of the chain from a given country. Building new chains involves creating new export opportunities through creating new chains associated with existing ones (Humphrey 2003). Thus, AfT can be useful in helping policy-makers better understand the use of value chains in contributing to economic and social development. There is a need to ensure that the actual barriers faced by enterprises to joining GVCs are known to the policy-makers and dealt with. Indeed, there is a need to address the lack of understanding of the role of intermediaries in supply chains and the lack of appreciation of the value added by intermediaries' marketing enterprises. These lacks prevent business- and trade-supporting institutions from emphasising value added (ITC 2009). Yet there have not been substantial studies examining the utilisation of AfT for the purposes of building chains and enhancing the participation of developing countries, particularly SVEs and LDCs, in GVCs.

Nevertheless, there has been work on donor-led value chain interventions from which the utilisation of AfT can draw experiences.⁹ Altenburg (2007) argues that value chains are used by international organisation and national donor agencies in the context of private sector development. Such value chain interventions focus, among other areas, on improving market access conditions, upgrading opportunities for poorer countries' firms and promoting export-based development. Staritz (2012) identifies several common characteristic of donor-led value chain interventions. The

first is market access upgrading, which focuses on improving market access conditions to allow the identification of upgrading opportunities for firms and producers in developing countries, particularly for exports. Because productive capacities are underdeveloped in developing countries, this is expected to increase efficiency and competitiveness through value added and effective insertion into GVCs. Such market access upgrading is done by helping suppliers and producers gain access to information and resources, develop linkages with other businesses, comply with lead firms requirements and standards, increase productivity, gain new skills and develop competencies and capabilities as well as assuming new functions/activities related to higher value added in the chains (*ibid.*).

A second is the provision of market-based support services in a number of ways. Of significance to this chapter are those interventions which focus on increasing the capabilities of the private sector, with a focus on weak participants in GVCs, establishing and strengthening linkages between firms along the chain at both the domestic and the international level, and improving business services and the business environment as a whole with a view to improving the operation of value chains (Staritz 2012). Nevertheless, donor-led interventions in this instance are still selective, focusing on individual firms or groups of firms. The third characteristic is concerned with the involvement of the lead firm in trying to help developing-country suppliers and producers to access markets and skills, build linkages and upgrade their activities. This is because donor assistance is often given through lead firms to local businesses, and lead firms have a greater say in inclusion or exclusion, including the upgrading, of developing-country firms in chains, as they determine what is produced and where, how it is produced, conditions of entry into the chain and upgrading, and the distribution of profits (Altenburg 2007; Staritz 2012).

However, foreign-led value chains for development have limitations. They can have an impact on the export-developing strategies for developing countries as global shifts in supply and demand structures bring about increased competition between developing countries. Moreover, domestic producers in developing countries compete with imports from cheaper sources, thereby forcing the closure of some domestic enterprises. The other limitation is that upgrading does not necessarily bring about gainful placement in the value chains at the level of higher value added activities sufficient to secure higher sustainable incomes with effects on development. Donor-led value chain interventions can also create winner and losers as the process of inclusion and exclusion at the local and global level leave firms and regions not part of the GVC and thus excluded from global markets (Staritz 2012). There is also the possibility of competition between different chains as policy intervention in one chain may affect the position of a competing chain (Altenburg 2007). Donor-led value chain interventions assume that the interest of developing country firms and even the developmental interests of these countries will coincide with those of the lead firm. Yet a close examination shows the existence of a conflict of interest. There are trade-offs between different development objectives, with the structure of value chains depending on an ongoing negotiating process among stakeholders with different interests, which can lead to different outcomes including unintended side effects (Altenburg 2007). This is because countries tend to focus on specific business

functions rather than on specific industries or firms involved in specific activities (OECD 2012). For example, lead firms may want to suppress skills and technology transfer, whereas the governments of developing countries might see this as critical to ensure spillover effects for development purposes.

Most important is that the donor-led approach focuses on the firm level and interfirm networks and ignores a number of non-firm actors such as states, which have a critical role to play in value chains and development. States remain important players in value chains, as they influence upgrading trajectories through a number of policy measures. It is critical that donors work with the recipients in order to ensure that the development effects can be realised, as this will allow value chains to be mainstreamed in the development objectives of the recipient countries. Moreover, donor agencies may not know exactly what a supply chain requires. However, firms have to be part of supply chains which enable them to access external and diversified markets, technology transfer through learning, economies of scale and scope, and competitive imports for production of exports. This is because being part of a supply chain provides options for enabling learning, and makes incremental additions to existing knowledge to enable adaptation in the supply chain (Bessant et al. 2003).

This is important because, as discussed above and as demonstrated in the case of Lesotho (Box 10.1), integration into GVCs may lock firms in developing countries into low value added activities. Such a lock-in is not beneficial in terms of GVCs contributing to effective socio-economic development in these countries in terms of eradicating poverty. The challenge, as argued in this study, is for SVEs and LDCs to climb to higher levels of value added activities (upgrading) for export, which is essential for their export-led growth and development. Value chains brought in by MNCs may not always bring supply chain linkages between foreign firms and local firms, as the MNCs may prefer to source cheaper inputs from outside, as is the case with Taiwanese firms in Lesotho. It is from this understanding that AfT can be useful in filling in the gap and help in creating an enabling trade and investment environment. Unlike in the case of donor-led interventions, AfT will allow demanders to have a say in the intervention in the value chains through designing and developing their own projects. The main challenge is to ensure that trade policy incorporates the rapid and increasing changes in the global trade landscape, as this will give us a better understanding of a country's position in global production networks and enable us to take necessary policy measures (OECD 2012). For instance, it can allow the identification of sources of national competitiveness and also highlight the challenges in upgrading or building new chains in competitive areas.

10.4 Aid for Trade and value chains in small states and LDCs

AfT is intended to assist developing and least-developed countries to increase their exports of goods and services, to integrate more effectively into the multilateral trading system and to benefit from trade liberalisation through increased market access. To realise this, the initiative is intended at helping these countries in overcoming their supply-side constraints, build their economic infrastructure and increase competitiveness. The initiative is about mobilising funding, policy coherence and

getting WTO members to use trade in the service of their developing objectives (WTO 2006). For SVEs and LDCs, this entails getting their regulatory, business and trade policies right in order to make use of opportunities offered in regional and global markets. However, SVE and LDC projects should be considered AfT activity if they are trade-related development priorities in the recipient countries (Cali et al. 2011). These activities fall into the broad categories of trade policy and regulation, trade development, trade-related infrastructure, other trade-related needs, and trade-related adjustment and building productive capacity. It is the last category which is critical when assessing the potential for utilising AfT to support value chains for SVEs and LDCs. This is because the resources made available in this category include, among others, business development, assistance to banking and financial services, forestry, mining, agriculture, industry, fishing, mineral resources and tourism – all of which hold the potential for SVEs and LDCs to move up the supply chain from raw material production to value added processing and also generating new capacity.

Measuring the effectiveness of AfT has not been an easy thing to do; most studies use case studies to assess the impact of AfT. Moreover, the data do not show the utilisation of AfT for the purposes of value chain activities. Given this, it is assumed in this chapter that part of AfT to the productive capacity category is for activities that enable the creation of a trade and investment environment conducive to value added processing and integration in GVCs. AfT can be a fitting source of financial resources that can be used for a well-co-ordinated technical assistance and training programme in developing productive capacities and transforming industries in these countries to assume the roles of value added processing and move up the supply chains they are part of. However, much trade-related technical assistance to LDCs has tended to be policy-oriented and institutional support, with less support for enterprises (ITC 2010a). Yet trade-related technical assistance that leads to developing productive capacity remains critical. The ITC Export-led Poverty Reduction Programme (EPRP), which aims at linking LDC communities to world markets by inserting them into value chains of products and services, has projects in 12 LDCs, which have so far benefited 38,000 poor people by creating additional jobs and higher incomes (ITC 2010a). This work by the ITC gives us an example of technical assistance in productive capacity and private sector development. The issue is that SVEs and LDCs should focus on the value of exports rather than the quantity, as is the case with commodity exports. However, this requires a lot of thinking about innovation for diversification (ITC 2010b). This requires financial resources which SVEs and LDCs do not have. Nevertheless, the AfT initiative can provide poorer countries with financial resources for the ‘proper functioning’ of the productive and export sectors, including enhancing their competitiveness (ITC 2010b).

10.5 Lessons learnt and recommendations

What emerges from this analysis is that, because of a number of characteristics, SVEs and LDCs have found it difficult to use trade as a tool for economic growth and poverty reduction. However, GVCs offers an important avenue that can help SVEs and LDCs harness trade for development through providing important routes to export markets. Not only do GVCs provide routes to export markets but they also offer

new opportunities for SVEs and LDCs firms to expand their business opportunities. There is also scope for generating new capacity and diversification of export product range through expanding into new activities, which also creates employment and improves the standards of living in these countries. The other important issue that emerges from the analysis is that LDCs and SVEs often participate in low value added activities which give them the basis for moving up supply chains through value added processing. However, SVEs and LDCs do not have the capacity to move up and would benefit from financial support for those activities which help create a trade and investment environment that is conducive to higher value added processing. The role of AfT in this respect cannot be overemphasised:

- AfT can be used to help in the implementation of policy interventions aimed at making the business environment more reliable and more transparent, fostering enterprise development, including in new areas of economic activity which involved value added production. This can be done through support for trade policy and regulations as trade and investment policies which can help determine the extent of SVEs and LDCs benefit from value added processing as well as affect competitiveness for local firms and value chains compared to imports and market-seeking foreign investment.
- AfT in productive capacity and private sector development should be made an important aspect of enabling businesses in SVE and LDCs to participate in and benefit from regional and global value chains, thus allowing them to participate effectively in world trade. One way of doing this is by utilising AfT for conducting value chain analysis to identify concrete policy constraints that affect competitiveness as well identifying areas in which businesses in small states can add value and participate in regional and global value chains. This will also, in a way, help in the diversification of the export bases of SVEs and LDCs. For example, technical assistance given to countries can help in the formation of sector co-operatives, clusters and networks, and pilot group purchases which provide opportunities for strengthening supply and value chains.
- AfT can be used to try and sustain already existing value chains. This can be done by strengthening the supply capacity of local firms to produce at competitive costs and to supply reliably and in compliance with standards, through developing skills ranging from technical skills in production process to management competencies. This is important, as local suppliers in value chains are constantly threatened in terms of competition from other global suppliers. Given this, SVEs and LDCs have to try and build resilience through improved productivity, improved competitiveness and building new skills. Export promotion, on the other hand, may help facilitate the integration of SVEs and LDCs firms and businesses in global supply chains. There is also a need for the industry and government to develop a strategy that will help move from chains that create employment only but have the potential to generate skills and spill over to the larger economy.
- AfT can be a source of financial resources for country-specific studies to help recipient countries identify areas for use of AfT in developing production and

the private sector for exports. AfT, in such a case, can be used to start producing competitive value added products.

- There is a need to find ways that AfT can be used to overcome particular institutional and other bottlenecks that hinder the effective participation of existing export businesses in regional and global value chains.
- AfT can also be used to meet adjustment costs brought about by economic activities which make it possible for firms from SVE and LDCs to join GVCs: activities such as reforming employment regulations, trade policy and industrial policy. Support for adjustment costs can also be used for developing productive capacity, which can also help develop value chains.

Notes

- 1 However, it should be noted that these countries are not homogeneous but share characteristics that have a bearing on their ability to fully participate and integrate in regional and global value chains.
- 2 Commonwealth SVEs and LDCs include Antigua and Barbuda, The Bahamas, Bangladesh, Barbados, Belize, Botswana, Brunei Darussalam, Republic of Cyprus, Dominica, Fiji Islands, The Gambia, Grenada, Guyana, Jamaica, Kiribati, Lesotho, Malawi, Maldives, Malta, Mauritius, Mozambique, Namibia, Nauru, Papua New Guinea, Rwanda, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Samoa, Seychelles, Sierra Leone, Solomon Islands, Swaziland, Tonga, Trinidad and Tobago, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu and Zambia.
- 3 Goods cross borders many times, first as inputs and last as final products. This brings about the need for increased trade facilitation through fast and efficient customs procedures to smooth the operations of supply chains.
- 4 Tariffs and other barriers on imports are a tax on exports.
- 5 Opportunities come with activities such as outsourcing, offshoring, sub-contracting, joint ventures and outright shifting of production to a different location.
- 6 The OECD and the WTO have already initiated work in measuring value added and explore some of the methodologies and the challenges they pose (OECD/WTO, 2012). So far the data are only on OECD countries, making it difficult to get data on SVEs and LDCs.
- 7 This is notwithstanding the fact that such examples only show the situation for that specific product and country.
- 8 Cashew nut farming is also a source of income and livelihoods for many people; 85 per cent of cashew nut growers are smallholders farming around one hectare (INIDOP 2011b).
- 9 Donor-led value chains interventions evolved when major international organizations and national donor agencies developed their own value chain approach, largely aimed at private sector development (Altenburg 2007, Humphrey and Nava-Aleman 2010). A number of agencies, such as the United States Agency for International Development (USAID), the Organisation for Economic Co-operation and Development (OECD), German Development Cooperation (GIZ), World Bank, the Food and Agriculture Organization (FAO) and the International Labour Organisation (ILO), have designed comprehensive value chain analysis tools in order to define entry points for intervention. Such value chains have been labelled as 'value chains for development' (Staritz 2012).

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Chapter 11

Aid for Trade and Global Value Chains (GVCs): Engaging with High-value Agriculture GVCs and Developing Trade¹

Jodie Keane

11.1 Introduction

Aid for Trade (AfT) can be used to enhance global or regional value chains by working with the private sector and focusing on alleviating the binding constraints, or market failures, that hold back the appropriate functioning of value chains. For example, AfT can improve logistics, infrastructure or services. The research and analysis presented in this chapter assesses the role of AfT in assisting the integration of agricultural producers in sub-Saharan Africa (SSA) into high-value agricultural global value chains (GVCs).

Since the 1980s, when the latest phase of globalisation began, characterised by the fragmentation of global production across countries, agricultural producers in SSA have been increasingly integrated within the global trading system through their participation in GVCs, including through their integration within high-value agricultural GVCs such as horticulture. The rationale underpinning the adoption of some of these export-orientated growth strategies was an implicit assumption by donors that the revenues generated would subsequently be utilised for product and process upgrading, promoting the development of domestic capabilities, increasing productivity and wage-earning opportunities.

All trade takes place within value chains; however, there are different types of value chains, as will be discussed in this chapter. The GVC approach is a distinct methodological tool that focuses on the dynamics of interfirm linkages and international industrial organisation, as opposed to considering the production and export of goods in isolation. This study reviews and makes reference to specific GVCs and country case studies in SSA including Kenya. The country case study of Kenya is focused upon because interventions to facilitate trade and producers' integration within GVCs have been ongoing since before the term AfT was agreed upon among World Trade Organization (WTO) members (in 2005), and there have been some shifts in approaches as lessons have been learnt.

This chapter seeks to explore the following key questions: How has AfT been used to help developing countries tap into high-value GVCs and global production networks? How could the potential benefits of the approach be enhanced, and disadvantages be mitigated? These research questions are assessed qualitatively, first, through reviewing the existing literature, including AfT disbursements, modalities and the support used

to assist different types of producers (and labourers) in participating in high-value agricultural GVCs. Second, the relative success and merits of such an approach are reviewed and assessed; a range of data sources are used, including key-informant interviews undertaken within the country.

This chapter is organised as follows. Section 11.2 discusses recent trends in global production and trade. It then proceeds to discuss how the GVC approach has been adopted by development practitioners to identify the scope for potential intervention. It provides an overview of the different types of AfT and disbursement mechanisms. In section 11.3 we review the existing literature related to the use of AfT and high-value agriculture and link these interventions to specific value chain nodes, objectives and outcomes. We then proceed to focus on the country case study of Kenya in section 11.4. Finally, section 11.5 concludes the analysis and highlights the main policy lessons that can be drawn from this experience.

11.2 Trends in global trade, global value chains and the role of Aid for Trade²

The GVC literature became prominent during the 1990s as product- and sector-specific studies were motivated by the need to better understand how producers engage with the most recent process of globalisation and its implications for the development of productive capacity and capabilities. A number of comparative value chain studies across sectors, including agriculture, acknowledged changes in global production and methods of co-ordination and explored what this meant for firms and their labourers (Cramer 1999; Dolan et al. 1999; Daviron 2002; Ponte 2002).

The GVC approach to analysis takes as its starting point asymmetric trading relations between developed and developing countries. Although the GVC literature continues to develop, both conceptually (e.g. increasing recognition of production networks) and empirically (e.g. by employing more robust research methods), the basic unit of analysis remains the same: looking at production by firms and labourers that are linked to international markets through the GVC lens and assessing their relative returns (e.g. wages, skills development) at a point in time, as well as over time.

The concept of a GVC refers to a configuration of co-ordinated activities that are divided among firms and have a geographical scale (Ponte and Gibbon 2005: 77). To some extent, therefore, the GVC methodological approach follows a casual chain approach to analysis. It therefore focuses on the dynamics of interlinkages and the way in which firms and countries are globally integrated. It raises the question of how producers (firms, regions or countries) participate in the global economy. Analysis goes beyond firm-specific linkages to reveal the dynamic flow of economic, organisational and coercive activities between producers within different sectors on a global scale (Kaplinsky and Morris 2001: 2).

Some types of GVC governance may facilitate rapid producer upgrading, whereas others may hinder this process. For example, engaging with global agribusiness

Table 11.1 Key determinants of global value chain governance

Governance structure	Complexity	Codification	Capabilities	Degree of explicit co-ordination
Market	Low	High	High	Low
Modular	High	High	High	
Relational	High	Low	High	
Captive	High	High	Low	
Hierarchy	High	Low	Low	High

Source: Adapted from Gereffi et al. (2005)

by smallholders may initially mean a rapid transfer of knowledge and expertise as producers are integrated within supply chains. Although this may mean that producers are upgraded at a point in time it does not necessarily mean over time. Table 11.1 summarises a classification of governance structures identified by Gereffi et al. (2005) with reference to the relationships that exist between firms organised within GVCs.

11.2.1 GVC governance structures

The five types of GVC typologies are distinguished by their governance structures, which are functions of the complexity of the transaction, the ability to codify aspects of it and the capabilities of producers. Given this classification, the GVC approach considers trade to be embedded in, but also to a considerable extent determined by, specific (but changing) institutional structures and organisational aspects of international trade (Raikes et al. 2000).

However, external GVC governance structures usually remain outside the modelling sphere of ‘which GVC takes what shape and why’.³ The governance structures posited by Gereffi et al. (2005) do not include reference to external structures, including those negotiated by governments for private actors, but rather focus on the internal structures between firms and private actors. That is, it is fair to say that the GVC literature is not wholly satisfactory in respect of the links between different types of internal and external chain governance (see Keane 2012).

For example, the depth of liberalisation of trade and finance undertaken by countries in SSA since the 1980s has determined the type of actors and firms involved with production and trade within GVCs. Since contract farming is a form of vertical co-ordination between firms, it means that attention must be paid to how global agribusiness accesses smallholder supply and the terms of sale. This means taking account of the playing field negotiated by governments for private sector actors. Much of the more recent debate about how producers and farmers in SSA engage with buyer-driven GVCs highlights the tensions caused by, on the one hand, achieving rapid process upgrading for some types of producers but, on the other, raising barriers to entry for others. However, the literature is divided on the circumstances when smaller, and poorer, producers (and farmers) are excluded from rather than included in high-value GVCs.

Adherence to the standards required to access higher-value markets may act as a catalyst and spur to productivity (Jaffee 2003), as well as increase incomes for producers and wage-earning opportunities (Humphrey 2003). At the same time, this upgrading process may marginalise other producers who are unable to meet such demanding requirements (Dolan and Humphrey 2000). One response, therefore, is to improve the organisation of producers to reduce the diseconomies of scale which result if procuring from individual producers. This would require purposive actions to be undertaken by the government with private sector collaboration.

This suggests that an understanding of the nature of value chain governance, as well as the permanent structural changes which may result, is crucial to understanding the dynamics of barriers to entry and creation of rents. Increased co-ordination, when it is forthcoming between value chain nodes, could be temporary and necessary in order to drive through innovations within a value chain at a point in time. The mechanisms through which co-ordination and the complexity of information is conveyed between actors trading within GVCs could, however, also become permanent and embedded within the external governance structures surrounding trade: either as *de facto* market access requirements, or as benchmarks for which *a priori* capabilities are needed before being included within a GVC.

In effect, therefore, governance structures, both internal between firms but also external and negotiated by governments for firms, may serve as barriers to entry and a force for exclusion as well as inclusion. These structures may result in the creation of rents for some types of producers relative to others, which may be influenced by government action to facilitate entry and participation within GVCs.

The export of products within the category of horticulture (such as green beans and cut flowers) has formed the basis of export diversification strategies for many countries in SSA (Humphrey 2003). The growth of the horticultural industry in Kenya, in particular, is regarded as one of the major export success stories in SSA (Jenkins 2005). Investment into the sector has taken the form of outsourcing production through developing contractual relations between firms across borders.

Movement into high-value agriculture GVCs has in some cases been facilitated by preferential market access into developed country markets. The tariff rent made available through preferential market access to some groups of countries, relative to others, has provided a form of locational advantage to attract investment. Preferential market access into the EU market is recognised as having played a significant role in the development of the industry in Kenya during the 1990s (Stevens and Kennan 2000). This level of access has so far been maintained, as a result of the initialling in 2007 of an Economic Partnership Agreement (EPA) between the East African Community (EAC) and the EU – which is a reciprocal free trade agreement (FTA).

There are current uncertainties though – since, at the time of writing, the EPA is yet to be signed and ratified. The external trading environment has, therefore, changed: before 2007, Kenya benefited from preferential market access under the Cotonou agreement, a non-reciprocal trade agreement. Stevens (2001) argues that

trade analysis suggests that past EU trade policy effectively excluded many of the most important global suppliers from the UK market. However, this advantage has been eroded over time, as the Cotonou agreement has expired, and as a result of the proliferation of FTAs more broadly. The role of trade preferences therefore plays an important role in terms of determining some of the power relationships inherent in GVCs, as a variable part of external governance structures.

11.2.2 The role of Aid for Trade

It is increasingly recognised that countries may need further assistance to tap into the modern export sector, beyond the tariff rent made available through the granting of a unilateral trade preference. Reductions in tariffs and non-tariff barriers (NTBs) have not always resulted in increased flows of trade; therefore, partly in response to this, AfT was developed as an instrument to assist countries in addressing other supply-side constraints, as discussed in detail by Basnett et al. (2012). Since then, attention has shifted towards increasing the effectiveness of AfT. Table 11.2 provides an example of the co-ordination and market failures whose elimination may assist countries to tap into modern sector exports, including high-value agriculture. We have then linked these types of interventions to AfT categories. We discuss some of the challenges of operationalising these interventions in the following section.

Table 11.2 Market failures affecting entry and participation with GVCs, and responses

Type	Examples	Responses	AfT category
Co-ordination	Externalities, complementarities ignored; linkages not exploited; no policy coherence	Capacity building for industrial policy	Trade development; trade-related infrastructure; building productive capacity
Technology: developing, adapting and adopting	Incomplete and imperfect information; network externalities	Promotion of technology transfer and adoption	Trade development and trade-related infrastructure
Skills formation	Externalities, imperfect information	Co-ordination and/or subsidies for training	Building productive capacity
Environment: protection, conservation, cleaner technologies	Negative externalities not accounted for	Product and process standards and regulations	Trade policy and regulations

Source: Adapted from te Velde and Morrissey (2005)

11.3 The use of AfT to help producers to enter and participate in high-value agricultural GVCs⁴

The following section briefly reviews the available literature on the assistance provided to producers in relation to entering, and enhancing participation in, the horticultural GVC in Kenya. Most recent estimates suggest that approximately 60 per cent of Kenya's horticultural exports are sourced from smallholders, including those under contract farming arrangements. The sector is estimated to comprise around 240 large-scale producers and 150,000 smallholder farms (Mbithi 2009). This is a fairly high share, given the concerns that were raised in the 1990s regarding the potential exclusion of smallholders from high-value GVCs as a result of the introduction of more stringent standards. For example, Dolan et al. (1999) documented how, by the 1990s, the demands for capital and technological capabilities had excluded smaller producers, who were unable to meet technical requirements. This finding was further substantiated by Minot and Ngigi (2004), who reported that Kenya's largest exporter at that time, 'Homegrown', had reduced its smallholder sourcing to less than 10 per cent, with the remaining 90 per cent being supplied directly from owned units.

The horticultural chain became increasingly dominated by large retailers by the late 1990s (Dolan et al. 1999). As a result of these shifts, production shifted away from smallholders towards large farms, many of which were owned by exporters. This is because sourcing from directly owned units means that firms are able to exert greater control over production processes and are better able to comply with quality, environmental and social standards. Larger farms also have the necessary scale to buffer major investments in, for example, irrigation systems as well as other relevant technologies.

It is the consolidation of the marketing nodes of the horticulture GVC, for example through supermarket mergers and acquisitions, that results in a buyer-driven and therefore hierarchical governance structure, as discussed in section 11.2. In striving for achieving economies of scale at nodes of production, some backward vertical integration took place between exporters and producers. This transformation meant that, during the 1990s, arm's-length and market-based relations between independent firms were replaced with more hierarchical governance structures, with transactions being undertaken mostly on an intrafirm basis. Standards were harmonised across retailers in the UK and Dutch markets through the introduction of the EurepGAP standard (now known as GlobalGAP).

Because this private voluntary initiative raised the standards bar, there were concerns that smaller producers would not be able to overcome the technical as well as financial barriers associated with obtaining certification and complying. In order to avoid the potential marginalisation of smallholders from the horticulture GVC in Kenya, donors intervened to cover the costs of compliance associated with the standard. At that time, donor support was crucial in subsidizing the certification process for smallholders and therefore ensuring their continued participation in the horticultural GVC. However, it remains debatable how far the programmes supported by donors also subsidised exporters (and indeed buyers), given that it is difficult to assess whether the benefits accrued mainly to farmers or retailers (FAO 2006).

Despite these concerns, the more stringent export requirements associated with the horticulture GVC have resulted in significant investments in efficiency and productivity in the sector; Kenya is often referred to as a country which has been able to transform the challenges of adhering to standards in production into opportunities (Henson and Jaffe 2006). We discuss the case study of Kenya and the broader implications highlighted by its experience in more detail in the following section.

11.4 Upgrading producers to meet standards in Kenya⁵

GlobalGAP, previously known as EurepGAP, is an example of a private voluntary initiative agreed by retailers in order to ‘reassure consumers about the environmental impact of farming, and engender a responsible approach to worker health and safety as well as animal welfare’ (Ellis and Keane 2008: 29).⁶ The code of practice was initially launched in 1996 by a group of 11 British and Dutch retailers with the objective of creating a single private sector standard for ensuring the food safety and quality of fruit and vegetables from seed to farm gate.⁷

Although the standard helps to avoid multiple audits of standards required by buyers through providing a standardised monitoring of these standards, it also goes beyond mandatory market access requirements. Although some of the standards included within GlobalGAP may be defined as being private voluntary initiatives, they have effectively become a prerequisite for market access and inclusion within the GVCs that supply retailers in the UK and the Netherlands (the market structure of which exhibits oligopolistic tendencies). Most European buyers of agricultural products now demand evidence of certification as a prerequisite for doing business. Thus GlobalGAP has a major influence on how horticulture GVCs are structured, including in Kenya.

11.4.1 Initial donor interventions

There are two options for certification. Option 1 is more stringent and requires compliance with all control points. Most large-scale growers opt for this. Most small-scale growers take the second option, which is less stringent, but requires quality management systems (QMSs) to be put in place (see IIED and NRI 2008). Most donor efforts have been devoted to certifying small holders organised as groups under GlobalGAP Option 2 (group certification). Under this option, farmers have to develop their own technical teams and QMSs.

The IIED and NRI (2008) estimated that on average £1,000 was required per small-scale grower to ensure compliance, a major investment which would have meant the exclusion of many producers unable to cover such high costs. However, in the cases they analysed, these costs were spread over stakeholders: 36 per cent borne by small-scale growers; 44 per cent by exporters; and 20 per cent by external agencies (donors). They also found that the recurrent costs associated with compliance were on average £175 per annum, with 14 per cent paid by the growers themselves and the remainder by exporters. The most challenging criterion in the implementation process of GlobalGAP was reported to be the record-keeping requirements associated with the demand for traceability of produce and chemical applications.

Non-recurring costs, however, vary according to the size of farms and number of employees etc. For example, Henson and Jaffe (2006) estimated non-recurring costs to be in the region of US\$450 to \$510 for outgrowers (with 15–20 acres) who supply exporters and from US\$75,000 to \$100,000 for integrated producer/exporters (with 1,000–1,800 acres). These costs vary from less than 4 per cent of annual sales for producer/exporters to 6–11 per cent for smaller producers. Although initial investments may be substantial, they may be recovered over time through the ability to access a higher-value market. According to survey results, Asfaw (2008) points out that the initial costs of investment by individual farmers may be paid off within three years (with donor support and finance) or seven years (without).

Despite this, UNCTAD (2008) notes that certification remains an immense challenge for most producers in SSA, requiring investments at both macro and farm levels. Even with donor interventions, the ability of some producers to remain within the horticulture GVC, particularly in Kenya, has been rather limited. For example, based on case study and survey data, the IIED and NRI (2008) point out that, between 2003 and 2006, 60 per cent of Kenyan growers were dropped from compliance schemes owing to problems with implementation. Of those able to attain certification, 15 per cent were subsequently dropped by their exporter, as the costs of maintaining their certification were not matched by the level of income obtained.

Many Kenyan exporters have significantly reduced their involvement with small-scale growers since the introduction of GlobalGAP in mid-2003. This is because recurrent costs remain high relative to average smallholder margins. The results of a survey by Asfaw et al. (2007) of adopters of EurepGAP and non-adopters empirically demonstrates that resource-poor farmers with limited access to information and services hardly comply with the food safety standards. The sustainability of donor interventions to subsidise certification processes has, therefore, been called into question.

11.4.2 Successes and continued challenges

The sustainability of donor interventions in the sector should be analysed in two ways: first, in relation to the continued inclusion and participation of some producers within the horticulture GVC; and, second, in relation to the potential spillover effects that may result from participation in the horticulture GVC, even if this participation is not sustained over time. Donor assistance in meeting the standard has delivered benefits for some producers, such as training as well as infrastructure development. Some of the benefits reported by the IIED and NRI (2008) for African smallholders include the following:

- continued ability to profit from preferential market access;
- non-financial benefits, such as improved field hygiene, better knowledge about pesticide use and improved farm management capabilities;
- learning about good agricultural practice; and
- transferring this knowledge to family farms.

However, what is clear is that the benefits of GlobalGAP certification for producers depend on the institutional context, and the extent to which private and public actors collaborate in the development of producer organisations to reduce transaction costs and enhance potential spillover effects. Although compliance with the standard enables the effective management of the risks associated with the spread of plant/animal pests and the incidence of microbial pathogens or contaminants (see UNCTAD 2008), and this learning may have long-term benefits, the ability to embed such knowledge within institutions – and therefore enhance institutional memory and national knowledge systems – requires collaboration between private and public sector actors.

An alternative approach for donors, therefore, could be to focus on strengthening public organisations so that capacity is built both to undertake certification processes and to reduce transaction costs. The ability of producers to reduce recurrent costs is a means by which smallholders continue to be included within the horticultural GVC; this may be achieved through the strengthening of producer organisations. It is in this sense that Henson and Jaffee (2006) view standards as catalysts for development if compliance is viewed as a strategic issue to overcome. The World Bank, in its World Development Report 2008, also finds this.

Notwithstanding these propositions, however, it is important to note that, even when producers have been upgraded and comply with the standards, and Kenyan producer organisations are accredited to undertake certification and to audit firms, this is not always recognised by buyers in end markets in the EU. We discuss these more recent challenges in the following sections, where we also highlight recent shifts in donor as well as government interventions in the sector. Before doing this, however, we first provide an overview of the cut flower value chain in Kenya, as a sub-sector of horticultural production.

11.4.3 Structure of the cut flower GVC

This analysis is based on the results of field work and a number of key informant interviews undertaken in and around Nairobi between September and October 2012. Three types of cut flower firms were identified, which vary in size, ownership and the functions they undertake. These are:

- **Type 1:** small firms;
- **Type 2:** medium-scale firms; and
- **Type 3:** large multinational enterprises which specifically grow for auction.

Although there are number of clusters of cut flower production in operation, the following bullet points briefly summarises their breakdown in terms of the major hubs and their ownership structure:

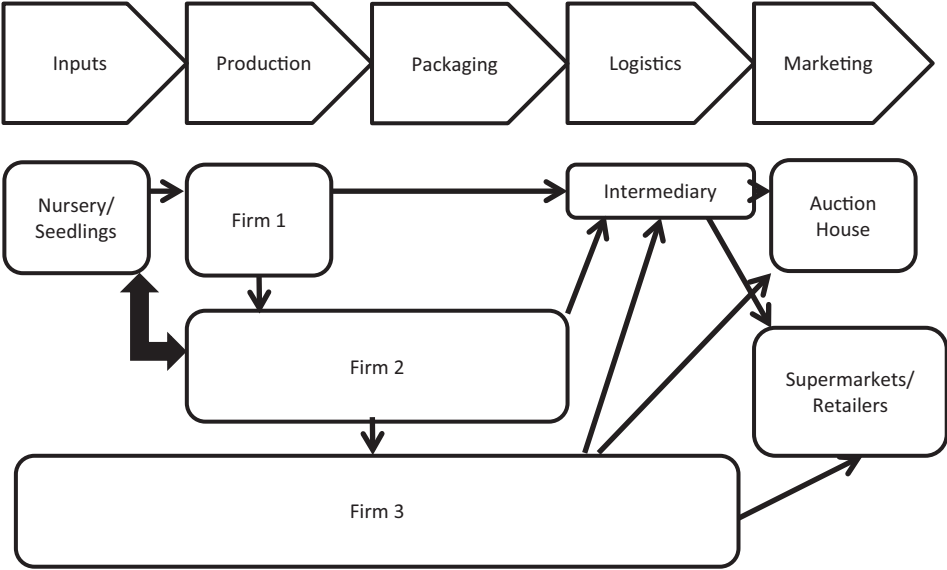
- **Lake Naivasha:** consists of approximately 35 per cent domestic Kenyan farmers; the other 65 per cent are Dutch and other foreign growers (Israeli and Indian). In this area the size of farms is estimated to be large.

- **Thika:** 70–80 per cent Kenyan growers; the rest foreign. The area contains rather more medium-sized growers.
- **Nakuru (and other):** mostly Kenyan small-scale growers; farm sizes are relatively small (approximately 5–10 ha).

Most of the cut flowers produced in Kenya are destined for auction houses in the Netherlands (65 per cent) and others supply retailers in other EU markets, notably the UK.⁸ An estimated 97 per cent of total flower exports are from the largest firms, most of which are owned by foreign investors (Bolo 2008). The reasons for this are the highly capital- and knowledge-intensive nature of the industry, in addition to the need to forge strong links with buyers and retailers. For example, it is estimated that capital investment in flower production requires at least US\$50,000 per hectare in addition to access to marketing networks (Bolo 2008); these requirements have confined most small-scale growers to summer flowers that can be grown outdoors and which do not require such heavy investments in greenhouses as roses, the major flower exported.⁹

Figure 11.1 presents a stylised overview of the cut flower value chain in Kenya. Given some of the similarities that are apparent between how the cut flower GVC and the garment sector operate, in terms of the functions undertaken, we have used a similar overview to that developed by Gereffi and Frederick (2012). This is because, as is the case in the garment GVC, there is a clear division across firms in terms of the functions they undertake, and therefore their functional capabilities. Figure 11.1

Figure 11.1 Cut flower value chain in Kenya



Source: Field work and key informant interviews

therefore identifies the relative position of the three types of firms identified in the cut flower GVC and provides an overview of the functions they undertake. Table 11.3 then discusses these in more detail.

The number of firms in operation has reportedly been stable since around 2006.¹⁰ However, there is some evidence of accumulation processes under way which are changing the structure of the industry. For example, the smallest firms (Type 1 firms) are increasingly being bought out by medium-sized firms (Type 2 firms) as some consolidation across nodes of production is taking place. A number of more medium-sized suppliers have been brought under new contractual arrangements as a result of a recent merger between two of the largest cut flower farms in Kenya.

Because of continued inconclusive negotiations for the EPA with the EU, there are reports of relocation by some of the larger growers (Type 3 firms) to countries such as Ethiopia (which will continue to receive a trade preference in the EU market even if it does not sign and ratify an EPA with the EU, because it is classified as a least developed country). As previously mentioned, investment by Israeli and Dutch flower growers in the sector was initially attracted to Kenya in the 1990s by its preferential access to the EU market relative to other countries. The strategy adopted by some Dutch growers, of beginning production in Ethiopia, forms part of a diversification strategy: to increase the number of suppliers and reduce the market power of Kenya.

Where large firms have left, other large firms in Kenya have typically taken over, which has meant that production has become increasingly concentrated amongst the largest and best-connected firms (in relation to end markets).¹¹ These processes, to some extent, mean that a new period of consolidation within the sector seems to be under way, while at the same time the Kenyan government is becoming more involved in the sector. The following sections describe in more detail the response of donors and governments to these shifts.

Shifts in donor interventions

The results of firm-level interviews and a review of current major donor activities, notably those undertaken by the Netherlands and the UK, suggests a change in donor interventions in the sector:

- firstly, towards supporting the inclusion of medium-sized enterprises rather than smaller ones;
- secondly, promoting private sector development more broadly; and
- thirdly, addressing more generic measures and NTBs at borders through adopting a corridor approach and establishing one-stop border posts.

The vacuum left by donors in the provision of support for smaller firms is increasingly being filled by the public sector as the Kenyan government has geared up efforts to ensure the inclusion of smaller producers. However, this process goes beyond simply supporting certification procedures – which have presented new challenges – to include the promotion of cluster development and the better organisation of smaller producers.

Table 11.3 Functional capabilities of cut flower firms

Functional capabilities	Description of activities
Type 1: sub-contractor/assembler Product: foliage/summer flowers/roses Supplier tier: marginal supplier	Small Indian/African firms are integrated into the cut flower GVC through acting as sub-contractors to larger firms (Type 2) or intermediaries based either in Kenya or overseas markets (predominantly in the Netherlands or the UK). This is a form of sub-contracting in which the Type 1 firm is responsible for the supply of the product up to its final destination (free on board, f.o.b., see below), exporters or Type 2 firms. In general, Type 1 firms are relied upon to provide products on an as and when basis and may have more than one buyer in the end market, as shown in Figure 11.1. In some cases, inputs may be supplied by Type 2 firms to Type 1 firms depending on the sub-contracts specified and end product specified.
Type 2: package contractor/assembler	Medium-scale firms tend to rely on their intermediaries, based either in Kenya or in overseas markets, to supply end markets. However, they have greater functional capabilities than Type 1 firms, both growing and packaging to specification. They may also have their own nurseries and use these to supply other firms with plant varieties. These firms tend to have set annual contracts with their buyers for specific volumes. They may, however, also develop more informal linkages with Type 3 firms and supply on an as and when basis; similarly, they may in turn sub-contract Type 1 firms to fulfil their buyers' requirements. Generally, Type 2 firms operate on an f.o.b. basis and are responsible for the supply of the product up to its final destination. This means that, for the quoted price, goods are delivered on board a ship or to another carrier, via an intermediary, at no cost to the buyer.
Product: roses and/or foliage/summer flowers Supplier tier: preferred supplier; may sub-contract	

(continued)

Table 11.3 Functional capabilities of cut flower firms (continued)

Functional capabilities	Description of activities
Type 2: package contractor/assembler Product: roses, and or foliage/summer flowers (bouquets) Supplier tier: preferred supplier and may sub-contract; or niche supplier	Type 2 firms may be preferred suppliers to their buyers or they may be niche suppliers. For example, Dutch auction houses typically require a steady supply of high-volume and high-quality roses. In comparison, retailers may require specific products, such as bouquets, which require both roses as well as summer flowers/foilage. Some firms may supply both markets, or specialise in the supply of one rather than the other. We have specified these differences in Figure 11.1.
Type 3: full package provider Product: roses Supplier tier: strategic supplier; or niche supplier	Large multinational enterprises typically not only have their own nurseries integrated within their supply chains but also tend to be vertically integrated, taking care of production, packaging and logistics as cost, insurance and freight (c.i.f.) suppliers. This means the price invoiced or quoted by Type 3 firms includes insurance and all other charges up to the named port of destination, or named place (carriage and insurance paid, c.i.p.) in the country of destination such as a warehouse. A full package supplier carries out all steps involved in production; this includes the selection, purchasing and production of materials; the completion of production; and delivery of the finished product to the buyer – predominantly Dutch auction houses but they may also include supermarkets/retailers, as indicated in Figure 11.1. Type 3 firms may sub-contract Type 2 firms in order to fulfil their buyers' requirements.

Source: Field work and key informant interviews

Shifts in governance

There has been an increase in efforts to provide agricultural extension services to different regions across Kenya; this includes the provision of services provided by Kenya's Horticultural Crops Development Authority (HCDA) across all provinces. The HCDA was established in 1967 and grants licences to buyers and sellers of horticulture. More recently it has begun to provide support to growers and traders so that they do not need to resort to arbitration. It does this through, for example, witnessing contract signing. It therefore tries to foster relationships between small-scale growers and medium-sized firms in terms of adhering to best practice.

Although all buyers and sellers in Kenya must be registered with the HCDA, not all growers are registered with producer organisations such as the Kenya Flower Council (KFC), formed in 1996, or the Fresh Produce and Exporters Association of Kenya (FPEAK), formed in 1975. Both organisations are private initiatives designed to increase the lobbying power of the industry as well as improve co-ordination between firms in terms of learning about and sharing best practice, including in relation to certification issues. Both are self-regulating bodies.¹² Their members pay fees for industry representation, which includes market access issues.

Government intervention in the sector is likely to increase in the future as a result of the implementation of the Horticultural Bill, which is considered by most industry representatives to be a long time coming, given that the industry has developed for more than 20 years without an explicit policy. A horticultural development fund will be created; the HCDA will manage part of this fund, in addition to other public and private partners. The objective is to extend the coverage of the HCDA so that it has a representative body in each province of Kenya.

The lack of policy on the horticultural sector, despite its relative importance in generating employment and foreign exchange, is posited as being a result of the hypersensitivity of the industry (which is also very powerful) to government intervention. The increased attention of the government on the horticultural sector has, to some extent, been driven by external events, which are now also being brought to the fore by firms. These include a severe current account imbalance; the uncertainty surrounding EPA negotiations with the EU; and the concerns raised by some industry representatives regarding loss of competitiveness, particularly notable given initiatives launched by the Ethiopian government to promote the development of its cut flower sector, including attracting Kenyan investment.

In the absence of an explicit government policy specifically designed for the cut flower sector, the KFC has developed its own regulations and guidelines for the sector. The KFC is also an accredited certifier of a number of private voluntary standards. The new policy embodied in the Horticulture Bill is viewed positively by the KFC as providing some leverage for forcing the government to act to support the sector better. There are a total of approximately 120 growers of cut flowers in the sector, of which around 70 are members of the KFC. Although the KFC does not represent all registered growers,

it accounts for around 60–70 per cent of the volume of exports from the sector. Its members employ 90,000 individuals directly and around 500,000 indirectly in other types of services provision.

The reorganisation of the sector, as a result of mergers and acquisitions, has led to new concerns being raised by workers, including in relation to increases in workloads without commensurate increases in pay. The Horticulture Bill will include a minimum level for wages in the sector and provide for a wages council to effectively review levels in the sector. The inclusion of this is expected to mitigate claims made against the sector in relation to wage levels, particularly for entry-level workers, which are considered inadequate in relation to costs of living.

Although prompted by structural changes within the sector, the introduction of these new policy measures is also being brought about by changes in governance structures more generally within the current administration. There has been limited capacity to implement trade policy in Kenya effectively during recent years (see Were et al. 2010). The current ongoing governance reforms are two-fold. First, they entail devolution of power. Second, they also mean constitutional reform and the creation of an independent judiciary, etc. This is expected to result in the creation of a much more formidable civil service with the governance capabilities to both design and implement an effective trade strategy. This is particularly important given ongoing trade policy challenges related to EPA negotiations as well as to more recent upgrading challenges.

Overcoming other upgrading challenges: testing governance structures?

One limitation of interventions in the sector to date is that they have still not adequately addressed asymmetries in the trading relations that exist between producers and buyers within the cut flower GVC. One example is the fact that the certification processes undertaken by the KFC for quality standards are still not recognised as equivalent to the dominant standard used in auction houses in the Netherlands. This means that:

- producers in Kenya still have to cover the costs of audits undertaken by Dutch certifiers, in addition to those undertaken by the KFC;
- the resultant effect is an increase in costs for exporters;
- this reduces their relative competitiveness vis-à-vis Dutch producers; and
- moreover, it can also mean discretion over whether producers are certified or not.

A situation could therefore be said to be arising whereby donor efforts to reduce costs of certification and overcome other NTBs which prevent the ability of traders to access markets are being undertaken without due consideration of the actual requirements of the buyers.

These more recent challenges related to the effective participation of producers within GVCs show how these lie outside the direct control of governments.

A question therefore arises about how the KFC can achieve mutual recognition by auction houses in the Netherlands, which effectively operate as a private members' club. The most that the Kenyan government can do is to try to facilitate this process. This could provide a new role for AfT to assist in creating space for dialogue between producers and buyers, and would also require the creation of more effective public-private dialogue mechanisms.

Obtaining a more secure supplier position?

The evidence from stakeholder interviews and market share analysis suggests that only the largest firms (Type 3) have managed to move from being solely contractors towards directly supplying buyers and retailers. In both the UK and the Dutch market, Kenya has been able to increase its market share for cut flowers. The increase has been much more pronounced in the Dutch market than in the UK; in the Netherlands, Kenyan growers accounted for almost 50 per cent of supply in 2010, and 44 per cent in 2011, the latest year for which data are available. See data presented in Table 11.4. This increase in market share has been accompanied by an increase in unit values, which suggests that, over time, Kenyan firms may have also been upgrading their position, for example by selling higher-value products; this has also been accompanied by an increase in market share.

As discussed by Kaplinsky and Readman (2005) and Kaplinsky et al. (2009), use of unit values and market shares combined provides an indicator of relative upgrading performance by firms. The logic for this, as discussed by Kaplinsky et al. (2009), is that firms engaging in successful product innovation, whether minor alterations or more substantial changes in product design and performance, can expect to receive higher prices for their output. However, because higher prices may also reflect inefficiencies

Table 11.4 Kenya's market share in Dutch and UK markets for cut flowers

Year	Netherlands			UK		
	World (US\$000)	Kenya (US\$000)	Kenya share (%)	World (US\$000)	Kenya (US\$000)	Kenya share (%)
2000	424,589	92,541	21.8	542,297	34,738	6.4
2001	414,620	98,842	23.8	592,152	45,997	7.8
2002	440,177	116,954	26.6	799,913	53,098	6.6
2003	477,504	150,643	31.5	910,105	58,214	6.4
2004	497,672	178,058	35.8	978,245	84,433	8.6
2005	535,558	205,849	38.4	957,371	94,377	9.9
2006	590,737	246,812	41.8	1,004,890	99,621	9.9
2007	672,374	275,808	41.0	1,133,862	104,541	9.2
2008	821,100	337,324	41.1	1,056,847	132,813	12.6
2009	711,073	300,933	42.3	877,690	112,782	12.8
2010	634,123	295,811	46.6	935,360	85,985	9.2
2011	750,498	329,893	44.0	1,006,189	94,275	9.4

Data reported by Netherlands/UK, based on product code 0603, cut flowers and flower buds

Source: UN COMTRADE database, downloaded 4 January 2013

in production, suggesting a decline in innovative performance, this suggests that an indicator of cost competitiveness is also needed, and for this reason market shares are used.

Although the combined results of analysis of unit values and market shares may be viewed positively, a note of caution is urged within this discussion since, although some firms may have been able to obtain a more secure supplier position, these firms have been identified as those belonging to the Type 3 category as indicated in Figure 11.1. The ability of *all* firms to obtain a more secure supplier position would therefore appear to be rather limited.

Overall it could be said that there is some evidence that some Kenyan firms are moving towards a position of a full package supplier (as defined in Figure 11.1). However, this is not the case for the small and medium-sized firms identified in Figure 11.1. These are the same firms that may also face increased costs in the Dutch market because of the inability of the KFC to obtain mutual recognition of the standards its producers adhere to and those demanded in Dutch auction houses, because the latter are not directly owned but have rather more indirect relations with buyers in their end markets. This barrier to entry could hinder growth for this category of firms; moreover, it could ensure that the productive structure in Kenya remains relatively polarised between very large growers and small growers, with medium-sized firms either reducing in size or being consolidated into larger firms (although much more evidence is needed to substantiate this hypothesis).

11.5 Conclusions

This chapter has shown how the evolution of the cut flower GVC has affected the participation and engagement of producers with this type of trade, which operates within a hierarchical structure of governance with highly consolidated marketing and retailing nodes. It has argued that some of the more recent challenges for some types of producers require a greater consideration of power asymmetries between firms.

In a globalising world where GVCs are increasingly important, the ability to shift goods in and out is essential to a country's competitiveness, and infrastructure and low tariffs matter. However, the cut-flower industry also faces a set of NTBs, such as the need to satisfy stringent private sector standards in Dutch auction houses. We can therefore see a situation arising where donor efforts to reduce costs of certification and overcome other NTBs, which can prevent traders from accessing external markets, are being undertaken without necessarily considering the need to also influence the private relations that exist between firms operating within GVCs. The reasons for this are rather unclear.

A question arises, therefore, about how the KFC can achieve the recognition of its standards by Dutch auction houses (which effectively operate as a private members' club). In effect, these auction houses can set whatever standards they want and so it is up to the KFC to reach an agreement with them. This could provide a new role for AfT. Such an approach might help not only to resolve some of the governance issues that exist between firms and buyers, but also to ensure that such firms are better able

to influence the external governance structures within which they trade. Although the Kenyan cut flower GVC has been in operation for a considerable amount of time, as has been shown in this chapter, only some types of firms have been able to obtain a more secure supplier position over time.

Notes

- 1 This chapter is adapted from a larger programme of work funded by the Gates Foundation which assesses the role of Aid for Trade in assisting producers integrate with global value chains and reducing food insecurity. The author is grateful for the constructive comments provide by Sheila Page, Senior Research Associate, Overseas Development Institute (ODI), and assistance with trade data by Jane Kennan, Research Officer, ODI.
- 2 This section draws on Keane (2012, forthcoming).
- 3 These include other external governance structures such as mandatory standards that producers must legally adhere to in order to access markets.
- 4 This section draws on Keane (2012, forthcoming).
- 5 This section is adapted in parts from Ellis and Keane (2008).
- 6 The protocol defines the elements of good agricultural practices (GAP) and includes standards for integrated crop management (ICM), integrated pest control (IPC), quality management system (QMS), hazard analysis and critical control points (HACCP), worker health, safety, welfare and environmental pollution, and conservation management.
- 7 See Ellis and Keane (2008) for further information.
- 8 According to estimates by the Kenya Flower Council.
- 9 The current stock of investment in the horticulture sector is in the region of 650–750 billion shillings according to estimates by the Horticultural Crops Development Authority.
- 10 This has also been the case with exports of cut flowers, which have recovered since a reduction in demand was felt immediately after the start of the global financial crisis.
- 11 Historically, the horticultural sector has always resided within a relatively tight-knit community of a select number of large-scale growers, many with strong contacts in industry in end markets. A number of the largest firms/farms around Lake Navaisha were previously owned by former prime ministers (Kenyatta and Moi), who took over the most productive land left by colonialists.
- 12 The Chief Executive of the KFC is also the managing director of one of the largest cut flower firms in Kenya (Findlays).

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Chapter 12

Aid for Trade and Infrastructure Development for Agriculture

Marie-Agnes Jouanjean

12.1 Introduction

Agriculture constitutes an important part of most low-income countries' economies, and is generally the primary source of income in rural areas, directly through crop production, and indirectly through on-farm and off-farm employment in agriculture-related industries (Haggblade et al. 1989; Reardon et al. 1998).

The issue of the importance of improving rural infrastructure, and in particular rural roads, is not new in the development community. It is a topic that has long been at the centre of development policy and research; development theorists commonly used to assume that remote areas' disadvantageous position vis-à-vis economic opportunity and social welfare could be remedied with road building (Bryceson et al. 2008).

Investments in rural infrastructure were considered to have important positive effects on agricultural production and trade, and governments and donors invested heavily in the development of rural roads and transport corridors. Yet – perhaps because the importance of such infrastructure for development seemed so obvious – there has for some time been little formal evidence on how and under what conditions roads benefited rural households and agricultural development. By the end of the twentieth century various studies nonetheless showed that the causality between road building and rural development should be more nuanced. The World Bank 1994 *World Development Report* on infrastructure for development highlighted that focusing solely on increasing the quantity of installations was not adequate: more should be done on the quality and efficiency of related services.

Over time an increasing amount of analysis looking at the impact of road construction argued that the simple construction of paved roads did not prove to be enough to foster poverty alleviation in many instances, and that road provision is only part of a wider issue of high transaction costs, market access and inclusion. For instance, in an analysis of the impact of rural roads in Nepal, Jacoby (2000) provides evidence of the effective distributional effect of rural roads, as farmers in remote areas are typically poorer than those in less isolated areas. Although he highlights that, in general, decision makers did not sufficiently target the construction of rural roads in a way that would have supported a reduction in population spatial inequality, he also acknowledges that 'rural road construction is certainly not the magic bullet for poverty alleviation' (Jacoby 2000: 735).

At the beginning of the twenty-first century, the Millennium Development Goals (MDGs) gave more importance to social development projects. The issue of infrastructure development resurfaced in the development agenda and poverty debate with the Aid for Trade (AfT) initiative, but against a different background. The question of developing countries' access to developed markets for agricultural and food products focused for a long time on efforts to reduce traditional barriers to trade, including tariffs and quantitative restrictions. In the debate over trade liberalisation and development, part of the discussion of developing countries' agricultural exports to developed countries' markets switched from tariff issues to the building of effective export capacities, as participants recognised the importance of supply-side constraints for some countries, which prevented them from take advantage of trade liberalisation. For these, the main question was therefore how to relieve those constraints and to provide developing countries' producers with more opportunities to connect with the regional and international market. As Hoekman and Njinkeu (2010: 1) say: 'Market access – which assumes center stage in bilateral and multilateral trade relations and negotiations – is a necessary but insufficient condition for harnessing trade for development. To exploit access to export markets, firms and traders must be able to offer a competitive product.' Trade-related infrastructure is one of the four AfT categories of support – as defined by the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO) – along with technical assistance for trade policy and regulations, productive capacity building (including trade development) and trade-related adjustment.

According to new international trade theories based on the assumption of firm heterogeneity, a country's capacity to engage in trade relies on various elements, including, as usual, fixed and variable costs to trade, but also firms' productivity. Accordingly, all other things being equal, only the more productive firms, meaning firms producing at the lower variable costs, can export. However, variations of those models also highlight the importance of quality to the capacity to export specific goods, even if quality means higher costs of production and prices. Although international trade models adopting a quality definition of competitiveness were long considered relevant only for manufactured goods, evidence shows that quality also matters for the capacity to export agricultural products (Jouanjean 2012a).

Since the emergence of the AfT agenda, and along with the changes in the patterns of trade and the further fragmentation of global production, the understanding of the potential scope of AfT has evolved, with the latest debates suggesting a move towards the specific question of developing-country producers' inclusion in global value chains with the final objective of increasing the 'value for trade'.¹

The AfT agenda stimulated the production of new analyses of the effect of rural infrastructure, taking a more systemic approach that emphasises the indispensable complementarity of soft infrastructure.

As highlighted by Ulimwengu et al. (2009), achieving agricultural growth requires both investments *for* agriculture, which includes investments in rural roads, and investments *in* agriculture, such as research and development, extension services,

irrigation projects and input distribution policies. Hard infrastructure – roads, energy and communication infrastructure – facilitates spatial integration of product and factor markets, in both the agricultural and non-agricultural sectors. By lowering the transactions costs of market exchange they can boost net returns to agricultural production. Better market connections increase the availability of inputs (improved seeds, fertilisers and pesticides) and agricultural extension services, all of which are likely to increase agricultural productivity and, consequently, welfare. The increase in physical and informational connections reduces transaction costs caused by information asymmetry at all stages of production from the supply of inputs to the negotiation of prices.

Various studies (among others, Hettige 2006; Cadot et al. 2010; Porto et al. 2011) also highlighted the importance of tackling governance and policy issues in order to reduce transaction costs. These are often inflated by monopoly and cartels in transport services (for examples in Madagascar and West Africa, see USAID 2011; World Bank 2012) and irregular payments at roadblocks. To highlight the underlying difference in approach from previous analyses, some of the literature refers to the issue of high transport prices, rather than transport costs, in order to differentiate the impact of market structure from the underlying ‘physical’ cost incurred by operators on the final price of transporting goods. In general, analysis of rural economic infrastructure, and in particular roads, is now focusing more on the systemic inefficiencies arising from transport infrastructure and services (USAID 2011; Raballand and Macchi 2008), and therefore on the key intermediate logistical infrastructures.

The provision of soft infrastructure is key to the reduction of costs but also to the provision of high-quality products. The lack of competition in transport-related services results not only in high transport costs but also in poor services (Porto *et al.* 2011). Access to information on production technologies, quality, and sanitary and phytosanitary (SPS) requirements and to inspection infrastructures is crucial for sustainable productivity increase, but also for inclusion in sophisticated domestic or global value chains. For instance, getting access to the horticultural global value chain requires access to knowledge about good agricultural practices, standards and SPS regulations, knowledge of post-harvest management practices, and infrastructure such as cold storage facilities.

This chapter is an analytical overview of recent literature that provides evidence on the effect of investment in rural infrastructure on market access, trade and, in particular, agricultural trade, and on conditions and complementarities pertaining to maximising the benefit to agricultural development and poverty reduction. It gathers evidence suggesting that investments in hard infrastructure (roads, communication and energy supply) are necessary but are not sufficient for successful market integration. Investments in rural infrastructure should be addressed in terms of a more holistic approach, and should consider complementarities between hard and soft – otherwise called logistic – kinds of infrastructure (in this overview: transport-, extension- and standards-related services), rather than addressing topics in silos. This overview is organised in two main sections. The first addresses the issue of the supply of hard

infrastructure, and in particular roads, and its importance for market integration, development and trade in agriculture from both a macro and a micro perspective. The second part looks at soft infrastructure, here defined as key value chain logistical infrastructures, and looks more specifically at transport, extension and standards-related services.

12.2 Hard infrastructure: on the importance of roads for development and trade in agriculture

12.2.1 Impact of infrastructure on trade: evidence at the regional and international scales

If the role of infrastructure for trade development has been extensively discussed in policy-oriented descriptive analysis, it has been addressed much less in the evidence-based formal literature. Studies on the impact of infrastructure have focused on the effect at the micro level, looking at the impact on income, whether from on- or off-farm new income opportunities. However, some more recent studies have tried to highlight the impact of infrastructure development at a more aggregated level, looking at the impact on regional and international trade of goods, or sometimes more specifically on trade in agriculture products. One impediment to such quantitative analysis is the interactive nature of various types of infrastructure (Bouët et al. 2008). Moreover, no theoretical model provides the basis for this type of interaction between infrastructure and trade. Therefore, when pursuing quantitative analysis, care should be taken to identify the real effect of infrastructure on trade.

Nevertheless, Limão and Venables (1999) find that a drop of 10 per cent in transport costs for landlocked African countries would increase the volume of international trade by as much as 25 per cent. To circumvent the interactive nature of infrastructure, Bouët et al. (2008) use a semi-parametric variant of a gravity equation, the workhorse model of international trade, allowing for unknown, non-linear impacts of infrastructure on trade, and complementarity among several types of infrastructure. They show that poor transport and communication infrastructure accounts for most of Africa's under-trading. Moreover, investments in infrastructure are likely to have a much greater impact if transport and communication infrastructure development are taken jointly. Moïsé et al. (2013) also use a gravity model approach to look at the constraints to trade in agriculture. Their analysis gives further evidence of the importance of quality of transport and trade-related infrastructure for developing countries' exports of agricultural products.

In a study on regional agricultural transport and trade policy, USAID (2011) studies transport costs of cereals in Western Africa. Making use of cereal isoprice maps, it provides evidence of steep price gradients along trade corridors in ECOWAS, indicating the weak linkages between key surplus and deficit markets in the region. According to its analysis, the causes of such weak linkages are constraints to efficient transport along the corridors. More specifically, the analysis shows that the transport and logistical costs of movement of both maize and livestock along key trading corridors between Burkina Faso, Ghana and Benin account for

approximately 59 per cent and 18 per cent of the respective end market prices. Of these, transport costs – that is fees paid to transport-service operators as well as losses in transit – were found to weigh most heavily on the end market price along the corridors studied.

These recent trade analyses use econometric analysis and new indicators to confirm the importance of improving infrastructure as a step to trade integration. However, they also show that the link between trade development and infrastructure goes beyond the provision of roads.

12.2.2 Bring the market to the poor or the poor to the market? Impact of roads on local market development

A supply perspective: the effect of investment in hard infrastructure on market development

Whereas most of the literature looks at the incidence of infrastructure development on the reduction of travel costs to existing markets and institutions, some analyses introduce the possibility that better transport infrastructure could also improve access to markets through inducing relocation of markets and institutions.

According to Hettige (2006), evaluating a rural road investment in Yogyakarta, Indonesia, improved roads and the increased ability to transport goods provided opportunities for those with skills and/or savings to invest in small businesses and small stores in the village, or sometimes to become intermediaries, selling the village's products to nearby market centres. Among project respondents, 64 per cent observed that the number of small businesses in the community had increased since the road was built or rehabilitated. Of the 17 per cent of project respondents who had started a business since road rehabilitation, 69 per cent declared that the road was a factor in their decision to start a business. Furthermore, 54 per cent of households declared that more buyers visited the community than five years before the project, compared with 36 per cent of the control households.

It has usually been the case that, on the ground that rates of returns would be higher there, infrastructure project designers have targeted regions that are already well endowed and have the market institutions necessary to foster further economic development. Mu and van de Walle (2009) ask if, on the contrary, development institutions should focus their resources on areas without such attributes. Referring to the economic geography literature and to literature analysing social development and institutional arrangements in missing market environments (for instance Fafchamps and Minten 1999), they underline the theoretical ambiguity of the impact of better roads on local markets. Indeed, the literature reports a multiplicity of initial conditions that could either encourage the development of local markets or reinforce the importance of established markets. Mu and van de Walle provide evidence from Vietnam and show that, on average, rural road rehabilitations have an impact on the development of local markets through the development of off-farm, mostly service-related, activities. Furthermore, because those areas present more scope for road improvements to help develop markets, market-related institutions and services, their

analysis provides evidence of a larger impact on the poorer communes of their sample. However, other attributes of poor areas – such as poor agro-climatic endowments, a high share of ethnic minorities, high illiteracy rates and less well-functioning credit and other markets – which usually correlate with a higher level of isolation as well as lower population density, tend to work in opposite directions and will clearly mediate impacts of road improvements across communities. Therefore, their analyses do not completely depart from previously mentioned assumptions about the importance of local and human capital on the impact of road improvement. However, at least in the regions of Vietnam which they examined, the high potential return because of the low initial market development was strong enough to outweigh the effect of such attributes.

A demand perspective: transport and transaction costs and the impact of infrastructure on smallholders' market participation decisions

If previously mentioned studies analyse the supply perspective of infrastructure by looking at their impact on market creation, Cadot et al. (2010) and Azam et al. (2012) analyse the demand side by looking at the determinants and causal factors behind farmers' decision to participate in the market instead of adopting a subsistence strategy. The transition from low-productivity, semi-subsistence agriculture to high-productivity, commercialised agriculture has been a core theme of development and agricultural economics for more than two centuries. A large volume of literature looking at farm households emphasises the importance of transaction costs and the institutional environment in households' decisions to participate to markets (for example Key et al. 2000; Vakis et al. 2003; Kydd and Dorward 2004; Poulton et al. 2006; Barrett 2008).

There is evidence that some households in developing countries have seized on emerging opportunities for more remunerative, market-oriented production, often coupled with technological progress and improvements in institutional and physical infrastructure (Kherallah et al 2000; Minten et al. 2007). However, Barrett (1998) and Reardon et al. (1999) show that, in some places, there has been persistence of, and even some level of retreat into, subsistence agriculture, suggesting that there can be multiple equilibria. Such multiple market participation equilibria commonly arise as a result of the fixed costs of investment combined with missing markets and co-ordination failures that hamper households. Barrett and Swallow (2006) find that households with access to adequate assets and infrastructure, and faced with appropriate incentives, engage actively in markets, whereas households that lack one or more of those three essential ingredients – assets, infrastructure and incentives – do not.

Broadly, this literature looking at farmers' decisions to participate in the market finds that differences in transaction costs, as well as differential access to assets and services to mitigate these transaction costs, are possible factors underlying heterogeneous market participation among smallholders. Key et al. (2000) differentiate fixed and variable transaction costs. Fixed transaction costs relate to the cost of searching and screening for the best business partner and the cost of negotiating and implementing a contract,

as well as its follow-up and execution. The agent bears these costs in order to reduce the risk of transaction failure. Such costs are particularly high in situations of asymmetric information. According to the Peruvian survey used by Vakis et al. (2003), costs related to searching, matching and bargaining are important variables in a farmer's decision to participate in the market. The World Development Report (World Bank 2008: ch. 5) mentions a number of initiatives to improve the spread of agricultural information by means of radios, mobile phones and other media. Evidence shows that investment in mobile phones has had an important impact on the reduction of such fixed transaction costs, and therefore in reducing the barriers preventing farmers from taking up market opportunities. Better access to roads, if it gives access to markets, reduces information asymmetry about input quality and prices as well as output prices. Such costs are not directly related to the volume traded, and therefore represent a larger constraint to small producers. Variable transaction costs, which the provision of roads should reduce, represent the unit cost of transferring the product to or from the market.

12.2.3 Which types of infrastructure for which impacts: market access, agricultural productivity and poverty reduction

In addition to reducing the cost of acquiring inputs, better access to markets reduces the impact of shocks and provides new opportunities for more profitable on- or off-farm activities. Many theoretical and empirical papers in the development literature have addressed the issue of transportation and transaction costs, in particular the link between market access and poverty, and more generally the impact of roads and infrastructure on development dynamics (among others, Platteau 1996; Fan and Hazell 2001; Fan 2008). Some have demonstrated that roads encourage agricultural development; for example Van de Walle (2002) and Ulimwengu et al. (2009).

Various studies from the end of the twentieth century and the beginning of the twenty-first argued that, despite a consensus on the importance of rural roads for development (Gannon and Liu 1997), there was very little evaluation of the extent of this impact. Indeed, the limitation relative to the evaluation of impacts at the micro level is the same as at a more aggregate level. Difficulties inherent in estimating the magnitude of the effects are attributable to infrastructure because much infrastructural development is endogenous. Road investments are often targeted, making it difficult to isolate causal impacts from placement effects. Also, it is often difficult to accurately capture the impacts on a diffuse beneficiary group as well as to account for substantial differences in road quality. Nevertheless, an increasing number of evaluations using various household surveys and other indicators provide evidence on the size and nature of the benefits of roads and on the factors affecting the relationship. Among others, Gannon and Liu (1997), Escobal and Ponce (2004), Lokshin and Yemtsov (2005), Dercon et al. (2008) and Khandker et al. (2009) provide evidence about the positive welfare effect of rural roads. Rural roads, reducing transport costs and prices, may allow farmers in remote and often poor rural areas to get higher prices for their output, and/or reduce the prices they face for inputs and consumer goods.

In a study in Indonesia, Kwon (2001) shows that a 1 per cent increase in road investments is associated with a 0.3 per cent decrease in incidence of poverty. In their

paper ‘Geographic poverty traps?’, Jalan and Ravallion (2002) found that road density was one of the significant determinants of household-level prospects of escaping poverty in rural China: for every 1 per cent increase in kilometre of roads per capita in poor regions in China, household consumption rises by 0.08 per cent. Dercon et al. (2008), drawing from previous analysis (Dercon 2004, 2006), examine the impact of roads on poverty reduction in Ethiopia. They find that access to all-weather roads or good-quality roads – defined as roads capable of supporting (i) truck traffic, and therefore trade, and (ii) bus traffic, facilitating the movement of people during all seasons – increases consumption growth by 16.3 per cent and reduces the incidence of poverty by 6.9 per cent. Dillon et al. (2011) provide evidence about the welfare-improving effects on households of rural investments in roads in Nepal as measured by land values, consumption growth, poverty reduction or agricultural income growth. An advantage of this approach is that it can form the basis of benefit–cost ratios and thus allow researchers to compare investments in infrastructure with other forms of public spending.

Other analyses look more specifically at agricultural production and productivity. Fan et al. (2000) relate country- or regional-level public expenditure data to changes in agricultural productivity. The advantage of this approach is that it allows researchers to compare investments in infrastructure with other forms of public spending. They find that, in rural India, public investment in rural roads had the largest positive impact on agricultural productivity growth. Other analyses based on household data about the effect of road connectivity on input use, crop output and household income, such as those by Chamberlin et al. (2007) in Ethiopia and Stifel and Minten (2008) in Madagascar, suggest that isolation, defined as travel time during the dry season from the commune centre to the nearest urban centre, implies lower agricultural productivity, increased transport and transaction costs, increased insecurity and a reduction in per capita consumption. In other words, they find a relationship between isolation, poverty and agricultural productivity at the household level; Stifel and Minten observe that distance to a passable road and the cost of transporting rice significantly decrease the use of fertiliser in rice production. Controlling for soil fertility, and therefore for the non-random placement of roads, they demonstrate that crop yields for the three major staples in Madagascar, rice, maize and cassava, are lower in isolated areas than in areas that are not isolated. However, as highlighted by Dercon et al. (2008), these approaches do not tell which component of infrastructure spending generates these benefits. Moreover, Raballand et al. (2010) believe that, even if many of these analyses use sophisticated econometric analysis, many still share severe limitations in not dealing with the endogeneity bias in the poverty equation. They argue that road placement appears to be non-random, i.e. that roads might be constructed in already more productive areas.

Using geographic information systems (GIS), Ulimwengu et al. (2009) and Dorosh et al. (2010) look at the link between road connectivity and agricultural production in the Democratic Republic of Congo and sub-Saharan Africa. They estimate the long-run relationship between market access and agricultural production. Although the results are much less emphatic in the former paper, both analyses show that agricultural production is highly correlated with proximity to urban markets as measured by travel

time, not physical distance to the market. In other words, reducing travel time to major cities has significant effects on agricultural productivity in sub-Saharan Africa.

Renkow et al. (2004) develop a conceptual framework for quantifying fixed transaction costs facing semi-subsistence maize farmers in Kenya. Their analysis shows that, on average, households they analysed face fixed transaction costs that are equivalent to a 28 per cent *ad valorem* tax and that both remoteness and infrastructure quality have significant impacts on transaction costs. More importantly, if transaction costs are higher for poor households, the authors believe that public investment in infrastructure to lower transaction costs is more likely to increase the welfare of households already participating in input and output markets rather than to change the situation of autarkic households. Therefore, they conclude that, for public investment in infrastructure to provide direct support to the poor, it needs to be specifically targeted towards supporting autarkic households.

Where and how to better allocate investments in infrastructure is discussed by Fan and Chan-Kang (2005), Fan et al. (2000), Fan and Hazell (2001) and Fan et al. (2002). Their conclusion is that donors' investments should be directed to the construction and maintenance of rural, low-quality roads and not to roads for trucks, which they consider irrelevant to coping with the issue of rural poverty. They note that the predominant view is that, even though investing in what they define as less-favoured or low-potential rain-fed areas might have a greater impact on the poor living in those areas, social returns were the highest for investments in irrigated and high-potential rain-fed lands. One popular hypothesis is also that benefits are highly dependent on local human capital endowments necessary to take advantage of the opportunities provided by new roads. Fan and Hazell (2001) look at both India and China, two countries that have biased their past public investments towards high-potential areas. Although it allowed both countries to achieve large productivity gains in those specific high-potential areas, less-favoured areas are still lagging behind. Fan and Chan-Kang (2005) investigate the cost-benefit ratio for GDP of investment in low-quality (mostly rural) roads versus high-quality roads. They find that the former is about four times as much as than the latter. Moreover, they show that, whereas high-quality roads do not have a statistically significant impact on agricultural GDP, low-quality roads generate as much as 1.57 yuan of agricultural GDP for every yuan invested. Finally, they find that investments in low-quality roads have a much larger impact on poverty rates per yuan invested than high-quality roads.

A related question is whether infrastructure investments should focus on a 'transport corridors' development strategy or on a 'rural feeder road' strategy. There is a consensus in the literature that investments in corridors do not have large effects on smallholders and agricultural production. Rather, as reported by Byiers (2013) in a study of corridors in Tanzania and Mozambique, they are most likely to be 'corridors of power', benefiting relatively few, rather than 'corridors of plenty', with 90 per cent of smallholders likely to be left out of value chains. Byiers (2013) concludes that smallholders should be provided with additional opportunities and support to benefit from corridors by linking those large infrastructure developments with the upgrading of feeder roads and storage facilities.

Van de Walle (2002) and Mu and van de Walle (2011) also examine how rural road investment projects should be selected when the specific objective is taken to be poverty reduction. A second issue relating to the appraisal of the benefits to investment in rural infrastructures is that a sizable share of the benefits cannot be measured in monetary terms to be aggregated consistently with monetary measures of other benefits and costs. The acknowledgement of this issue by development institutions led them to adopt hybrid road investments appraisal methods combining the usual cost–benefit methods with cost-effectiveness calculation. Mu and van de Walle (2011) look more specifically at the determinants – geographical, community and household factors – explaining the variance of the impact of rural road rehabilitation on market development in rural Vietnam. On average, they confirm the significant impact of such projects on rural communities and on the development of rural markets, but they also show that impacts are significantly higher for poorer communes as a result of lower levels of initial market development.

Uganda has a low level of physical infrastructure and public services, with more than three-quarters of its population living two or more hours from any market centre. The impact of such poor infrastructure development on agriculture has been extensively addressed by various recent analyses. Gollin and Rogerson (2010) look at the relationship between high transport costs and low productivity of the agricultural sector and between transport costs and the size of the quasi-subsistence sector, and they provide detailed information about the scale of transport costs in Uganda. They find that the high variation of prices across space reflects the underlying transport costs preventing any arbitrage between regions. Their analysis is supported by a study conducted by the Government of Uganda's Plan for the Modernization of Agriculture, which estimates transport costs or distributional costs² associated with moving food from rural to urban areas. With a farm gate price between US\$50/kg and US\$65/kg for maize, transport from farm gate to primary market was estimated at US\$10/kg, with an additional US\$5/kg to US\$10/kg for further transport to secondary markets. The cost of logistic services was estimated to add around US\$10/kg. Finally, adding other transportation costs in order to reach urban markets, the pure transport cost of moving maize to wholesale markets was estimated as US\$55/kg, about the same as the farm gate price. Comparing a matching situation in the USA, Gollin and Rogerson (2010) estimate that the implied unit transport cost in Uganda is about seven times the cost in the United States. Finally, using a static general equilibrium model to test various scenarios of changes in policies and interventions, they show that the welfare gains of an improvement in agricultural total factor productivity (TFC) along with a reduction in transportation costs exceed those achieved from the two interventions separately. They conclude that this result suggests an interaction effect between the two interventions.

12.2.4 Evidence of the impact of roads infrastructure on changes in agricultural technology

Woelcke (2006) presents an analysis of Uganda's Lake Victoria Crescent region, in which agricultural production was characterised by low input–output systems even though

the region presented comparative advantages for intensive agricultural production: high agricultural potential, high market access and high population density. His analysis finds that farm households would not pursue sustainable intensification under current socio-economic conditions: high transaction costs, including transport costs, imperfect credit market, no agricultural services (extension and ancillary services) and no economic incentives for the adoption of environmentally sound production methods. The consequence was a lack of dynamism in agricultural production in the region despite its seeming potential; in fact, productivity in the agricultural sector in Uganda had either stagnated or declined (APSEC 2000).

The literature mentions many other case studies relating the effect of the reduction of transaction costs on change in agricultural production technology and, in particular, on better agricultural practice and management of natural resources leading to increased agricultural productivity. Dercon and Hoddinott (2005) provide evidence that improvement in road quality increases the likelihood of purchasing inputs by 29 per cent to 35 per cent according to the season. Nkonya et al. (2011) find that, by reducing transaction costs and linking farmers to the market, rural services – rural roads, extension services, communication infrastructure, markets etc. – increase the returns to investment and, as a consequence, influence farmers' decisions to adopt and invest in better land management technologies. They mention the example of improved access to roads and markets in Machakos, Kenya, which led land users to increase investments in soil erosion prevention methods, thereby increasing agricultural productivity. The same holds in Uganda, where Okoboi and Barungi (2012) show that low access to credit and constrained access to input and output markets due to distance are key constraints on fertiliser use.

In Nigeria, small-scale private irrigation (SPRI) schemes have been popular among farmers. They multiply by ten the average irrigated surface compared with the traditional irrigation devices and fill in the labour gap associated with the ageing of farmers, which is becoming a serious issue in Nigeria, compounded by rapid out-migration from rural communities. However, the pace of adopting irrigation pumps is low relative to their potential. Takeshima et al. (2010) show that transaction costs, defined by farmers as the cost of identifying sellers, making certain of the pump's quality, and the time and transportation costs for purchasing it, are an important impediment to the adoption of SPRI. In comparison with pure transport costs and prices, such transaction costs are unobservable, difficult to quantify and therefore difficult to include in cost–benefit analysis of infrastructure investment. Moreover, investment in SPRI often comes along with investment in whole packages of complementary inputs (farmland, water, improved seeds, fertiliser, fuel and electricity), further increasing potential sources of transaction costs and the complexity of their estimation. Hence, investment in irrigation pumps may also be limited by low output price and little access to complementary inputs. More interestingly, although Takeshima et al. (2010), like other researchers looking at farmers' investment decisions in environments of high transaction risks, find that household characteristics affect the level of those transaction costs directly related to the action of investing in irrigation pumps; they nonetheless emphasise that those characteristics may not affect the expected profitability once the investment

has been made. This suggests that large agricultural productivity increases have been forgone in Nigeria as a result of the single transaction costs for purchasing irrigation pumps.

12.3 Soft infrastructure: key intermediate logistical infrastructures

This section provides evidence of the importance of investment in logistical infrastructure to maximising the benefice of investments in hard infrastructure. It covers four types of logistical infrastructure identified as key to the competitiveness of agricultural value chains: competition in transport services, provision of agricultural extension services, storage capacity, and sanitary and phytosanitary (SPS) institutions including inspection infrastructures.

12.3.1 Competition in transport services

The Asian Development Bank (ADB) Operations Evaluation Department (Hettige 2006) conducted an analysis based on case studies of road improvement with the objective of understanding when and how rural roads benefit the poor. It questions the assumption according to which investment in roads should spontaneously leads to the provision of transport services by the private sector, so that the increase in competition rapidly leads to cheaper and better transport. Their case studies do not provide evidence of a straightforward relationship among rural road investment, transport services development and competition. In each case study, investments in rural roads decreased travel time and led to the emergence of a variety of transport modes, but increases in transport volume and decreases in fares occurred only when there was competition among transport providers. Therefore, competition seems a critical precondition for transport services' development and accessibility to the poorest.

Moser et al. (2005), Raballand and Macchi (2008), Teravaninthorn and Raballand (2009), Raballand et al. (2010), USAID (2011) and Porto et al. (2011) confirm this analysis and show that, in Africa, transport costs are not necessarily excessively high, but rather the lack of competition and regulation in the trucking services increases transport prices.

In Madagascar, Moser et al. (2005) analyse the spatial integration of rice markets to identify some of the factors that explain the observed considerable forgone arbitrage opportunities leading to poor price transmission and price equalisation within the country. Their analysis shows that reducing transportation costs is necessary, but not sufficient, for a better integration of markets at the national level. For 63 per cent of *communes*, trade at the regional level appears profitable but the lack of competition allows excess rents to persist. Therefore, policies intended to improve the performance of food markets should focus not only on reducing market pure transport costs through main trunk road improvements, but also on competition policies.

Teravaninthorn and Raballand (2009), reviewing the international corridors in Africa, find that the transport of freight between Sahelian countries and their ports – and thus the world market – features prices that significantly exceed the underlying

costs. Their analysis suggests that most of this situation is due to rent-seeking road-transport cartels benefiting from oligopolies. Of particular concern is that the trucking industry in West and Central Africa is characterised by cartels offering high prices and low service quality. East Africa's competitive market environment seems more mature but degraded by fuel prices and border controls. Therefore, they conclude that poor condition of the road infrastructure may not be the most critical factor behind transport prices and that much of the transport price burden along African corridors therefore seems to depend on the political economy of freight logistics.

However, Raballand et al. (2010) highlight that a one-size-fits-all approach to the development of roads and transport services is irrelevant. They argue that the level of production influences which policies will be most effective: because of high risk and low returns, low agricultural production means low competition between truckers. Truckers need to cover their marginal costs, which in low-production areas can already be difficult for a single trucker.

12.3.2 Extension services

Technological change, adoption of inputs such as organic and non-organic fertilisers, new agricultural and resource management practices, and use of improved seeds can sustainably increase agricultural productivity. Technological change therefore plays a pivotal role in rural poverty reduction. Agricultural extension services can inform farmers of new agricultural technologies, advise them on best agricultural practices and help them deal with adverse shocks such as insect infestation or plant disease (Dercon et al. 2008). The ADB analysis of various case studies (Hettige 2006) shows that the construction of a farm road near Yogyakarta in Indonesia helped extension officers to achieve more efficient coverage of their areas of responsibility and to deliver more regular and reliable service. Before the project, basic and extension services from the government did not seem to be reaching farmers. Agricultural extension services rarely came to the village because transport was unavailable. Roads and communication infrastructures are essential to the development and efficiency of extension and ancillary services. However, as the ADB evaluation highlights, those services are also essential for farmers and, in particular, poorer smallholders to take full advantage of new opportunities created by the development of roads.

Okoboi and Barungi (2012) look at the constraints on fertiliser use in Uganda. Declining soil fertility is one important factor in low productivity of agricultural production in Uganda. Their analysis shows that, in addition to credit constraints and distance to the market, the constraints that most limit the adoption of both organic and inorganic fertilisers are the lack of knowledge about their use and the lack of market information because access to fertiliser-specific extension services is limited.

Focusing on three resettlement areas of rural Zimbabwe, Owens et al. (2001) find that access to agricultural extension services – defined as receiving one or two visits per agricultural year – raises the value of crop production by about 15 per cent.

Finally, Dercon et al. (2008) wrote one of the first papers providing empirical evidence of the direct impact of extension services on poverty in a developing country. Their

analysis looks at whether or not public investments in road quality and increased access to agricultural extension services led to faster consumption growth and lower rates of poverty in 15 rural villages in Ethiopia. They find that receiving at least one extension visit increases consumption growth by 7.1 per cent and reduces poverty incidence by nearly 10 per cent.

12.3.3 Storage capacity

Post-harvest management capacity is an issue in developing countries. About 25 per cent of food production is estimated to be left to rot in fields because of the lack of labour capacity to harvest and the lack of storage infrastructures. Such storage infrastructures allow perishable products to be preserved better, and give farmers an opportunity for time arbitrage for less perishable products.

Basavaraja et al. (2007) note that ‘agricultural commodities produced on the farm fields have to undergo a series of operations such as harvesting, threshing, winnowing, bagging, transportation, storage, processing and exchange before they reach the consumer, and there are appreciable losses in crop output at all these stages’. Reducing losses at each of those stages is, therefore, critical. Better post-harvest management technologies and infrastructure are crucial to the increase in effective – as effectively consumed – agricultural production. They are important tools for increased food security as well as for better market integration. They not only allow time arbitrage but also increase product quality.

USAID (2011) conducted a series of analyses on trade and agribusiness competitiveness in Western Africa (Schacht 2010). They highlight that generally improving agricultural productivity, storage life and product quality are among the top priorities of the agricultural value chain actors. Within ECOWAS member states, USAID (2011) mentions the existence of a demand from producers and traders for better storage and warehousing of cereals as well for the establishment of regional quality standards for cereals, to promote trade.

Indeed, their analysis finds significant inefficiencies in trade arising from post-harvest handling and storage practices. In the country analysed, it appears that high post-harvest losses are related to spoilage due to the shortage of cold and dry storage facilities, as well as to low-quality packing and inefficient handling and transport. For maize, they estimate direct transport costs at US\$81 per metric ton (MT), but product losses due to storage and handling problems between the farm and the end market are estimated at \$79 per MT. More generally, Schacht (2010) estimates that poor product quality and poor storage – that is storage lacking properly designed granaries with cement floors, controlled air flows, barriers against vermin, proper preservation techniques such as sacks stacked off the floor on pallets, and regular use of pesticides and fungicides – are responsible for almost 40 per cent of the extra costs in the value chain. A second analysis estimates that they represent approximately 20 per cent of market logistics costs and more than 85 per cent of avoidable market costs (USAID 2011).

The lack of high-quality warehousing to store cereals in good-quality conditions limits bulking, which would enable more traders to conclude contracts with large buyers. Hence, although the improvement of regional policy and reducing the costs of transport are the

most important recommendations identified by USAID in terms of overall regional impacts on food security, it highlights the importance of addressing other constraints on the competitiveness of value chains. USAID suggests that action could be taken towards improving the management of existing regional storage infrastructure in order to increase trade competitiveness. Also, the implementation of a regional warehouse scheme or increasing access to credit for storage and equipment could allow traders to take advantage of economies of scale and to invest in equipment and storage.

As in the trucking sector, there also seems to be a lack of competition and transparency within the private sector for warehousing. Even if this is not further analysed in the USAID study, we can easily guess that the same reasons of low productivity and cost coverage prevail and maintain this state.

The FAO (2008) promotes the use of metal silos – a post-harvest storage technology for staple grains – as a key post-harvest technology in the fight against hunger and for food security. According to the FAO, not only do they have a great potential for saving post-harvest losses, but also they allow small or medium-sized farmers to store surpluses more safely and efficiently for off-season sale when prices are more attractive, thus increasing household income. Bokusheva et al. (2012) look at the effect of the dissemination of such silos in four Latin American countries by the Swiss Agency for Development and Cooperation (SDC) from 1983 to 2003, and they find that, compared with the non-adopters, the households that adopted silos experienced a significantly higher improvement in their food security and well-being from 2005 to 2009.

The lack of proper storage facilities is a problem for cereals, but it is an even more important constraint on the development of value chains for highly perishable fruits and vegetables. Cold storage is very energy-intensive and many rural areas do not have any reliable connection to the national grid. The only solution is, therefore, to rely on decentralised power production. Better access to electricity seems, therefore, an important measure for the development of high-value agricultural trade such as trade in fruits and vegetables.

12.3.4 SPS institutions and inspection infrastructures

Quality matters to the capacity to access and sustain exports to developed-country markets, but so does reputation (Easterly and Reshef 2010; Jouanjean 2012a; Jouanjean et al. 2012). The capacity to provide evidence of quality as well as a consistent supply of high-quality products is, therefore, a prerequisite to ensure the sustainability of agricultural exports. Many developing countries' SPS agencies lack the adequate expertise and physical infrastructures to conduct proper SPS inspections and controls.

Many standard-setting and controlling agencies have been built, often using donor support. However, partly because of limited budget allocation from the government, many struggle to secure financial viability to sustain their operations (World Bank 2012). As a consequence, many have been trying to raise revenues from their inspection and certification activities rather than assisting. The World Bank (2012) provides the example of Tanzania, where the Plant Health Service (PHS) of the Ministry of Agriculture, Food Security and Co-operatives has around 150 inspectors posted at

only 28 out of a total of 56 entry points, mainly international airports, major sea and lake ports, and selected border posts. Moreover, all of them lack basic pest inspection tools and only six are equipped with a computer. This is a problem not only for exports, but also for the protection of domestic plants and animals, with little capacity to prevent and monitor pests and outbreaks of disease within the country. For maize in Western Africa, the cost of control procedures, such as obtaining an SPS certificate or paying a bribe at the border, was calculated by USAID (2011) at US\$40 per tonne. Jouanjean (2012b) also provides examples of the difficulty of many developing countries in developing proper institutions and infrastructures necessary to enforce any phytosanitary regulations and to implement pest risk assessments (PRA), often mandatory in order to gain access to various developed but also developing countries' markets. In a presentation to the International Plant Health Risk Analysis Workshop in 2005, the Director of the Plant Protection and Regulatory Services Directorate of the Ghanaian Ministry of Food and Agriculture highlighted the difficulties Ghana was encountering when implementing PRA, in the context of new foreign market access but also when protecting its own agriculture of imported pests:

- weak human and equipment resources resulting in incomplete pest records;
- poor and unreliable data generation;
- difficulties in implementing surveillance as well as having access to adequate information resources (ICT);
- limited expertise in and capacity for export inspection and certification;
- limited research support by government; and
- outdated phytosanitary legislation and inappropriate regulatory frameworks.

Because of the lack of proper institutions and infrastructures, some importing countries directly set up temporary inspections infrastructures in the exporting country. For instance, the United States has agreed to import mangoes from India on condition that both countries implement a co-operation and trust fund agreement to pay for the cost of preclearance activities in India. If the preclearance system as implemented by the United States can be described as a way to create and facilitate trade, the corollary is that countries' capacity to enter and implement a co-operation agreement with the United States for preclearance becomes a determinant of access to their market. One can easily figure that, for many budget-constrained governments in developing countries, such agreements can be particularly burdensome to implement.

Therefore, investments in soft infrastructure, from standards-setting institutions to extension services and other rural infrastructure determining the increase in agricultural productivity and efficiency of the agricultural value chain, seem as important as the reduction of pure transport costs through the construction of rural roads.

12.4 Conclusion

The recent literature provides new evidence about the impact of rural infrastructures on agricultural productivity, trade and poverty. It confirms that rural roads are

important for poverty reduction, increasing agricultural productivity and market access. However, there is little evidence that roads have a direct impact on the poorest communities, and studies suggest that they rather benefit from indirect job creation.

International trade analysis provides evidence that road quality is important for trade. However, from a welfare impact point of view, evidence shows that (low-quality) rural feeder roads are more essential to poor rural households than high-quality roads for trucks. Nevertheless, if roads, and in particular rural feeder roads, still appear an undisputable necessity, they are still not sufficient to guarantee any escape from poverty.

The key recommendation that can be drawn from the recent debate over trade, agriculture and infrastructure, and from the analysis presented in this overview, is that rural infrastructure development projects should be appraised in a more holistic way, and should consider combining investments in hard infrastructure with investments in soft infrastructure to address systemic inefficiencies decreasing agricultural value chains' competitiveness. Soft infrastructure is crucial in fostering agricultural productivity and to help subsistence farmers overcome some of their constraints and connect to the market. Also, both consumers and farmers will benefit significantly if transport and transaction costs are reduced simultaneously.

Since the launch of the global initiative on AfT in 2005, efforts by donors, partner agencies and recipients to strengthen trade capacity and improve trade-related infrastructure have been driven by the public sector. With part of the AfT initiative's shift in focus to the issue of developing-country producers' inclusion in global value chains, the scope of the initiative should more than ever open to the private sector. Indeed, as mentioned by the World Bank (2011: 7), 'With a growing number of companies looking to the developing world for new markets, the private sector has a profound interest in ensuring sound investments through access to trade-related infrastructure, an educated workforce, and quality standards for inputs to their goods.' Therefore, private sector participation could stand as a powerful tool in the identification of key infrastructure investments that should not be forgone by the AfT community.

Notes

- 1 See OECD (2012: 4): The value for trade is measured in terms of: direct and indirect job creation; increased level and predictability of income; economic and social upgrading; diffusion of technology and knowledge; better and more sustainable use of resources; political and economic stability.
- 2 Cost of shipping agricultural goods, to which can potentially be added cost of grading, bagging, storing and milling, among others.

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Chapter 13

Aid for Trade Adjustment: Implications for Small and Vulnerable Economies and Least Developed Countries

Sacha Silva

13.1 Introduction

This chapter analyses the role of Aid for Trade (AfT) in supporting the costs of trade-related adjustment (TRA). The inauguration of the World Trade Organization (WTO) Work Programme on AfT at the 2005 Hong Kong Ministerial was widely hailed as the creation of a permanent policy link between the aid and trade debates, which (apart from the African, Caribbean and Pacific (ACP)–European Union (EU) process) had previously been conducted largely in isolation from one another. The creation of the AfT programme was particularly welcomed by developing countries, which had been calling for aid flows to build supply-side capacity and bridge gaps in export growth with more developed economies. The link between aid and trade was particularly seen as beneficial for the small and vulnerable economies (SVEs) and least developed countries (LDCs), as a means to overcome their relative isolation and narrow engagement with the global trading economy, and their vulnerability to sudden changes in revenue and welfare resulting from trade policy shifts at home and abroad.

This chapter analyses, in particular, how the adjustment needs of SVEs and LDCs are (or are not) being met by aid flows. Virtually all SVEs and LDCs are engaged in trade negotiations, at the bilateral/biregional (both South–South and North–South), regional (within existing integration processes such as the Southern African Development Community (SADC), South Asian Association for Regional Cooperation (SAARC) and Association of Southeast Asian Nations (ASEAN)) or multilateral level (i.e. within the WTO, for those countries that are Member States). These processes – while varying significantly in their geographical scope, liberalisation ambition, implementation timeline and sector coverage – can potentially create large trade adjustment costs for SVEs and LDCs that can, particularly in the short to medium term, offset the political, economic and social gains from trade liberalisation. AfT flows – particularly those within the ‘trade-related adjustment’ category – can assist SVEs and LDCs to smooth consumption and shift factors of production while prices shift to a new post-liberalisation scenario. This study analyses the collection and analysis of TRA¹ flows, and compares it with the stated adjustment needs of SVEs and LDCs. It examines, in particular, such issues as (i) what existing data suggest about the scope of TRA aid flows; (ii) why trade-related trends suggest that – at least in the case of SVEs and LDCs – TRA flows should, in theory, be higher, given

the adjustment-related challenges facing these countries; and (iii) what factors might contribute to the current share of TRA in overall AfT flows and what solutions can refocus the AfT debate on adjustment needs.

13.2 The marginal role of trade-related adjustment

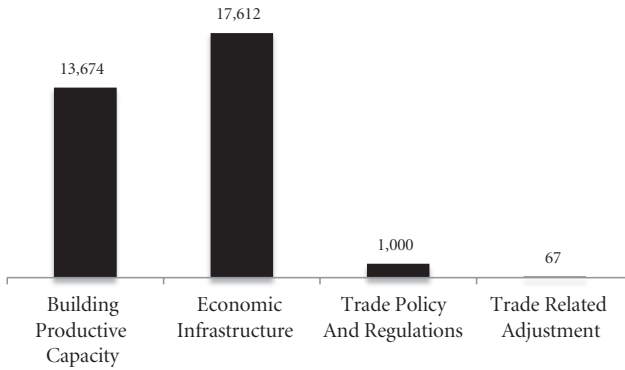
13.2.1 Adjustment in overall aid flows and strategies

The WTO originally classified AfT flows into six different categories. Although the analytical framework for measuring, implementing and monitoring AfT is still being developed, a basic classification was created in 2006 by the WTO AfT Task Force, which identified six different categories of AfT:

- *trade policy and regulations*, with sub-components on trade policy and administrative management, trade facilitation, regional and multilateral trade agreements and trade education/training;
- *trade development*, with sub-components on investment promotion, analysis/institutional support for trade, market analysis and development;
- *trade-related infrastructure*, with sub-components on transport and storage, communications and energy generation/supply;
- *building productive capacity*, with sub-components on business support services, banking and financial services, agriculture, forestry, fishing, industry, mineral resources and mining, and tourism;
- *trade-related adjustment*; and
- *other trade-related needs* (trade-related activities in sectors outside the above categories).

These flows are captured – with some changes – in databases maintained by multilateral institutions. The Creditor Reporting System (CRS) of the Organisation for Economic Co-operation and Development (OECD) collects donor data on individual aid activities² in developing countries from 1967 to the present, classifying all entries under a range of sectoral and geographical breakdowns; the reporting states include the 22 countries comprising the OECD's Development Assistance Committee (DAC), as well as non-DAC countries and multilateral agencies.³ The CRS creates specific codes for different sub-sectors of AfT, under which donors are asked to self-assign the relevant code for each project entry into the database. Certain changes to the classifications have been made to the CRS to accommodate the AfT categories. For example, following the development of the above-listed categories by the WTO Working Party, the OECD did not create a separate 'trade development' component within the CRS, opting rather to flag various projects of the 'building productive capacity' category as having either a principal or a secondary trade development objective. The OECD database also provides a separate category for the last classification of 'other trade-related needs' (OECD 2008).

Figure 13.1 Aid for Trade disbursements by category for all developing countries, 2010 (US\$ million)



Source: Authors' calculations based on OECD DCD-DAC Database, accessed online at www.oecd.org/dac/aft

Based on OECD data, TRA flows are far lower than those classified under other categories. Figure 13.1 draws on data collected by the OECD CRS Aid Activity Database. Drawing on the sub-set of AfT data within the CRS, the OECD data show that – for all donors and for all developing countries – flows classified under TRA (the final and barely visible column on the right) are negligible compared with the other three categories, particularly those destined for ‘building productive capacity’ or ‘economic infrastructure’.

The low measured share of TRA flows persists across different regions and country classifications. As shown in Table 13.1, the negligible share of measured TRA in relation to total AfT flows is present across all major country classifications, irrespective of the year chosen in the CRS database. For 2009, TRA flows do not equal more than 0.38 per cent of the value of total AfT flows when countries are disaggregated by geographic area, income group or status as an SVE. Certain CRS project classifications – for example, Oceania, non-LDC low-income countries, and regional/cross-border – show less a negligible share of disbursements in 2009 for TRA. Data for other years in the CRS (2007, 2008 and 2010), however, show similarly negligible (and, in some cases, smaller) amounts of aid destined for trade adjustment. The percentages fall even further if one considers other categories of aid flows – the analysis above, for example, considers aid *disbursements*, whereas TRA *commitments* are up to two-thirds lower for the same time period.

Major overviews of AfT are largely silent on the specific issue of TRA. At present, the OECD/WTO ‘Aid for Trade at a Glance’ report, coupled with the WTO/OECD biannual Global Review of AfT, are the main outlets for analysing and disseminating AfT data. In these outlets, however, the issue of adjustment is largely ignored, even when discounting for analytical work done on the basis of the CRS. For example, the 2011 OECD/WTO report on AfT flows summarises the findings of 269 case studies of AfT in developing countries, covering more than 150 countries, with over 40 per cent of case studies submitted by developing countries. Following the trend set in the

Table 13.1 Trade-related adjustment as a share of total Aid for Trade disbursements, 2009

<i>By region</i>	<i>%</i>
Africa	0.29
America	0.04
Asia	0.02
Europe	0.07
Oceania	0.00
By income group	
Least developed countries (LDCs)	0.38
Other low-income countries	0.00
Lower middle-income countries	0.03
Upper middle-income countries	0.09
Unallocated by income group (i.e. cross-border)	0.00
Small vulnerable economies (SVEs)	0.25

Source: Authors' calculations based on OECD DCD-DAC database

AfT data, the OECD summary of the case studies largely focuses on AfT categories outside TRA, with six major themes ranging from trade facilitation and infrastructure to policy reform and private sector adjustment. Whereas the 'policy reform' theme addressed TRA as a sub-sector, only three case studies – slightly over 1 per cent of the total 269 studies – explicitly addressed adjustment: one study on support to Mauritius following the 'triple shock' of the phase-out of sugar quotas, the end of the Multi-Fibre Agreement and rising oil prices; one study on assistance to China's agricultural sector during WTO accession; and one study on support to Costa Rica's unilateral and dramatic reduction in tariffs. The 2011 Global Review notes (OECD/WTO 2011: 147) that 'the silence of the international community on the issue of Aid for Trade for adjustment is noteworthy', and briefly lists several possible hypotheses that are explored in further detail in subsequent sections of this study.

The lack of emphasis on TRA is also notable in the AfT strategies being currently prepared by potential AfT recipients. The West Africa Economic Partnership Agreement (EPA) Development Programme (EPADP or PAPED in French) has been described as 'first and foremost a West-African initiative, which has been elaborated by and for the region through a broad participatory approach led by the ECOWAS and UEMOA Commissions at both the regional and national levels' (ECDPM/ICTSD 2010: 10). TRA is included as one of the four 'axes' of the PAPED strategy, but – as shown in Table 13.2 – West African stakeholders allocated less than 9 per cent of aid flows for adjustment needs, with the largest share dedicated to trade-related infrastructure. In the Pacific region, the current draft AfT strategy indicates that funding will be focused on the first two categories identified by the WTO Task Force (trade policy/regulations and trade development); although adjustment is seen as a 'strategic goal', the draft strategy contains no proposals under the TRA theme, indicating that initiatives related to adjustment will be formulated at a future date 'when all [Forum Island Countries] and Timor Leste have developed

Table 13.2 Share of estimated costs by PAPED programme axis (%)

Improvement and reinforcement of trade-related infrastructure	63
Diversification and production capacities	19
Making necessary adjustments + other trade-related needs	9
Intra-regional trade development and facilitation of access to international markets	7
EPA implementation monitoring and evaluation	2

Source: ECDPM/ICTSD (2010)

their trade policy frameworks and when these are mainstreamed into their national development plans' (PIFS 2009: 23). Although there is no AfT strategy at the regional level in the Caribbean, project documents related to the Caribbean Aid for Trade and the Regional Integration Trust Fund (CARTFund) indicate that the fund (albeit a donor-driven initiative) is almost exclusively focused on supporting EPA implementation, trade facilitation and deepening regional/sub-regional trade integration. CARTFund documents make no mention of funding adjustment aspects, and an overview of projects submitted to the fund by Caribbean Community (CARICOM) Member States is exclusively focused on either supporting to the formulation of policy documents (e.g. national export strategies) or the establishment of specialised institutions (e.g. national EPA Implementation Units) (see DFID 2010; Gill 2010). Within the Caribbean, Jamaica's national AfT strategy is built on three pillars (infrastructure, competitiveness and diversification) that do not specifically refer to supporting adjustment costs (see *Jamaica Business Observer* 2011). Among developing-country recipients, only the Common Market for Eastern and Southern Africa (COMESA) region has a strong emphasis on funding TRA costs.

13.2.2 Main TRA donors, regions and sectors

Based on the OECD CRS data, the main provider of TRA aid is the European Union through its collective institutions. Notwithstanding its low representation in AfT databases and policy documents, some trends emerge from the CRS data. On the donor side, the majority of TRA is provided by the European Commission, largely through the European Development Fund. From 2007 to 2010, EU institutions (including the European Commission, the European Investment Bank and the European Parliament) implemented 93 out of 122 TRA projects in the CRS database, with an additional two projects undertaken by individual EU Member States (Belgium and Sweden). Nearly all of the EU projects are related to payments under Stabilisation of Export Earnings (STABEX), which provides funds to ACP countries to compensate for the decline or fluctuations in export earnings for primary exports (such as bananas and sugar), and cover support to commercialisation, agricultural/economic diversification, and social sector and social protection measures. The STABEX payments listed in the CRS database are primarily targeted at other agricultural exports such as coffee, vanilla, tea, cotton, palm and groundnuts. It is worth noting, however, that as of 2011 the EU reporting in the TRA category covers only ACP countries, creating a possible bias in the CRS

Table 13.3 Number of TRA projects per CRS regional classification, 2007–10

Recipient region	No. of projects	Recipient countries
Sub-Saharan Africa	63	Benin, Burkina Faso, Burundi, Cameroon, Comoros, Côte d'Ivoire, Ethiopia, Gambia, Guinea-Bissau, Madagascar, Malawi, Mali, Mauritania, Rwanda, Senegal, Sierra Leone, Sudan, Tanzania, Togo, Uganda, Zimbabwe
Americas	30	Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Suriname
Oceania	9	Papua New Guinea, Solomon Islands, Tonga
East Asia	8	Laos
South and Central Asia	4	Afghanistan, Azerbaijan
Europe	3	Bosnia, Montenegro, Ukraine
Middle East	2	Syria
North Africa	2	Algeria, Tunisia

Source: OECD CRS database

database. The major non-EU contributor to TRA flows in the OECD database is Australia, although it is difficult to assess, solely on the basis of descriptions within the CRS database, whether or not the two main projects listed – support to the Laos Ministry of Industry and Commerce under the Enhanced Integrated Framework (EIF) and contributions to the CARICOM Development Fund – are properly classified.⁴

Among all developing-country regions, sub-Saharan Africa is the primary beneficiary of TRA flows. Table 13.3, drawing from the CRS database, shows that the majority of TRA flows are destined for sub-Saharan Africa. Given the weight of the EU institutions and, in particular, the STABEX funding in the TRA category, the ACP Member States collectively absorb more than three-quarters of the total amount of TRA funding. The CRS database also shows that, in slightly more than half of all cases, LDCs are the main recipients of TRA flows, with upper middle-income Caribbean countries absorbing much of the remaining share.

13.3 The adjustment needs of SVEs and LDCs

13.3.1 A typology of TRA

There are several different categories of TRA costs. Adjustment costs are generally defined as the short-term costs of transition from one state to another (UNCTAD 2010). Within the realm of trade reform, several attempts have been made to categorise adjustment costs to key resource (e.g. labour and capital), across both the private and public sectors. The wide range of categorisations attests to the lack of conceptual and empirical clarity that still exists with regards to TRA, particularly in the developing-country context. Table 13.4 shows a matrix drawn from the United Nations Conference on Trade and Development (UNCTAD 2010), where the authors

Table 13.4 Typology of trade-related adjustment costs

Private sector	<i>Labour</i>	Opportunity costs of unemployed labour Obsolescence of skills and skill specificity Lower wage levels Retraining costs Personal costs such as psychological suffering Other costs (e.g. rent seeking)
	<i>Capital</i>	Opportunity costs of underutilised or unemployed capital Cost of capital rendered obsolete (capital write-offs) Transition costs of shifting capital from one activity to another
Public sector		Shift tax revenue base Social safety net spending (e.g. unemployment benefits) Erosion of benefits from preferential treatment Efforts to ensure macroeconomic stability Implementation costs of trade reforms Non-trade concerns: food security, support to rural areas, environmental concerns

Source: UNCTAD (2010)

note that the costs imposed on labour markets are the most widely studied within the private sector, whereas trade-related revenue losses are the largest concern to the public sector, particularly in developing countries that are highly dependent on trade taxes. An ACP-specific study prepared at the time of the launch of the EPA negotiations identified four broad categories of adjustment costs (Milner 2005), namely

- fiscal adjustment costs, i.e. the need to replace tariff revenue losses;
- trade facilitation and export development costs, i.e. developing new export products for new export markets;
- production and employment costs, i.e. unemployment compensation, support for relocation and retraining costs for displaced workers; and
- skills development and productivity enhancement costs, i.e. increasing competitiveness and improving infrastructure.

A more comprehensive and recent publication by the World Bank covers a wide range of adjustment metrics, from classic indicators such as wages and prices to more novel analysis of immigration flows, firm survival rates, school enrolment and intermediation margins (Porto and Hoekman 2010).

Trade-related adjustment costs are of particular importance to developing countries. A recent UNCTAD study succinctly noted why the debate over TRA costs is particularly salient for the SVE/LDC developing-country community:

The challenge of adjustment to policy change is much more significant for developing countries for several reasons: a) they are starting from more protected situations (nominal tariff levels in some sectors in some LDCs are as high as

100 or even 200 per cent), and therefore the required adjustment is greater; b) developing countries economies are less diversified (with lower opportunities to expand into other sectors), and therefore the relative impacts are higher; c) factor markets are less deep and efficient, and less able to cope with adjustment; d) administration lacks adequate capacity to put the necessary policies in place; and e) some small economies are very trade dependent.

The authors of the UNCTAD study note that developing countries more often face political constraints that hinder the efficient implementation of trade adjustment remedies, and that market imperfections within developing-country markets can lead to either the dampening (or complete disappearance) of the trade liberalisation benefits predicted by the classical literature, or the benefits of trade liberalisation being unequally shared as a result of labour market segmentation and high economic inequality. The authors note that trade liberalisation may reduce the capacity (and choice of instruments) for developing-country governments to conduct redistribution programmes, and thus help smooth the short- and medium-term impacts of trade reforms. Moreover, the analysis of adjustment costs in developing countries is particularly difficult (*vis-à-vis* similar efforts for developed countries) given lack of data on trade, production and consumption, as well as small sample sizes and – perhaps most importantly – the lack of comprehensive, up-to-date economic models of individual economies.⁵

SVEs and LDCs face particularly acute adjustment costs. In the case of the smallest and least developed economies, TRA is a pressing issue because of several well-documented factors, including:

- the SVEs' relative openness to trade, particularly in those countries that have already undertaken wide-ranging trade reforms;
- the high levels of poverty and high incidence of informal economic activity within many SVEs and LDCs, leading to unclear transmission channels for economic shocks and public policy responses;
- the small market size and isolation from major markets, leading to high-cost, small-scale, import-dependent and low-efficiency economic platforms; and
- the dependence of many SVEs and LDCs on unilateral preference regimes that provide an economic advantage over larger and lower-cost producers – with many regimes now being threatened with erosion and/or elimination due to multilateral negotiations and bilateral agreements.

Given the SVEs' and LDCs' dependence on unilateral preference schemes for their participation in export trade, the erosion of the preferential margin within these schemes is of particular concern with respect to TRA. Based on a 2010 joint study by the Commonwealth Secretariat and Overseas Development Institute, some 15–29 per cent of the total estimated loss of developing-country exports due to preference erosion would come from SVEs. For certain countries, such as St Vincent and the Grenadines, St Lucia, Dominica, and São Tomé and Príncipe, the loss of exports due to preference erosion could be as high as 29–60 per cent of their merchandise exports (see Calì et al. 2011).

13.3.2 A multiplying SVE/LDC trade agenda

The light emphasis on adjustment needs in the AfT debate is at odds with a heavy trade negotiations agenda, particularly for SVEs and LDCs, beginning at the national level. While AfT databases and strategies from donors and recipients alike seem to marginalise the notion of supporting adjustment costs, developing countries – particularly small and least-developed economies – face a trade agenda on multiple fronts. This agenda begins at the national level, with several LDCs and SVEs either embarking on or having previously implemented wide-ranging unilateral trade reforms (and, in the latter case, with many countries still managing the adjustment costs). Many SVEs and LDCs have implemented trade reform programmes at the behest of major donors and international financial institutions, with the reforms ranging from significant reductions/simplifications of national tariff rates and introduction of new ‘behind the border’ taxes such as value added tax (VAT) and excise. In the Pacific islands, for example, several countries (including Papua New Guinea, Vanuatu and Samoa) implemented Asian Development Bank-funded ‘Comprehensive Reform Programmes’; in some cases (e.g. Vanuatu) the programme is still under implementation after several false starts (see Soni et al. 2007). In Jamaica, tax reform has been under way for two decades, from a 1994 World Bank-funded project to a current effort funded by the Inter-American Development Bank. Well before the current rush of preferential trade negotiations, regional integration projects and WTO accession, many SVEs and LDCs were undergoing adjustment challenges to transform their import duty-heavy revenue systems to less trade-distorting (but often far more difficult to implement) internal taxes.

These national reforms are being undertaken in a context of an ambitious schedule of bilateral and regional trade negotiations. All LDCs and SVEs are engaged in free trade agreements (FTAs) with countries both within and outside their geographic regions. At the regional level, Table 13.4 shows that small and least-developed countries are engaged in RTA negotiations, in many cases in multiple theatres: for example, the Organization of Eastern Caribbean States (OECS), Pacific Melanesian Spearhead Group (MSG) and East African Member States are also engaged in both sub-regional and regional trade negotiations; Afghanistan is a member of the Greater Arab Free Trade Area (GAFTA) but also pursuing FTA negotiations within the framework of its membership of SAARC. Outside their regional groupings, SVEs and LDCs have either signed, or are in the process of negotiating, bilateral trade agreements with both developed and developing countries. These agreements range in scope from unilateral grants of preference (e.g. the Australia–Papua New Guinea PACTRA) through bilateral FTAs (e.g. India–Bhutan) to partial scope agreements (e.g. India–Afghanistan, Guyana–Brazil, Laos–Thailand, Belize–Guatemala). In several instances, bilateral agreements have been concluded by SVEs and LDCs as part of their memberships of regional groupings, such as CARICOM’s bilateral agreements with Costa Rica, Colombia, the Dominican Republic and Venezuela, and ASEAN’s FTAs with Australia, New Zealand, China, India, Japan and South Korea (Table 13.5).

SVEs and LDCs are also taking part in biregional negotiations, particularly the EU–ACP EPAs. All 78 ACP Member States, divided into regional groupings, are

Table 13.5 Regional trade negotiations/agreements involving SVEs and LDCs

Region	Agreement/negotiation
Caribbean	CARICOM, OECS
Sub-Saharan Africa	SADC, SACU, UEMOA, COMESA, ECOWAS, EAC, CEMAC, WAEMU
South and South-East Asia	ASEAN, APTA, SAFTA, SAPTA, BIMSTEC
Middle East	GAFTA, PAFTA
Pacific	PICTA, MSG, PACER

Source: WTO Regional Trade Agreements database, accessed online at www.wto.org

currently in the process of either implementing or negotiating biregional trade and development agreements with the European Union. As shown below, the adjustment costs of the EPAs have been estimated in billions of euro, despite the fact that the EU is – for most ACP countries, particularly in the Caribbean and Pacific – a currently and increasingly marginal trading partner compared with such hemispheric neighbours as Canada, the United States, Australia and New Zealand. Despite the fact that EU negotiations in all regions apart from the Caribbean are still ongoing, several attempts have been made at quantifying potential adjustment costs (largely in terms of tariff-related fiscal losses). The 2005 study prepared for the Commonwealth Secretariat in 2005 (albeit before substantive negotiations began) estimated that ACP countries would undergo more than €9 billion worth of adjustment (Milner 2005).⁶ The United Nations Commission for Africa (UNECA) estimated, also in 2005, that some sub-Saharan economies could see EPA-related fiscal losses of up to US\$55 million (Ethiopia) and 26 per cent of customs revenue (Tanzania). Pan-ACP studies commissioned by the European Union in 1998 also showed large potential falls in customs and total public revenue following the implementation of an EPA.

SVEs and LDCs are also actively engaged in trade negotiations at the multilateral level. Further TRA costs are likely to occur from the participation of small and least developed economies in the WTO Doha Round of trade negotiations. Despite the fact that the Round is still ongoing (and currently on indefinite hiatus), the few studies that assess the potential impact of Doha liberalisation on SVEs and LDCs generally reach pessimistic conclusions. For example, a 2006 study by the Carnegie Endowment for International Peace found that East Africa, Bangladesh and sub-Saharan Africa (minus South Africa) would be net losers under proposed modalities for agriculture and manufactures, regardless of whether the scenario ambition is set at ‘high’ or ‘modest’ (Polanski 2006). A follow-up 2009 study on Kenya by the Carnegie Endowment found that Doha-related impacts are ‘likely to be significant’, with decreases in output of up to 10 per cent for certain economic activities, and job losses of up to 5 per cent for total employment and unskilled workers (Zepeda et al 2009). An otherwise positive 2011 study by the European Commission shows an overall welfare decrease for many SVE- and LDC-heavy regions (e.g. sub-Saharan Africa and the Caribbean) (Decreux and Fontagné 2011). It is worth noting that many of these studies were calibrated to measure the long-run impact on various economies from multilateral liberalisation, not adjustment costs *per se*.

Several SVEs and LDCs that are acceding to the WTO face significant adjustment costs. Although there is no established template for WTO commitments for acceding countries, the experience of recent accessions suggest that many new entrants are required to agree to significant commitments – i.e. going well beyond those agreed to by established WTO members (even those with larger economies and incomes).⁷ Recent experience also suggests that LDCs and SVEs have not been spared this WTO-plus requirement, creating significant adjustment costs for becoming a WTO Member State. Assessment of the costs of implementing commitments undertaken by WTO acceding countries has not been given much analytical attention to date. A recent study on Nepal and Cambodia, however, provides anecdotal evidence in selected sectors (Sauvé 2005). The study suggests that the estimated technical assistance costs involved in implementing the WTO Customs Valuation Agreement for Cambodia alone total more than US\$4 million over a six-year period, further acknowledging that (a) technical assistance could still leave key institutional gaps and (b) assistance from some donors (e.g. the World Bank and Asian Development Bank) could be provided in the form of loans, rather than grants, putting further pressure on government budgets. The study suggests that the total of potential costs is much wider: acceding countries make lose large amounts of revenue (either by the implementation of bound duties, which may be lower than applied duties, or when the transaction value is introduced in place of the minimum price system, according to the WTO Customs Valuation Agreement); government budget expenditures may increase in order to create or strengthen regulatory agencies and ministries responsible for regulatory oversight and compliance with international commitments, and/or repay technical assistance loans from international financial institutions.

13.3.3 Adjustment as strategic priorities: on paper

The low emphasis on TRA is also at odds with the stated co-operation priorities of many donors and recipients. A brief overview of trade-related aid programming documents and legal agreements suggests that TRA flows should be higher than are suggested by current data, particularly when considering that terms such as ‘diversification’ implicitly suggest a recognition that trade-related economic adjustment will need to take place. The range of documents that makes specific reference to adjustment/diversification needs includes:

- *bilateral/biregional North–South trade agreements* such as the CARIFORUM–EU EPA text, which lists ‘the provision of support measures aimed at promoting ... diversification of the CARIFORUM economies’(EPA 2008, Article 8.1.iii) as a key co-operation priority, and contains explicit language recognising the adjustment needs in both agriculture and labour;
- *donor-country strategy papers* such as the EuropeAid Country Strategy Papers, virtually all of which make specific reference, in the SVE and LDC case, to the need to support diversification away from traditional commodity exports;
- *AfT recipient-country strategies* such as the Poverty Reduction and Growth Strategies for heavily indebted and low-income countries – which often form the

basis of donor country strategies – that unanimously refer to the need to support trade diversification as a tool of poverty reduction;

- *AfT recipient-country questionnaires* such as those submitted to the annual OECD review of AfT flows, which stated in 2011 that ‘export diversification is what partner countries expect most from aid for trade’ – with a higher importance assigned to it by recipients than to economic growth, poverty reduction or increased AfT flows (OECD/WTO 2011: 94); and
- *loan documents*, such as the written requests submitted for International Monetary Fund (IMF) loan facilities (e.g. St Kitts and Nevis’s 2011 and Jamaica’s 2009 Request for a Stand-by Arrangement), that specifically refer to the financing difficulties created by adverse trade developments, including the erosion of trade preferences for traditional agricultural products.⁸

13.4 Sources and solutions: (i) definitions

The previous two sections of this chapter suggest a contradiction. On one hand, a review of existing AfT data and key documents suggests that TRA is not a priority for either donors or recipients. On the other hand, an overview of trade negotiations, trade agreements and aid programming priorities suggest that adjustment needs should be front and centre in the AfT debate. This section and the following three discuss hypotheses to explain (and solutions for) this paradox, which is that:

- definitional problems related to TRA are leading to both donors and recipients either avoiding the category entirely or misclassifying and ignoring potential adjustment flows;
- the global level at which AfT data are collected creates a bias against a focus on adjustment needs; and
- AfT donors are reluctant to address adjustment needs, based in part on past experience.

13.4.1 Novelty, vague definitions and misclassifications

The first hypothesis points to problems in defining, monitoring and measuring AfT flows. Since the creation of the various AfT categories by the WTO Task Force, both the aid and trade policy communities have been struggling to clearly define different AfT flows. Although improvements have been made to the AfT classification process, particularly within the context of the development of the CRS database, the AfT monitoring and evaluation system continues to suffer from a lack of clarity about exactly which projects are meant to fall under individual CRS codes. This has resulted, for example, in overlaps between different categories (explicitly recognised within the CRS by, for example, the demotion of ‘trade development’ to a sub-category within ‘building productive capacity’). Donor reporting of AfT is also plagued by discrepancies between not only donor and recipient classifications of the same project, but also classification of an entire project under a single category and

its component parts, which may fall under different CRS codes. Thus the accuracy of AfT data depends heavily on individual donors' perceptions about definitions of categories, and the level of attention paid to allocating individual project budget lines to their appropriate CRS code. This complexity is further increased in multi-donor and multi-recipient projects (e.g. where projects are being administered and/or funded by different agencies), resulting in a multiplicity of expenditure, accounting and reporting databases (Turner 2008). This lack of clarity has, in addition to its technical challenges, a strong political dimension as well.

The problems of defining and measuring AfT are particularly acute in the case of TRA. The definitional problems in the wider AfT debate are prevalent within discussion of TRA – so much so that, within the European Union's own AfT strategy, one of the document's 'quantitative ambitions' (and the only substantive mention of addressing TRA needs) is to 'seek to establish a common understanding of the notion of "trade-related adjustment" at [the] EU level, in conjunction with promoting an international understanding of this concept' (Council of the European Union 2007: 5). Several definitions have been provided for TRA, with different sources emphasising different areas:

- Some sources take an *expansive* view of TRA, such as the OECD CRS database, which defines TRA (CRS code 33150) as 'contributions to the government budget to assist the implementation of recipients' own trade reforms and adjustments to trade policy measures by other countries; assistance to manage shortfalls in the balance of payments due to changes in the world trading environment' (OECD 2008: 1). Another OECD paper refers to costs 'associated with trade liberalisation such as tariff reductions, preference erosion, or declining terms of trade' (OECD/WTO 2010a: 2). Other observers see TRA as a general form of compensation to the 'losers' of trade liberalisation, without a specific sectoral target (see Azis 2011). The structure and definition of the EU's STABEX fund – whereby payments for declines in certain sectors (e.g. bananas, sugar) were compensated by payments for budget and programme support for other products – suggests that the aid institutions of the European Union share (or once shared) a similar philosophy; this is partially confirmed by the dominance of STABEX payments under TRA in the CRS database. The 2006 AfT Task Force took a more positive but equally vague/expansive view of TRA, defining it as 'supporting developing countries to put in place accompanying measures that assist them to benefit from liberalised trade' (WTO 2006: 6).
- Others however (even within the same organisation) look at adjustment needs in a *narrow/specific* context. Notwithstanding the wider definition above in its own donor database, the most recent OECD global review of AfT, for example, focuses primarily on TRA as support for tax reforms that respond to trade-related declines in tariff revenues, with some consideration of TRA as support to balance-of-payments – although the discussion is primarily focused on domestic macroeconomic instability, rather than trade, as a cause of external imbalances. The same global review defines TRA (during a discussion on AfT case studies) even more narrowly as dealing exclusively with adjustment programmes arising from the reform of tariff and non-tariff barriers.

TRA is also a relatively new category within AfT, suggesting that low measured adjustment flows might result in part from a problem of data availability. Data on TRA within the CRS database are available only for 2007 onwards. This is because the CRS code (33150) for TRA was added to the CRS database only in 2008, two years after the creation of the TRA category by the WTO Working Party. As a result of the novelty of the TRA category and ongoing struggles by donors to define its scope, the CRS database does not yet provide a full coverage of TRA activities, unlike other AfT categories/codes (such as 'trade policy and regulations'), which were in existence before 2007. This results in sporadic coverage of TRA activities within the CRS database. For example, in 2007 there is only a single entry (a Canadian aid project in the Nile Basin with a disbursement value of only US\$14,000); in 2008 the coverage increases significantly (30 projects with disbursements valued at \$27.2 million), and later years see increases as well (48 projects in 2009 valued at \$36.1 million, and 43 projects in 2010 valued at \$68 million). The novelty of the classification suggests that the year-by-year TRA values reported by donors may not reflect actual spending on adjustment-related activities. More importantly, data trends suggest that reporting may improve over time as donors become more familiar with the TRA category.

The problems of vague definitions and novelty have led to classification problems. The issues raised above have probably led to outright errors in the classification of projects within the TRA category. As noted earlier in this chapter, donors are primarily responsible for classifying projects into the various AfT categories; consultations with stakeholders suggest that a minor degree of validation is done by the OECD Secretariat. This has resulted in a number of clear misclassifications of TRA within the CRS database, including a 2009 EU project in Azerbaijan on food quality and safety assurance, and a 2010 International Development Association project in Afghanistan to reform customs administration and trade facilitation – both of which, based on the CRS guidelines, should fall under the 'trade facilitation' sub-category (CRS code 33120) of the 'trade policies and regulations' category, but were in fact classified under TRA.

The same problems have led adjustment-related flows to be classified elsewhere in the CRS database, such as tax reform programmes. Aid flows that deal with fiscal adjustment – for example, tax reform programmes – are often classified under non-TRA categories. In both 2009 and 2010, aid programmes focused on tax reform were found under 'economic infrastructure', 'building productive capacity' and 'trade policy and regulations', but not under TRA. In some instances, the programmes in question have several different budget lines, and the classification suggests that the non-TRA categories are given stronger weight. In other instances, however, even programmes where tax reform is the only budget line are classified in non-TRA categories; for example, a 2010 reform of Ghana's public finances by the German government was classified not under TRA but under the 'financial policy and administrative management' sub-category of 'building productive capacity'.

Similarly, adjustment programmes funded by general budget support are not listed as TRA. The CRS database lists general budget support under CRS code 51010 and, as late as 2007, the OECD itself considered budget support as the 'best proxy

Table 13.6 ‘Structural adjustment’ as a share of total AfT (2007, US\$ billion)

	2001	2002	2003	2004	2005
Trade policy and regulations	0.9	0.8	1	0.8	0.9
Infrastructure	9.8	9.4	9.7	13.7	12.1
Productive capacity building	9.3	7.4	9.2	9.6	9.5
Structural adjustment	4.8	5.9	6.4	5.2	3.5
<i>Structural adjustment as % of total</i>	<i>19%</i>	<i>25%</i>	<i>24%</i>	<i>18%</i>	<i>13%</i>

Source: OECD (2007)

for capturing trade-related structural adjustment’, covering flows such as unmarked/general contributions to the government budget, support for the implementation of macroeconomic reforms (e.g. structural adjustment programmes, poverty reduction strategies), and transfers for the stabilisation of the balance of payments and general programme assistance (when not allocable by sector) (OECD 2007: 4). For reasons that are not immediately clear, the OECD discontinued using budget support as a proxy for adjustment. The impact, however, has been dramatic: as shown in Table 13.6 (drawn from a 2007 study by the OECD on AfT), the use of the budget support proxy implied that TRA captured a major share (up to a quarter) of total AfT flows, with the levels (up to US\$6.4 billion) contrasting sharply with the current measured share of TRA (i.e. less than \$68 million). This aspect has not been overlooked by the OECD, which notes in its 2011 AfT review that one reason for the absence of TRA flows may be that budget support assistance – the main form that adjustment assistance takes – often involves a ‘package’ of policy reforms, including trade, and thus the relevant policy-makers were simply unaware of the call for trade-related case studies.

13.4.2 Multilateral flows

Another problem arising from a vague definition of TRA is the exclusion of potential multilateral flows from AfT databases and debates. As noted earlier, one OECD/WTO paper refers to adjustment needs arising from, inter alia, preference erosion and declining terms of trade. However, flows from multilateral lenders – such as IMF Stand-By Arrangements – that are specifically aimed at this purpose are not registered in the CRS database. For example, the most recent Stand-By Arrangement agreed to by the Government of St Kitts and Nevis makes specific reference to the fiscal pressures of funding the country’s adjustment away from sugar production to high-end tourism, and a similar document for Jamaica’s latest IMF arrangement refers to the difficulties in divesting the country’s main alumina-processing plant. The recent global food price spikes – when some net food-importing countries saw large terms-of-trade declines – resulted in an unprecedented increase in demand for IMF assistance: from 2007 onwards, the IMF approved 82 new financial engagements under concessional facilities and 33 augmentations of existing arrangements, 14 of which were directly related to increases in international food and fuel prices; total new commitments of concessional resources to low-income countries increased almost ten-fold in 2008, peaking at US\$3.8 billion in 2009, four times the historical average (IMF 2012). Multilateral agencies are, however, not members of the OECD,

and so are not obliged to report to the CRS (and, even where such flows are reported, the data may be incompatible with the CRS) (Turner 2008). More importantly, the CRS database focuses on measuring ODA flows – i.e. concessional lending, such as the IMF's Concessional Trust Fund – for which many SVEs do not qualify, with other flows captured in an 'Other Official Flows' category.

13.4.3 Category or marker?

One potential solution involves choosing an approach to identifying TRA that arguably fits more closely how donors and recipients see adjustment needs. One potential approach to solving the definitional ambiguities surrounding TRA is to change the scope and application of the TRA category itself. At present, the classification of projects in AfT databases is constrained by the fact that donors can 'tick' only one box (i.e. assign only one CRS code) to individual aid flows. This exclusivity is hard-wired into the CRS system by design, in order to avoid any donor potentially double-counting contributions across different AfT categories. As noted earlier, this avoidance of double-counting has a strong political rationale, given that some donors have made written pledges to reach quantitative targets for their AfT contributions. However, this rigidity – whereby an AfT project can be seen as related to adjustment or infrastructure, for example, but not both – works at cross-purposes with how many donors and recipients see the support of adjustment needs. The literature on adjustment and consultations with AfT recipients suggest that minuscule TRA flows should not be interpreted as a sign that recipients and donors do not see adjustment needs as a policy priority. Rather, the aid-programming documents reviewed in section 13.3 suggest the opposite: that adjustment and diversification are seen as primary priorities for all stakeholders in the AfT debate. One observer from a major Southern development bank, echoing similar interventions from other AfT recipients, even went so far as to say that he considered nearly every project that he implemented – whether it involved infrastructure, trade facilitation, tax reform or trade policy training – as related to supporting TRA.

The approach needs to acknowledge a difference in the way TRA is seen relative to other AfT categories. A quick glance at the categories and sub-categories of AfT within the CRS database (listed in Table 13.7) shows an immediate difference between TRA and the other AfT categories: it is the only category that is not split into several sub-categories. Moreover, the CRS code descriptions for non-TRA categories are generally clearly defined either in terms of a sector (e.g. tourism, industry, agriculture) or a certain activity (e.g. training, management). TRA, however, does not have that same level of specificity. This suggests a crucial difference: whereas other AfT categories can be easily defined by *what aid is spent on*, TRA is viewed more through the lens of *why aid is being spent*. This subtle but important difference, in turn, suggests that TRA cannot be confined to the same 'tick one box' mechanism of the other AfT categories.

This multiplicity is reflected in part in the academic debate over trade adjustment costs. A recent study on TRA costs (Francois et al. 2011) notes that, compared with the attention that adjustment challenges have received in the political debate, the academic literature on the subject is rather meagre, notwithstanding a certain revival

Table 13.7 Aid for Trade CRS purpose codes and categories

1. Trade policy and regulations	
33110	Trade policy and administrative management
33120	Trade facilitation
33130	Regional trade agreements
33140	Multilateral trade negotiations
33181	Trade education/training
2. Economic infrastructure	
21010 to 21081	Transport and storage
22010 to 22040	Communications
23010 to 23082	Energy supply and generation
3. Building productive capacity (<i>including trade development</i>)	
25010	Business support services and institutions
24010 to 24081	Banking and financial services
31110 to 31195	Agriculture
31210 to 31291	Forestry
31310 to 31391	Fishing
32110 to 32182	Industry
32210 to 32268	Mineral resources and mining
33210	Tourism
4. Trade-related adjustment	
33150	Trade-related adjustment

Source: OECD (2008)

of interest in the subject in recent years. The relevant lack of academic interest in the topic may be because in early empirical work adjustment costs have been estimated to be negligible when compared with the long-run gains for the economy as a whole. It can also partly be explained by the difficulty of obtaining data necessary to estimate adjustment effects and by the complexities adjustment considerations introduce into standard trade models (Francois et al. 2011).

In part, this complexity arises from the fact that in the academic debate over adjustment costs – much like the policy debate in AfT – adjustment is seen as a process that can potentially affect many different sectors and activities. In two recent overviews of trade adjustment in developing countries, a partial list of the range of areas affected by adjustment costs included, inter alia, the public sector (e.g. tax reform, revenue replacement, civil service retrenchment/retraining and increased expenditures); industry (e.g. reallocation of capital and investment, support against profit fluctuations); labour (e.g. unemployment insurance, retraining); and wider social costs (e.g. health, internal migration) (Francois et al. 2011; Porto and Hoekman 2010). A similarly wide-ranging view is taken in Milner's (2005) study on EPA adjustment costs for the Commonwealth Secretariat, which considers adjustment across several sectors/activities, including fiscal reform, trade facilitation, labour retraining and financial sector reform. This reinforces the idea of adjustment as a motivation for a given aid intervention, rather than a sector or activity unto itself.

The solution involves changing TRA from a separate category into a multicategory 'marker'. This suggests that the current approach to counting adjustment flows may be underestimating the true value that donors and recipients place on supporting adjustment needs. It also suggests that the currently expansive definitions of TRA – such as the OECD's suggestions that it covers all 'contributions to the government budget to assist the implementation of trade reforms' (OECD 2008: 2) – are, while subject to excessive overlap and lack of clarity, closer to how the AfT community actually perceives adjustment needs. The change in approach to TRA would thus involve transforming TRA from a 'tick one box', mutually exclusive category, into a 'marker' that could be applied to any AfT flow. This would be the same approach that was taken by the OECD and the WTO when the original 'trade development' category was changed into a marker within the 'building productive capacity' category, for the same reason that the goals of trade development (e.g. investment promotion) were seen as *why* the funds were being spent on an AfT project, not *where* or on *what* activities.

The definition of the TRA marker should still maintain its current focus. In order to guide stakeholders in which projects should be marked as TRA, the focus of the new marker should remain focused on those projects which support TRA. Thus a potential definition, one that builds on and combines current approaches, could be 'support for adjustment costs arising from the implementation of recipients' own trade reforms, or trade policy measures by other countries, allowing recipients to benefit from trade liberalisation.' This definition would include, for example, a tax reform programme specifically linked to reducing reliance on border taxes, but would exclude an infrastructure project by a country that has not undertaken recent reforms, or where the investment in question is not linked to a particular trade policy. The definition could be further augmented by specific reference to the adjustment costs that might arise (e.g. labour force retraining, capital retooling) or the impact of TRA (e.g. deteriorating balance of payments), or to sources of adjustment (e.g. preference erosion). Developing countries might, however, wish to avoid excessive specificity, allowing the recipients and donors who are more familiar with project design and motivations to mark budget lines as TRA.

This change could have several potential benefits, particularly for SVEs and LDCs. There would be several potential benefits of transforming TRA from a category to a marker designation within the CRS, including the following:

- First, it could potentially vastly increase the amount of AfT considered as adjustment-related, given that many donors and recipients see adjustment/diversification as a wider goal for a large number of projects that, under the current system, are classified under non-TRA CRS codes. This increase in flows classified under the TRA marker could provide a higher profile for adjustment concerns within the AfT debate, which could in turn be particularly beneficial for SVEs and LDCs, which have often struggled to give adjustment concerns their commensurate political profile within multilateral/intragovernmental organisations such as the WTO, World Bank, IMF and OECD.
- Second, a higher profile for TRA flows would lead to more investments in monitoring and evaluation, more resources invested in the analysis of adjustment concerns, and better design of both AfT strategies and TRA interventions.

- Third, the projects tagged with the TRA marker could provide useful quantitative and qualitative inputs into the academic debate over adjustment costs, which until now has been constrained by a lack of case studies over the size and scope of TRA costs.⁹ It would provide a direct report ‘from the field’ about what AfT projects are considered to be driven by adjustment considerations, and assist economists in better calibrating trade models to account for real-world views of adjustment costs.

The alternative solution would involve maintaining an exclusive category for TRA, although this may not ultimately solve the debate over definitions. If AfT donors and recipients wish to keep the current structure of CRS categories, then the definition of TRA by necessity would require narrowing to a clearly identifiable activity or sector, in order to avoid the misclassification and confusion that currently constrains TRA measurement. The single and exclusive definition could be drawn from the current set of competing TRA definitions: for example, AfT flows solely for the purpose of boosting hard-currency reserves that have been depleted by adverse trade developments (which in turn would require wider reporting from multilateral institutions such as the IMF, particularly for flows to non-LDCs); or funds such as STABEX that have the explicit and primary purpose of compensating shortfalls in trade income. Although this may solve some of the confusion over donor reporting of adjustment flows, it may not definitively solve the adjustment debate, given that recipients and donors continue to see TRA from different perspectives.

13.5 Sources and solutions: (ii) country/sector bias

This section proposes that the global view of AfT results in a bias away from emphasising TRA needs. In statistics, sampling bias is when a sample is collected in such a way that some members of the intended population are less likely to be included than others. If sampling bias is not accounted for, results can be erroneously attributed to the phenomenon under study rather than to the method of sampling. In the case of measuring AfT flows, the dominance of certain sectors and CRS codes may be partially accounted for by the dominance of certain developing countries in the AfT data, whose policy priorities may in turn be skewing AfT statistics away from emphasising trade adjustment needs.

13.5.1 Country bias

The top recipients of AfT are mostly large, non-LDC and non-SVE developing countries. Table 13.8 shows the income distribution of the top 50 AfT recipients in the CRS database for 2010. Although LDCs are well represented, the sample is dominated by large non-LDCs, and only a single SVE (Papua New Guinea) is listed. This skewed sample is significant given that the top ten AfT recipients in 2010 – India, Afghanistan, Egypt, Vietnam, Kenya, Tanzania, Morocco, Bangladesh, Pakistan and Turkey – accounted for nearly 40 per cent of total commitments. Before 2009, AfT flows were dominated by lower middle-income countries in Asia (particularly Vietnam and India), with the dominance of LDCs as an income group, and sub-Saharan Africa as a region, coming only within the last three years.

Table 13.8 Income distribution of top 50 Aid for Trade recipients (2010)

Least developed (LDCs)	Non-LDC low income	Lower middle-income	Upper middle-income
Afghanistan	Côte d'Ivoire	Bolivia	Brazil
Bangladesh	Ghana	Bosnia-Herzegovina	Serbia
Benin	Kenya	China	Turkey
Burkina Faso	Nigeria	Egypt	
Cambodia	Pakistan	Georgia	
Congo, Dem. Rep.	Papua New Guinea	India	
Ethiopia	Tajikistan	Indonesia	
Haiti	Uzbekistan	Iraq	
Laos	Vietnam	Moldova	
Malawi		Mongolia	
Mali		Morocco	
Mozambique		Nicaragua	
Nepal		Sri Lanka	
Rwanda		Thailand	
Senegal		Tunisia	
Sudan			
Tanzania			
Uganda			
Yemen			

Source: OECD/WTO (2011)

For many of the top AfT recipients, trade adjustment – for example, arising from preference erosion – may not be a primary policy priority. In 2009, nearly half of AfT commitments to India went to funding transport projects, with the remainder dominated by flows to agriculture, electricity and banking/financial services. The same three sectors dominated AfT flows to Afghanistan in 2009, and not a single project related to adjustment was listed for either country. For many large developing countries – particularly those in Asia – the main imperative for channelling AfT flows is the need to address infrastructural weaknesses (particularly in energy, transport and telecommunications), improve private sector growth and public sector efficiency (through regulatory reform), and address the high costs of trade (e.g. through trade facilitation initiatives) (ADB 2009: 6). Global trends that lead to adjustment costs – preference erosion, for example – are often not a primary policy priority in these large, lower middle-income developing countries, particularly those (such as India) that undertook trade reforms several decades ago. Table 13.9, for example, shows the top 25 countries with the highest trade-weighted preferential margin for their exports – that is, those countries that stand to face adjustment costs due to the erosion of these preferences, either by multilateral liberalisation or by FTAs signed by preference-granting countries with competing exporters (e.g. the EU–Latin America Trade & Association Agreements). Only four countries – Afghanistan, Bangladesh, Mozambique and Kenya – are among both the 25 countries most heavily dependent on trade preference and the top 50 recipients of AfT. This aspect was recognised in the 2011 OECD/WTO review of AfT, which noted that the silence on adjustment assistance may also reflect shifting concerns of the

Table 13.9 Top 25 countries with highest trade-weighted preferential margins for exports

Mauritius	24.1
Swaziland	21.8
Fiji	21.6
Seychelles	19.4
Belize	16.8
Guyana	16.2
Haiti	15.0
St Lucia	15.0
Malawi	14.6
Cape Verde	14.1
El Salvador	12.4
Afghanistan	11.2
Barbados	11.0
Lesotho	10.9
Honduras	10.9
Nepal	10.6
Madagascar	10.1
Maldives	9.4
Nicaragua	9.4
Greenland	9.1
Samoa	8.1
Bangladesh	7.8
Mozambique	7.4
Guatemala	7.4
Kenya	6.8

Source: Carpenter and Lendle (2010)

trade community, that the previous preoccupation with adjusting to lower tariffs and shrinking preferences has diminished in the light of the Doha Development Agenda's slow progress, and that countries are now more concerned with overcoming supply constraints to take advantage of market opportunities.

Even for some SVEs and LDCs, supporting adjustment costs may not be seen as an immediate priority, particularly where trade reforms were taken several decades ago. Within individual SVEs and LDCs, the balance of policy priorities may not always fall in favour of adjustment costs, particularly for those small and least developed countries that have already undertaken wide-ranging unilateral domestic reforms, in many instances with a trade rationale and/or impact. Among the LDCs for example, Bangladesh undertook deregulation and privatisation measures as early as the late 1970s, and was one of the first countries to adopt IMF and World Bank Structural Adjustment Programs, resulting in, inter alia, substantial reductions in tariff and non-tariff barriers (North South University 2005: 2). Several Pacific island developing countries (such as Papua New Guinea, Vanuatu and Samoa) undertook substantial tariff reductions and elimination of quantitative restrictions in the mid-1990s, as did Jamaica during the 1980s and Mauritius from 2000 onwards. Although only some of

these reform processes were successful – Jamaica, for example, continues to struggle for fiscal solvency (see Hudson 2003) – the immediate TRA costs for these countries, in several cases, were felt many years before the current AfT debate. This does not imply, however, that adjustment is a non-issue for SVEs and LDCs. Many of the same countries face immediate or future adjustment needs arising from unilateral reform; in the Pacific alone, Vanuatu and Samoa are continuing to implement deep fiscal reforms in response to their recent WTO accessions. Other SVEs and LDCs such as Nepal and the Bahamas are only now undertaking deep trade-related reforms, again often in response to the requirements of WTO membership.

TRA may also not be an immediate priority for those SVEs and LDCs whose main preference margin has already been eroded, although this does not apply to most exports. For some key preferential exports from SVEs and LDCs, the lack of interest by AfT recipients in TRA funds may result from a perception that the costs of preference erosion – like those arising from the unilateral reforms discussed in the earlier paragraph – have already been borne by the economy. In the case of bananas, Windward Island producers have faced declining real prices since the early 1980s, in part due to booming export levels from competing Latin American producers; and recent bilateral deals such as that reached between the EU and Latin American producers (to settle a WTO dispute) have in many instances already been priced into the global market (FAO 2003: 24). The end of the Multi-Fibre Arrangement in 2005, removing commercially valuable quotas for major textiles producers, was implemented before the current AfT debate, and had particularly large impacts on SVEs and LDCs such as Bangladesh, Mauritius, Swaziland, Lesotho and Madagascar. This suggests that preference erosion remains an adjustment concern for SVEs and LDCs, particularly for non-agricultural products such as textiles and fish that will be subject to steep tariff-cutting formulas under the current set of proposed WTO non-agricultural market access modalities (see Lawrence and Rosito 2006).

The divergence in responses to AfT questionnaires is particularly revealing. Developing countries (including SVEs and LDCs) were asked to complete questionnaires that assessed changes in their AfT priorities since 2008, and the first chapter of the OECD/WTO 2011 review was dedicated to analysing their responses (which does not include SVEs as a separate category). The analysis found that competitiveness was the top priority across all regions and income groups ‘but particularly for West Africa, Central America and the Caribbean’ (OECD/WTO 2011: 32); for LDCs, economic infrastructure is their second priority, followed by export diversification. Only for some countries – such as the Gambia – did export diversification away from traditional exports remain a top priority (OECD/WTO 2011). This lack of emphasis on TRA issues, however, is contrasted with country questionnaires submitted by LDCs within the context of the EIF and publicly available on the WTO website. Malawi’s submission, for example, lists several adjustment-related projects as ‘priority’ technical assistance needs, particularly in agriculture, where Malawi wishes to:

- determine the support for adjustment problems arising from reforms that improve agricultural productivity and supply in terms of least-developed and net food importing from Malawi;

- calculate welfare gains and losses for Malawi's current and potential exports; and
- examine the erosion of preferences on the Generalised System of Preference (GSP), the GSTP and the Lomé Convention as a result of the reduction of the MFN rates (WTO 1998).

13.5.2 Sector bias

The value of individual projects within the CRS database also weighs heavily towards non-TRA flows. The marginalisation of adjustment flows within AfT database and policy debates may be rooted in the fact that undertakings in areas such as infrastructure (in particular transport), mining, banking/financial services and energy are often much more expensive, on an individual project basis, than those classified under TRA. Table 13.10 compares a random sample of large non-TRA and TRA projects. It shows that, in 2010, the US dollar values of the largest TRA commitments paled in comparison with the size of non-TRA commitments in areas such as transport and energy. Viewed from another metric, the 2010 value of commitments under all 43 projects classified under TRA totalled US\$29 million; this figure is significantly lower than the total disbursement for the top 43 projects in non-TRA areas, such as transport (US\$8.1 billion), energy (\$7.1 billion), agriculture (\$3.36 billion) and banking/financial services (\$1.5 billion). This demonstrates that, although adjustment considerations are important for many developing countries (particularly LDCs and SVEs), both donors and recipients choose to allocate scarce development resources to non-TRA categories – particularly in improving infrastructure, which is seen by many developing countries as having a higher pay-off in terms of increasing exports.

In many LDCs and SVEs, the significant year-on-year fluctuations in AfT disbursements are often caused by the initiation and/or unwinding of major projects in these non-TRA areas. The 2011 OECD/WTO AfT review shows that, even in sub-Saharan African LDCs and SVEs, non-TRA areas significantly influence aid investments. AfT flows to Nigeria, for example, are dominated by banking/financial services and mining; in Ghana, 62 per cent of almost US\$700 million of total AfT was used in 2009 to improve the transport sector; and, during the same year, the Democratic Republic of Congo (DRC) received US\$725 million, with energy-related projects receiving 36 per cent of total support. Even in Bangladesh, with its strong concerns over TRA in sectors such as textiles, more than half (55.9 per cent) of total AfT flows in 2009 went to fund projects in electricity generation and supply, and a further one-quarter between transport (20.1 per cent) and banking/financial services (3.4 per cent). During the same year, nearly half of all AfT flows to Burkina Faso and Mali went to agriculture (OECD/WTO 2011). Although these flows may have been fundamentally driven by TRA concerns, the current reporting framework places them outside the TRA category.

13.5.3 Addressing country and sector bias

A potential remedy involves increasing the involvement of non-OECD agencies in collecting and reporting AfT data, although the current system may partly work in

Table 13.10 Comparison of sample Aid for Trade project values (2010)

Donor	Recipient	CRS Classification	Project description	Commitment
Non-TRA				
Japan	India	Transport and storage	Construction of dedicated freight corridor between Delhi and Mumbai	US\$1 billion
Japan	Kenya	Energy	Geothermal power plant construction	US\$336 million
USA	Senegal	Transport and storage	Road construction	US\$320 million
USA	Afghanistan	Agriculture	Agricultural sector productivity	US\$314 million
TRA				
EU/EDF	Trinidad and Tobago	Trade-related adjustment	2010 sector budget support programme under the framework of Accompanying Measures for Sugar Protocol Countries	US\$22 million
Australia	CARICOM (regional)	Trade-related adjustment	Contributions to CARICOM Development Fund	US\$917,000
Canada	Benin	Trade-related adjustment	Improvement of Benin markets	US\$56,000

Source: OECD CRS database (accessed April 2012)

favour of SVEs and LDCs. The OECD's mandate to report global AfT flows is based on two aspects:

- first, the 2006 WTO Task Force's direction to the OECD/DAC to assist with periodic reviews of AfT; and
- second, the fact that – upon creation of the AfT framework – donors were reluctant to create a reporting process separate from the DAC/CRS process, preferring instead to adapt the CRS to the newly created AfT categories.

The channelling of AfT reporting through the OECD DAC process may, in part, work in favour of SVEs and LDCs, many of which face severe human resource constraints in their public sectors and are already overwhelmed with reporting requirements for agencies such as UNCTAD, WTO, World Bank, IMF and others. Given that donors (a) have much higher levels of reporting capacity and (b) are probably best placed to determine the sector- and priority-specific categories within their own funding programmes, donor reporting via the CRS is a means to ensure that global AfT databases continue to be populated by detailed/sector-specific, budget line-by-line data on aid flows that has the historical depth to allow for meaningful

analysis. Furthermore, there are fewer donor agencies (the CRS collects data from 23 DAC countries, 21 non-DAC countries and 28 multilateral agencies) than recipients (the CRS lists 180 recipient countries in total), and thus it makes a degree of sense to impose reporting requirements – many of which periodically change – on the smaller and more homogeneous group of donors than on a set of recipients that vary considerably in their capacity to regularly report detailed AfT flows.

This chapter has, however, highlighted ways in which the OECD's global view of AfT has led in part to a marginalisation of TRA considerations within the AfT debate. This section has shown that the dominance of non-LDC and non-SVE countries in global AfT flows has led to a sidelining of TRA concerns. This, in turn, has resulted to calls within the AfT community for the AfT reporting mandate to be shifted away from the OECD and the WTO, and towards other organisations, such as UNCTAD, that are considered more representative – given that the OECD's membership is composed exclusively of developed countries and many large, middle-income developing countries – and friendly towards SVE and LDC concerns, given that the WTO has resisted the creation of an SVE sub-group of Member States, and the OECD CRS does not recognise SVEs as a separate category. Moreover, there is a potential for conflict of interest between, on one hand, creating a political imperative for donors to make specific commitments on AfT flows, and, on the other hand, relying exclusively on those same donors' reporting systems to verify if those commitments have been met.

The immediate priority to balance the AfT debate in favour of adjustment needs is for other organisations to become actively involved in reporting AfT flows and case studies. Any transfer of the AfT reporting mandate away from the OECD is likely to be strongly resisted by donors (which, as noted above, wish to avoid multiple reporting streams for the same project) and large developing countries (which will probably not wish to see their AfT flows, case studies and policy priorities downgraded in the AfT debate, or are content with the status quo). Besides, as noted earlier, SVEs and LDCs may not wish to see their own reporting requirements increased by a transfer of the AfT mandate to another multilateral organisation. This implies that existing SVE and LDC advocates – including both multilateral organisations (e.g. UNCTAD, the Commonwealth Secretariat) and trade and development research centres (e.g. the South Centre, the Overseas Development Institute) – need to become more actively involved in preparing SVE- and LDC-specific perspectives on the AfT debate, including, *inter alia*:

- providing support to SVEs and LDCs to submit case studies that speak to adjustment needs;
- providing regular reviews of AfT flows that separately address SVEs and LDCs, providing an overall policy perspective that may differ substantially in tone and focus from the OECD's review at a global level; and
- ensuring that their own contributions for AfT activities are reflected in the CRS, by providing their own statistics to the CRS (for example, neither UNCTAD nor the Commonwealth Secretariat appears in the CRS, despite being – in some countries – major donors on trade-related issues).

As a basic first step, SVE advocates should ensure that – regardless of the reluctance of the WTO to create a separate sub-group – there is a separate SVE category within the CRS (building on the current ‘small island developing state’ category), which will facilitate analysis of SVE trends and policy concerns.

13.6 Sources and solutions (iii): donor bias

13.6.1 TRA and donor reluctance

Low TRA flows may arise from donors’ reluctance to fund programmes with an explicit focus on adjustment. An overview of donor AfT strategies shows, in several instances, a clear preference for funding AfT programmes that are not directly linked to addressing adjustment costs. The EU AfT strategy, for example, states a clear preference for non-TRA categories, setting quantitative goals for trade policy and regulations and for trade development, and relegating other categories to a ‘wider aid for trade agenda’ (EU 2011: 3) for which the EU declines to set specific financial commitments. The document clarifies that the ‘EU is already a major donor in trade-related infrastructure and productive capacity’ (EU 2007: 3), leaving adjustment as the only category not addressed to in any substantive depth. (In fact, the only explicit goal the EU sets for TRA is to resolve the definition and reporting difficulties referred to earlier in this study.) The Canadian government’s AfT support is focused primarily on areas such as private sector support, policy formulation and trade facilitation; no mention is made of funding adjustment needs (OECD/WTO 2010a). In a similar vein, the United States’ Aid for Trade strategy is primarily focused on pro-growth market reforms and private sector development, rather than supporting adjustment costs (OECD/WTO 2010b). The non-TRA emphasis is arguably even more acute in the case of South–South co-operation, given Southern donors’ traditional AfT focus on funding technical assistance, training and infrastructure projects (OECD/WTO 2011).

In part, this reluctance stems from past experience of adjustment programmes, particularly in the banana sector. Within the context of previous adjustment programmes, arguably the two most valuable case studies are those of the EU–ACP support programmes for bananas and sugar. A brief overview of the experience of these programmes suggests reasons for donor reluctance to propose further funds linked to TRA. In the case of *bananas*, targeted EU assistance took the form of the €95 million Special Programme of Assistance (SPA) in 1994 and the €287 million Special Framework of Assistance (SFA) from 1999 to 2005. Although both programmes were originally planned, in part, to assist in increasing the competitiveness of ACP producers, the focus of assistance gradually shifted over time to favour diversification into other economic activities. The gradual decline of both the banana sector and the general agricultural sector in many banana-producing ACP countries points to several obstacles faced by the EU and ACP in delivering banana-sector adjustment funds: the programmes often resulted in spikes in aid flows that overwhelmed the capacity of countries and producers to use the resources effectively; EU aid mechanisms were often unable to deliver funds in a market-sensitive and time-critical manner; the difficulties in delivering aid to smallholder farm systems at the right time hindered efforts to

create close and effective aid co-operation. In the case of *sugar*, targeted EU financial assistance has emerged relatively recently – within the context of reforms to the EU's sugar regime and the introduction of the Everything But Arms duty-free regime for LDCs – with the creation of a €1.25 billion envelope in addition to normal European Development Fund flows. The assistance provided to sugar producers has explicitly sought to avoid repeating the mistakes of the SFA and SPA in bananas, in part by emphasising adjustment/diversification measures for countries deemed uncompetitive in the long run. Early reports, however, indicated that funding arrangements for sugar adjustment were subject to many of the same obstacles (e.g. delays in disbursements, disillusionment of industry actors with the crafting of national response strategies) as those that had limited the effectiveness of the banana measures.¹⁰

Further caution may be grounded in the STABEX experience. The EU's STABEX facility was established in 1975 under the Lomé Convention; the mechanism was envisaged as a compensatory finance scheme to stabilise earnings from ACP exports of agricultural commodities, and operated until abolished under the 2000 Cotonou Agreement. In 1998, the EU undertook a major review of the STABEX regime (CERDI et al. 1998). Although the review found that STABEX had in part achieved its central objective – the prices of eligible ACP exports were more 'stabilised' than ineligible products of the same countries – it found some of the same problems listed above in the banana and sugar context, and several additional concerns, including:

- delays in disbursing funds – measured in one case at 22 months after a price fall, despite the 'automatic' nature of the STABEX mechanism;
- frequent failures to distinguish short-term revenue falls from a longer-term decline in the export prices of many products, resulting in serious resource constraints, including the inability of the EU to mobilise adequate resources when export prices experienced record falls (e.g. during the Lomé III and IV Conventions of 1985–99);
- the difficulty in measuring whether or not STABEX funds were truly additional to other EU flows, and concerns that STABEX negatively impacted other aid flows;
- difficulties in measuring the impact of STABEX funds in agricultural sector restructuring, with the review finding that STABEX 'has had no clear effect' on either export diversification or stabilisation of government revenue in ACP countries, and was 'likely to be more destabilizing than stabilizing' for export receipts of ACP beneficiaries (CERDI et al. 1998: 3).

This anti-adjustment bias is reflected in part in templates used to prepare national and regional assistance strategies. According to the most recent OECD review of AfT flows, 'the delivery of Aid for Trade is increasingly guided by the principles of the Paris Declaration on Aid Effectiveness', implying inter alia that 'partner countries need to integrate trade objectives into their development strategies and take the lead in their implementation' (OECD/WTO 2011: 70). This in turn implies that the process by which national development strategies are formulated, and their specific content (particularly the key priorities listed in the text), fundamentally determine

which sectors and programmes receive AfT funding. In the particular case of the LDCs and their funding via the EIF, the preparation of a Diagnostic Trade Integration Study (DTIS) is considered by its explanatory note as the ‘cornerstone’ for integrating trade into national development strategies, with EIF, donor and national budget flows meant to focus on the action identified within the DTIS. However, the template which guides external consultants in the preparation of the DTIS contains no specific reference to addressing the costs of TRA, although the document refers to the need to, for example, address technical assistance needs in the context of WTO accession (although this is applicable only to a handful of LDCs) (EIF 2011). This has, fortunately, not prevented some LDCs from addressing trade-related adjustments in their own DTIS: Samoa, for example, mentions adjustment arising in the private sector to improve competitiveness as a result of dramatic tariff reforms; and the Solomon Islands refers to the adjustment costs arising from tax reforms.

13.6.2 Making a stronger case for TRA

AfT recipient countries need to ensure that discussions of support for adjustment costs are central to policy debates. Although some donors may seek to focus on other areas of AfT, recipients should ensure that TRA is fully integrated into national development strategies, funding agreements and the legal texts of trading arrangements; for example, by crafting the terms of reference or other templates provided to consultants in the preparation of such documents to clearly specify that TRA needs should be addressed conceptually, qualitatively and quantitatively. More importantly, however, aid recipients should seek to influence the AfT debate by referring to best-practice case studies and current innovative approaches to supporting TRA, beginning with a concerted effort to highlight positive case studies in previous support programmes. In the case of the EU–ACP SPA/SFA banana measures, while regions such as the Windward Islands struggled with a declining banana sector, other producers – such as Côte d’Ivoire, Cameroon and Belize – were more successful in using EU resources to adjust to changing trade conditions, improve competitiveness and increase market share. The adjustment funds in these countries were more effectively mobilised by, *inter alia*, more closely involving larger-scale industry players in the process of restructuring, particularly through cofinancing arrangements that ensured that private agents had a direct financial stake in aid projects, and by relying on competitiveness and expansion plans drafted by firms rather than external consultants (Goodison 2007). These specific positive examples of adjustment funding should be highlighted in AfT policy debates, rather than the more general and pessimistic overview that currently dominates.

Recipients should also encourage donors to revisit the lessons learned in previous arrangements for new adjustment-related undertakings. In 2009, the European Commission approved a €500 million funding mechanism called Vulnerability FLEX (V-FLEX) to help ACP countries cope with the impact of the global financial crisis, focusing on those countries most affected by their poor resilience to external shocks. Although it is still too early to evaluate the degree to which V-FLEX flows are a direct improvement on earlier mechanisms, the language of the EC in launching V-FLEX suggests a concerted effort to avoid previous mistakes; for example, the fact

of its working ‘pre-emptively ... helping to ease the impact rather than acting after the damage is done’; its ‘acting as a complement’ to other aid flows; its targeting at countries that have ‘sufficient absorptive capacity’ and where ‘EU support can make a difference’ (see European Commission 2010). The design of the current financing arrangements for ACP sugar producers, in the context of reforms to the EU’s sugar regime and the advent of Everything But Arms for LDCs, also suggests an effort by the EC to absorb lessons from previous adjustment mechanisms, rather than abandon them entirely (Goodison 2007).

Both recipients and donors should look to recent TRA best practices. Following the signing of the COMESA FTA in 2000, South and East African countries established (in Article 150 of the COMESA Treaty) a ‘special Fund for Cooperation, Compensation and Development for tackling the special problems [...] arising from the integration process’. The COMESA Fund was established in 2002 and operates with two interlinked instruments: an Adjustment Facility and an Infrastructure Facility. The Adjustment Facility – to which the EC contributed €78 million under the 9th EDF – is aimed at supporting Member States in the implementation of internal FTA policies that may have potential short-term negative socio-economic impacts; funds are channelled through COMESA institutions rather than via the standard programme approach. Already, the Adjustment Facility has disbursed funds to two COMESA States (€4.4 million for Burundi and €10.3 million for Rwanda, both in 2009), representing in the Rwandan case approximately 65 per cent of COMESA-related customs duties and trade taxes (AllAfrica 2009). Whereas in these cases the funding was granted on the basis of revenue losses, future support will be channelled towards more broadly supporting the implementation of regional commitments at the national level, i.e. rewarding countries for their progress made, based on well-defined integration indicators that will in turn trigger disbursements and allocations under the Adjustment Facility (ECDPM 2006). Similar best practices within SVEs and LDCs suggest that a two-pronged approach – first, openly acknowledging the existence of TRA costs and, second, linking support to implementation of clearly defined market-opening measures – could potentially dispel donor hesitation regarding the support of adjustment facilities.

13.7 Conclusions: assessing trade-related adjustment costs

The current tools for measuring TRA are not optimally crafted to contribute to the discussion on AfT. This chapter has argued, in turn, that TRA flows are marginal not only within existing AfT databases but also within key AfT reviews and case studies (section 13.2), and that this low emphasis on TRA is at odds with heavy schedule of trade negotiations facing most SVEs and LDCs (section 13.3). In sections 13.4–13.6, the chapter has also argued that this disconnect could be explained, and solved, by, *inter alia*:

- the existence of TRA as a stand-alone category that refers to *why* funds are being spent on a given project, rather than *on what* activities – requiring a choice of either (a) a narrow sector- or activity-based definition, or (b) a cross-sector ‘marker’ approach, with a preference for the former approach;

- biases on the recipient side, including the dominance of non-SVE and non-LDC countries (and their policy concerns) in global AfT flows and the higher valuations for non-TRA projects, particularly in infrastructure and energy – requiring a broadening of the AfT reporting mandate to organisations that have SVE and LDC concerns at the heart of their mandate; and
- biases on the donor side, particularly the negative perception of funding adjustment programmes, requiring a concerted effort to implement both the lessons learned from past experience and the best practices being implemented among developing countries.

These reforms are urgently needed, given that the debate over TRA costs for SVEs and LDCs is highly political. There exists, at the multilateral level, an *acquis* suggesting that – among developing countries – SVEs and LDCs should be extended special flexibility within the context of trade negotiations, given their particular vulnerability to the negative impacts of trade liberalisation.¹¹ Moreover, SVE and LDC advocates have strongly resisted any effort to erode this *acquis* both inside and outside the WTO, building on the ACP–EU model, which explicitly recognises the need to support adjustment costs that arise from trade liberalisation. As a result – and particularly since SVEs and LDCs are being asked, with the EPAs and their associated regional integration processes, to undertake reciprocal tariff commitments for the first time – the participation of many Member States in trade negotiations is increasingly being predicated on a sufficient ‘development package’ or ‘development dimension’ as an incentive to implement trade measures (ECDPM 2006). The link between funding adjustment costs and agreeing to wide-ranging trade commitments has, as a result, become a highly sensitive and highly political element of trade negotiations, with close involvement from trade officials up to the Heads of State level.¹² The low measured TRA flows, however, may allow both donors and developed-country FTA partners to conclude that the concerns over TRA are either misplaced or overstated. Unless there is a stronger emphasis on TRA and an AfT framework that allows for adjustment concerns to be more clearly measured, then donors may not respond to requests to support adjustment costs when they actually occur, leaving already-overstretched SVE and LDC governments to foot the bill.

The need is particularly acute given that TRA programmes are often crafted without clear reference to actual adjustment costs. Whereas there is a clear push from the SVE and LDC Member States to recognise the need to support adjustment cost, there is often little to guide their negotiators, trade officials or Heads of Government regarding what might constitute an ‘adequate’ support package. This is because:

- funding support is considered a precondition to participation and/or signing of the final text, resulting in discussions on development financing occurring before specific country-by-country commitments have been agreed to and analysed; and/or
- economic data are lacking for key economic indicators (e.g. production, actual revenue collection, trade and employment), with the shortage being particularly acute in the case of most SVEs and LDCs.

Thus, in the absence of a clear signal from the global AfT debate of what constitutes adjustment costs, and therefore adjustment priorities, discussions within particular trade agreements are often conducted in a vacuum, largely limited to a consideration of the 'additionality' of funds vis-à-vis both previous and current support programmes, or previous adjustment measures agreed by the donor in question, or aid commitments made by donors (e.g. the DAC donor target of 0.7 per cent of GDP).

Only when TRA is more clearly recognised can SVEs and LDCs better integrate adjustment concerns into their negotiating positions, and into their national development strategies. Clarifying both the scope and level of TRA in overall AfT flows will create several benefits for the multilateral system. Donors will be better able to programme funds in the event of trade-related reforms, and provide a more measurable AfT 'carrot' to the 'stick' of trade liberalisation, particularly for SVEs and LDCs whose precarious finances or lack of competitiveness suggest that adjustment costs could overwhelm short- and long-term socio-economic benefits. Recipients will be better able to infuse the concept of TRA within their key planning documents, particularly their national development strategies that form the basis of country assistance programmes and ultimately determine the destination and level of AfT flows.

Notes

- 1 The use of TRA in this study for 'trade-related adjustment' should not be confused with the more common use of TRA as 'trade-related assistance' in the AfT literature.
- 2 The CRS defines aid activities as 'a project or a programme, a cash transfer or delivery of goods, a training course or a research project, a debt relief operation or a contribution to a non-governmental organization' ('Technical Guide to terms and data in the Creditor Reporting System (CRS) Aid Activities database', OECD website, www.oecd.org, accessed 23 July 2013).
- 3 A number of non-DAC countries with large aid programmes, such as China and India, do not report their AfT flows to the CRS database.
- 4 According to the AusAid website (www.ausaid.gov.au), the Laos support takes the form of funding a trade specialist, based within the Ministry of Industry and Commerce, who supports effective implementation and co-ordination of trade-related assistance and provides technical and policy advice to the Ministry. Australia also contributes to a multi-donor programme, the Trade Development Facility, which provides technical assistance in support of the Government of Laos's trade reform and economic integration agenda. The Trade Development Facility operates in five main sectors: trade facilitation, sanitary and phytosanitary (SPS) and technical barriers to trade (TBT), capacity building, trade policy and global opportunities, and strengthening trade programme co-ordination and implementation. The Caribbean funding is part of a C\$60 million development assistance programme that covers four areas: climate change and disaster risk reduction (C\$17.5 million); economic resilience (C\$10 million, with explicit trade components); people-to-people and institutional linkages (C\$16.5 million); and direct assistance to individual countries (C\$16 million).
- 5 See a list of relevant studies in UNCTAD (2010: 11).
- 6 The study identified four types of adjustment assistance that would be required (i.e. fiscal adjustment, trade facilitation and export diversification, production and employment adjustment, and skills development and productivity enhancement), and classified ACP countries according to size (micro, small, medium, large and very large) and degree of adjustment required (low, medium and high). The estimates were based on the implementation cost of representative World Bank programmes for each type of adjustment assistance, interpolated across the different country classifications. Other authors have used similar methodologies to derive competing estimates of EPA adjustment costs. Smith

- (2006), for example, provides a downward revision of Milner (2006) for the Pacific island economies, estimating adjustment costs of €170 million (relative to the original estimate of €430 million).
- 7 This may be remedied by the creation of guidelines within the WTO for LDC accession. Recent experience, however, suggests that these largely exhortatory guidelines – for WTO Members to ‘seek restraint in seeking concessions and commitments’, with ‘transitional periods taking into account individual development, financial and trade needs’ – have been largely ignored. See ‘Expediting and Facilitating the WTO Accession Processes for the Remaining Commonwealth non-WTO Members: Obstacles Demystified, Lessons Learned and Challenges Ahead’, study prepared by for the Commonwealth Secretariat, WTI Advisors (2012: 12). Although new guidelines have been established (WTO 2012), setting, inter alia, average bound rate levels for agricultural and non-agricultural market access, the language of key provisions remains non-binding.
 - 8 Poverty Reduction Strategy Papers and Requests for Stand-By Arrangements are available online at www.imf.org
 - 9 See, for example, Francois et al. (2011) and Porto and Hoekman (2010).
 - 10 This paragraph draws heavily from Goodison (2007).
 - 11 In the WTO, LDCs are provided a range of flexibilities in nearly all substantive areas of multilateral negotiations, ranging from exemptions from making tariff reductions in both agriculture and NAMA to targeted technical assistance and longer time frames for implementation. SVEs are similarly provided with flexibilities within WTO draft modalities (though not as generous as those granted to LDCs), including special product categories that allow for more moderated tariff cuts than those provided to non-SVEs.
 - 12 See Miller (2010) for a detailed discussion of the CARIFORUM–EU context.

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Chapter 14

Aiding Exports: Lessons from Emerging Economies

Clara Brandi

14.1 Introduction

Emerging economies have successfully supported their trade performance. This chapter reviews the cases of China, India and Brazil to describe which major activities they have implemented to improve their export performance. The specific contribution of the chapter is to examine how China, India and Brazil have facilitated trade, focusing on the provision of infrastructure and trade facilitation. Based on a review of the current literature, the chapter also reviews which lessons might be learned from these experiences in low-income countries (LICs).¹

The chapter puts the spotlight on support for trade-related infrastructure, trade facilitation and state–business relations because of their importance for trade performance. The high cost of trading in many emerging economies and developing countries is a major obstacle to the improvement of their export performance and the benefits this can generate. These costs are often the result of poor-quality infrastructure and slow and cumbersome procedures at the border.

Aid for Trade (AfT) support for trade-related infrastructure and trade facilitation seeks to address these binding constraints. In 2006, the WTO defined AfT as activities identified as ‘trade-related development priorities in the recipient country’s national development strategies’ and singled out six types of such activities, among them ‘trade-related infrastructure’ and ‘trade policy and regulations’, which constitute trade facilitation (WTO 2006: 2).

Recent research emphasises that support for trade-related infrastructure and trade facilitation is effective in improving trade performance (e.g. Duval and Utoktham 2011; Francois and Manchin 2007; Helble et al. 2009; Moïsé et al. 2011; Nordås and Piermartini 2004; OECD 2012; Portugal-Perez and Wilson 2011). For example, Calì and te Velde found that a US\$1 million increase in AfT funding directed towards trade-related infrastructure can generate a 6 per cent reduction in the cost of packing, loading and transporting goods (Calì and te Velde 2009). Research on aid effectiveness found that each \$1 of AfT facilitation can translate into \$70 in exports for recipients (Helble et al. 2009).

The chapter is structured as follows. Section 14.2 presents the successful trade performance of China, India and Brazil and outlines the framework for analysis in this chapter, focusing on two types of activities that are key to successful trade performance: support for trade-related infrastructure and trade facilitation. Three brief country case

studies of China, India and Brazil review these three types of measures, in sections 14.3, 14.4 and 14.5 respectively. Section 14.6 provides a summary of the lessons from the experiences in China, India and Brazil to promote their export success explored in the previous sections. Finally, the chapter concludes with recommendations on the way forward in section 14.7.

14.2 Successful export performance in emerging economies

14.2.1 Trade performance in China, India and Brazil

Emerging powers such as China, India and Brazil have successfully supported their exports and their trade performance more generally. Figure 14.1 shows how China's, India's and Brazil's export values, the current value of exports (freight on board) converted to US dollars and expressed as a percentage of the average for the base period (2000), have increased over the past three decades.

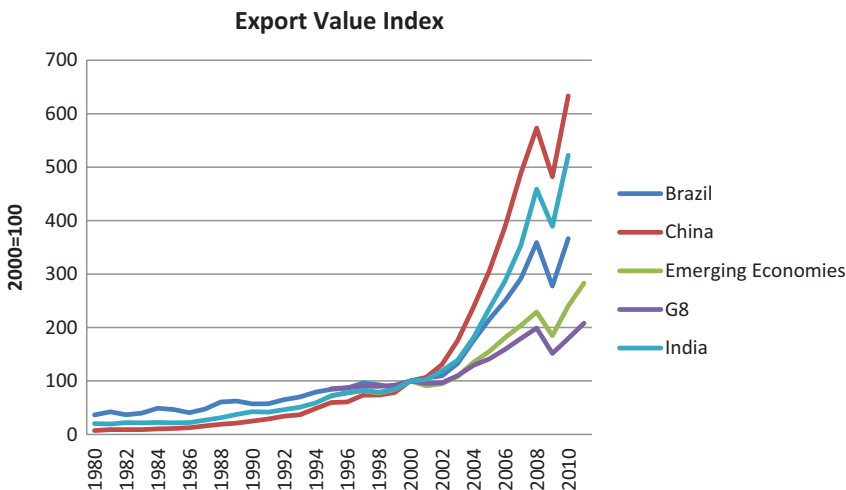
Sections 14.3, 14.4 and 14.5 will turn to three country cases and focus on the question: what makes China, India and Brazil successful in terms of their export performance?

14.2.2 Introducing the framework for analysis

Three main factors behind a country's export success are its productive capacity, its regulatory framework and its market access and trade promotion:

- *Productive capacity* is the capacity of a country to produce goods and services. Building productive capacity includes business development and activities aimed at improving the business climate, privatisation, assistance to banking, financial services, agriculture, forestry, fishing, industry, mineral resources, mining and tourism.

Figure 14.1 Export value index (2000 = 100)



Source: UNCTAD

- *Regulatory frameworks* are an appropriate institutional framework and supportive regulatory environment.
- *Market access and trade promotion* include the trade barriers a country faces for its exports and the trade barriers that exist for imports and also refers to policies aimed at increasing a country's or a company's exports.

The main part of the chapter will review three types of activities that can strengthen and improve the factors behind the export success outlined above. The chapter will focus on the following activities: promoting **trade-related infrastructure** and **trade facilitation**.

Trade-related infrastructure

The first part of each country case study presents how China, India and Brazil have supported trade-related infrastructure. Trade-related infrastructure comprises not only roads, railways and ports but also energy, water and telecommunication and arguably laboratories for quality, sanitary and phytosanitary controls and verification of compliance standards, together with border posts and associated computer and customs software. Empirical evidence indicates that quality of infrastructure is an important determinant of trade performance (e.g. Francois and Manchin 2007; Limão and Venables 2001; Nordås and Piermartini 2004; Portugal-Perez and Wilson 2011).

There is often a lack of high-quality infrastructure in developing countries due to market failures in the context of lumpy investments being delayed in uncertain circumstances (te Velde 2008). The financing of infrastructure gives rise to severe challenges, especially because the huge scale of the needed investment and the long gestation period call for investors who are able to accept a long time frame for debt repayment and return on equity, whereas many financial institutions are not able to invest in such very long-term illiquid assets (Anand 2010). Support for infrastructure can help to address this market failure, for example by providing incentives for public–private partnerships (te Velde 2008).

Trade facilitation

In contrast to common perception, poor-quality infrastructure such as ports, although significant, is not necessarily the most important impediment to trade; almost half of the hold-ups in the trading process are the result of burdensome pre-arrival procedures (World Bank 2007). These cumbersome procedures in turn could be addressed through AfT that focuses on trade facilitation.

There is no generally agreed definition of trade facilitation (Tantri and Kumar 2011). In a strict sense, 'trade facilitation measures' refers to steps undertaken to reduce the transaction costs of conducting business across the border. The WTO defines trade facilitation as 'the simplification and harmonization of international trade procedures' covering the 'activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade' WTO definition from http://gtad.wto.org/trta_subcategory.aspx?cat=33121 (accessed 29 July 2013). Recent research on how aid spent on trade

facilitation relates to trade flows indicates that the trade-initiating effect of US\$1 spent on measures directed towards trade policy and regulation reform is considerably higher than the trade creation from investments in other areas of trade support (Helble et al. 2009). Above all, the efficiency of customs has considerable effects on trade-related costs.

The benefits of trade facilitation measures typically more than compensate for the cost of such reforms and frequently exhibit a rather brief payback period (Engman 2005). Complex or inefficient border measures could raise the cost of goods between 2 per cent and 15 per cent (OECD 2005). Duval and Utoktham (2009) provide data that indicate that a 5 per cent reduction in the costs of exports can raise exports by 4.2 per cent. Wilson (2007) illustrates that a 10 per cent decrease in the importer's time at the border can raise trade by 6 per cent, whereas a 10 per cent decrease in the number of documents needed by the importer could raise trade by 11 per cent. Other studies (e.g. Fox et al. 2003; Kim et al. 2004; Wilson et al. 2003, 2004) further confirm this relationship.

Doing Business indicators depict a country's regulatory regime and make out those particular factors that improve trade activities and those that hamper them. Since 2006, the *Trading across Borders* elements of *Doing Business* mirror the overall official costs of exporting a standardised container (valued at US\$20,000), excluding ocean transit and trade policy measures such as tariffs, thereby representing the most comprehensive source of information on a country's approach to trade facilitation (see Table 14.1).

The *Logistical Performance Index* (LPI) is an additional set of World Bank indicators that offers valuable insights into a country's situation in terms of trade facilitation. The LPI is based on surveys carried out among logistics professionals and generates information (see Table 14.2) on the efficiency of the customs clearance process (Customs), the ease of arranging competitively priced shipments (International shipment), the competence and quality of logistics services (Logistics quality and competence), the ability to track and trace consignments (Tracking and tracing), the frequency with which shipments reach consignee within scheduled or expected time (Timeliness) and the quality of trade and transport-related infrastructure (Trade- and

Table 14.1 Trading across Borders 2012: China, India, Brazil

Indicator	China	India	Brazil	OECD members
Overall rank	68	127	123	
Documents to export (number)	8.0	9.0	7.0	4.4
Time to export (days)	21.0	16.0	13.0	10.6
Cost to export (US\$ per container)	580.0	1,120.0	2,215.0	1,037.5
Documents to import (number)	5.0	11.0	8.0	5.0
Time to import (days)	24.0	20.0	17.0	10.4
Cost to import (US\$ per container)	615.0	1,200.0	2,275.0	1,101.9

Source: Doing Business (2012)

Table 14.2 Logistics Performance Index (LPI) 2012

Country	Rank (out of 155)	LPI	Customs	International shipment	Logistics quality and competence	Tracking and tracing	Timeliness	Trade- and transport-related infrastructure
Brazil	45	3.13	2.51	3.12	3.12	3.42	3.55	3.07
China	26	3.52	3.25	3.46	3.47	3.52	3.80	3.61
India	46	3.08	2.77	2.98	3.14	3.09	3.58	2.87
OECD members		3.60	3.40	3.42	3.60	3.66	3.90	3.64

1, very low; 5, very high

Source: World Development Indicators

transport-related infrastructure). In 2012, China had attained rank 26 while India and Brazil were at positions 45 and 46 respectively out of 155 countries.² While there is still potential for future improvement, China, India and Brazil have all made progress in terms of trade facilitation in the recent past and their main initiatives in that regard will be presented in the respective country case studies.

The next three sections turn to three country cases that review the measures that China, India and Brazil have taken in order to foster trade-related infrastructure and trade facilitation.

14.3 China

14.3.1 Trade-related infrastructure

China's unmatched growth in the past two decades has coincided with immense infrastructure development arising from its export-led approach. In the light of its focus on exports, China has invested heavily in railways, port facilities, airports and highways (Syed and Walsh 2012). China's recent and current infrastructure investment is extraordinary. The World Bank estimates that the country spends about 9 per cent of gross domestic product (GDP) on it. By comparison, the EU and the United States spend about 5 per cent and 2.4 per cent, respectively. In September 2012, the National Development and Reform Commission (NDRC) approved the launch of another 55 major infrastructure projects (Back 2012; KPMG 2013).

Chinese infrastructure development is characterised by strong co-ordination between policy-making and implementation, and the presence of both market-based arrangements as well as traditional centrally planned command economy elements. This approach was successful, since the final decision-making authority continued to be with the central government and since this central control made it possible to be less risk averse and to defy the market economy when needed. The Chinese reforms included making use of a trial-and-error approach and also focused on boosting private and foreign investment. The focus is on planning coherent investment, regularly re-examining infrastructure gaps and reorienting resources (Bredenkamp and Nord 2010).

Among the main drivers of China's infrastructure boom have been sub-national governments after receiving economic autonomy (Walsh et al. 2011). The functional and fiscal decentralisation in the context of the 1994 tax administration reform severely amplified the incentives and capacity of local governments for infrastructure development (Liu 2004). For example, local governments began providing guarantees – implicit and explicit – for bank loans to infrastructure projects and in certain cases subsidies directly for infrastructure SPVs (Special Purpose Vehicles) to increase profits and improve credit ratings (Walsh et al. 2011). Further initiatives, such as the simplification of government review and approval procedures and the introduction of performance criteria, contributed to improving government capability of implementing infrastructure projects (Liu 2004). Since 2004, China has deregulated the cumbersome and lengthy project approval system for China's infrastructure, for example such that government approval will no longer be needed for projects not funded by the government (Chen 2010).

At the same time, there are challenges. Rapid infrastructure development has at times led to poor-quality, low-technology service and management (Chuan 2008). Moreover, recently, collapsing bridges, roads, dikes and dams have been a huge problem. They are often the result of corruption among local officials who sub-contract work to friends or inexperienced firms (Nunns 2012).

So far, public banks have provided most of the required long-term financing for infrastructure investments in the context of implicit local government guarantees and bond insurance provided by publicly owned banks (Walsh et al. 2011). It is remarkable that several infrastructure SPVs are listed in the Chinese stock market, directing funds from the capital market to infrastructure projects (Walsh et al. 2011). In 2012, the China Insurance Regulatory Commission (CIRC) decided to allow insurance companies to invest up to 10 per cent of their balance sheets in both real estate and private equity (KPMG 2013).

Deficiencies in the legal and regulatory framework, with slow approvals processes, underdeveloped property rights and restricted means of legal remedy, continue to be a barrier to more extensive private participation in infrastructure (Brooks and Zhai 2008). To promote the implementation of public–private partnerships (PPPs) in China, a series of policies have been introduced, for example, the Opinions on Acceleration of Privatisation Process of Public Facilities in 2002 by the Ministry of Construction (Wang 2013). In the context of the 12th Five-Year Plan's annual GDP growth target of 7 per cent and the search for alternative sources of finance, infrastructure investments are increasingly being opened to private capital, for example by relaxing the rules on Qualified Foreign Institutional Investors and other forms of direct and indirect investment (KPMG 2013; Shao and Yao 2013).

14.3.2 Trade facilitation

In 1998, China Customs decided to establish a modern customs regime and established a two-step strategy to achieve this objective (Shujie and Shilu 2010; Wenjing and Wei 2006). Important developments in customs clearance during the first reform phase until 2003 included, for instance, the nationwide use of fast customs-transfer operation and incorporation of the 'one-stop, single-window' approach to customs-transfer between inland and ports or between different customs offices (see also Tsen 2011). The second phase (2004–10) entailed, among other reform measures, an update of the electronic data interchange (EDI)³ customs clearance engineering, the expansion of paperless clearance procedures and the introduction of electronic customs, which enables enterprises to complete the customs procedures over the internet. Customs has also promoted co-operation with the customs authorities in the bilateral and regional trade partners in the context of China's FTAs, mainly in electronic networking with regard to preferential certificates of origin and customs data exchange systems (WTO 2012).

The implementation of trade facilitation measures has brought down time spent on customs procedures as well as the transaction costs of trade procedures in China. The introduction of paperless trading and the electronic quarantine and inspection framework reduced the costs for enterprises by around RMB 100 million per year

and the implementation of electronic declaration has cut back the time spent on each batch of goods by 30 minutes (Wenjing and Wei 2006). In late 2007, 85 per cent of the key performance indicator targets of the second step of the two-step trade facilitation strategy had been achieved (Liu 2008). Many exporters began using E-ports and all export goods starting being processed under the H2000 Customs Clearance System (Shujie and Shilu 2010). Almost all customs operations started involving risk management and more than 60 per cent of declarations are automatically processed by the risk-management platform (Liu 2008; Shujie and Shilu 2010). The total physical inspection rate was cut back to 3.41 per cent (Liu 2008). The clearance time was also reduced: 84 per cent of exports shipped by sea and 99.7 per cent of exports shipped by other means of transport could be released within eight working hours (Liu 2008). IT-based customs clearance procedures (known as the ‘golden-series projects’, including the ‘golden customs project’, and the ‘golden quarantine and inspection project’) have helped to boost tax revenue and reduce the amount of smuggling (Wenjing and Wei 2006). In 2010, the average time required for customs clearance was 1.7 hours for exports (2.4 hours in 2008) and 15.5 hours for imports (14.1 hours in 2008) (WTO 2012). In sum, the comprehensive initiatives taken by China Customs and other agencies have helped to foster a trade-enabling environment and helped business to increase export competitiveness in an international supply chain.

14.4 India

14.4.1 Trade-related infrastructure

In both China and India, the municipal government is an important factor in infrastructure development but, whereas in China infrastructure is constructed, operated and maintained by different companies established by local governments, in India it is the local government itself that performs these functions, which has made cost recovery less efficient than in China (Brooks and Zhai 2008).

The future development of India’s infrastructure presents a huge opportunity as well as a huge task. The challenges are reflected, for instance, in the Indian road sector. For example, whereas India’s road construction was better than that of China in the early 1990s, this situation changed radically in the more recent past, for the most part because of limited infrastructure investment in India. India’s investment philosophy differed from China’s, where the focus was on new arterial networks, while India, in contrast, centred attention on rural roads. While China now has a striking road system, India is characterised by an undersized and overcrowded road network (Kim and Nangia 2010).

However, toll road projects have proliferated in India, where highway projects account for more than half of all projects involving private participation in infrastructure concluded in 1990–2006 and accounted for more investment commitments in 2003–07 than any other sector apart from telecommunications (Leigland 2010). High traffic volumes and methods for reducing private partners’ risks and costs, such as viability gap funding, have helped to promote highway development but, in LICs, lower traffic

volumes and restricted funding for risk and cost reduction constrain the use of toll roads (Leigland 2010).

Investment in railways is difficult because of direct government ownership and, whereas several airport privatisations have been a success, investment in port facilities has been slow, and energy generation and transmission have been undermined by poor pricing models and regulations (Syed and Walsh 2012). The challenges for India's infrastructure sector, more generally, include major capacity improvements but also simpler finance structures with more focus on user fees and greater accountability for infrastructure agencies in terms of outputs.

So far, as in China, banks have dominated infrastructure finance in India, but the Reserve Bank of India (RBI) has not allowed the same high concentration in infrastructure assets as Chinese banks have taken on. In terms of foreign finance, India has so far relied mostly on multilateral lenders. The establishment of the New Pension Scheme (NPS) shows potential for an extensive growth of assets under management of pension funds and is therefore promising for future infrastructure development in India (Walsh et al. 2011). At the same time, Indian insurance and pension funds are constrained by their obligation to invest a substantial portion of their funds in government securities, which limits the direct investment of these institutions in the infrastructure sector (City of London 2012). Recently, India introduced Infrastructure Debt Funds (IDFs), which show significant promise to facilitate the flow of long-term debt in infrastructure projects by tapping into sources of long-tenure savings such as insurance and pension funds, which have so far played a rather small part in financing infrastructure in India (City of London 2012; Jain and Nair 2013; Mahajan 2012).

India attracts a substantial amount of private investment to its infrastructure sectors. In 2010, \$75 billion was invested in Indian of infrastructure-related PPPs (Urban Land Institute and Ernst & Young 2012). PPPs have been quite a success story in India and can offer lessons for LICs (ADB and Economist Intelligence Unit 2012). To further boost PPPs in infrastructure, the Government has introduced an SPV, the India Infrastructure Finance Company Limited (IIFCL), to satisfy the long-term financing needs of potential investors (Gupta 2009). Recently, the Indian Government took a range of measures to promote development of infrastructure in the country by putting in place an institutional mechanism to monitor the progress of PPP projects at the central and state levels and facilitating land transfer between government agencies for PPP projects.

Over recent years, a number of steps have been taken by Indian policy-makers to support infrastructure development and financing in India. However, there are still numerous challenges that should be addressed: the process of land acquisition should be streamlined; important policies and regulation reforms should be fast-tracked, including a single window clearance approach for approval of infrastructure projects; a sound dispute resolution framework should be established; better monitoring of projects should be introduced and their funding improved; and more favourable taxation policies for infrastructure projects should be put in place, including for foreign investment (FICCI National Committee on Infrastructure and Ernst & Young 2012).

14.4.2 Trade facilitation

In recent decades, India has taken several steps to facilitate trade (De 2011). For example, in the 1990s, India launched the Indian Customs EDI systems (ICES), which automated the clearance process for import and export consignments and introduced remote filing of import and export documents (Dominic et al. 2012). In 2002, India further facilitated trade by implementing an electronic commerce portal, ICEGATE (Indian Customs and Excise Gateway), which eases the electronic filing of import and export documents and related electronic exchange between customs and the trader, offering a choice of means of communication, including the internet, and offers a helpdesk on a 24/7 basis (Dominic et al. 2012). In 2005, India initiated a risk management system (RMS) in order to decide which containers to inspect and to selectively screen only high- and medium-risk cargo for customs examination (WTO 2011).

As a result, trade procedures have become more efficient over recent years. In the period between 2005 and 2011, the time needed to finish all trade procedures involved in moving goods from factory to ship at the nearest seaport – or vice versa – was cut back by more than 40 per cent, with an 18 per cent reduction being the average for developing economies in the Asia-Pacific region (ARTNeT and UNNExT 2012). Especially the implementation of the electronic data interchange (EDI) system in 1994 and of the risk management strategy in 2005, at India's major customs offices, has increased the efficiency of border procedures (WTO 2011).

14.5 Brazil

14.5.1 Trade-related infrastructure

Despite the chronic historical underfunding of its infrastructure, Brazil has in recent years demonstrated its commitment to rectifying the situation. The recent reduction in political and regulatory risks has strongly enhanced the investment environment in Brazil (Gregoire 2011). In fact, in 2008, Brazil received an investment-grade sovereign debt rating for the first time.

While trade-related infrastructure in Brazil remains to be improved, and it will take a while, for instance, before better transport makes Brazilian goods more competitive on global markets, now, at last, change is under way. Against the background of the current infrastructure needs, the Brazilian government implemented a large infrastructure programme, the so-called Growth Acceleration Programme (Programa de aceleração do crescimento, PAC), followed in 2010 by a follow-up programme (Centre for Development and Enterprise 2012; Mourougane and Pisu 2011; Walsh et al. 2011). The objective of PAC was to raise infrastructure investment and advance co-ordination among the numerous institutions engaged in infrastructure policy, as well as others, on the basis of the following measures (Mourougane and Pisu 2011): additional infrastructure investment, to be financed by the government as well as public enterprises and the private sector; tax exemptions for specific capital and goods related to infrastructure; a tax-exempt

national Investment Fund to finance infrastructure projects; and the monitoring of progress in the infrastructure programmes, with a regularly published progress report. Under its PAC 2 Accelerated Growth Programme, the government has committed to spending R\$959 billion on infrastructure projects by 2014 and R\$631 billion beyond 2014, capital which is channelled in part through the Brazilian Development Bank (BNDES) (Williams 2011). While the R\$274 billion in infrastructure investments estimated for 2010–13 corresponds to 2.2 per cent of GDP, only slightly higher than the average 2.1 per cent of GDP spent in recent years, at least some progress is being made and there are a number of drivers of higher infrastructure spending in the near future, including the 2014 FIFA World Cup and the 2016 Olympic Games. For instance, in an attempt to optimise the procedure for contracting with private providers, the government has recently issued a so-called ‘differentiated regimen for contracts’, which will apply for civil works and services related to the 2014 World Cup, the 2016 Olympics and projects that are part of the PAC (Leal 2012).

In 2004, a new law introduced a distinction between PPPs and concessions. It regulated a number of aspects of PPPs such as project selection, bidding, signing and management of projects at all levels of government, providing a favourable environment to benefit from private participation in infrastructure (Mourougane and Pisu 2011). This law contributed to constrain the frequency of costly renegotiations, which often undermined PPP contracts in the past (Calderón and Servén 2010). The current management process of PPPs and concessions should be still further simplified, for instance by consolidating responsibilities among the various authorities involved and offering standardised contracts to reduce some of the transactions costs that PPPs generate (Mourougane and Pisu 2011).

Long-term financing for Brazilian infrastructure has been primarily provided by BNDES. BNDES has granted a significant number of loans, and new financing products have been developed for investments in the infrastructure sector (Leal 2012). Brazil has been quite successful in mobilising foreign finance, for instance by attracting foreign companies to bid on road projects and to invest in PPPs. Moreover, Brazilian energy companies have managed to issue shares and bonds in international markets, benefiting from sovereign guarantees because the ratings of those companies are contingent on the rating of the sovereign that investors assume would stand behind the company (Walsh et al. 2011).

14.5.2 Trade facilitation

Over the past years, Brazil has sought to make import and export transactions less cumbersome and continued to take gradual steps to simplify and modernise its customs procedures. For example, Brazil introduced an express import declaration regime for frequent importers, and reduced by 26 per cent the number of rejected import declarations (WTO 2009). Since 2006, the unloading of imported cargo for physical inspection may be exempted where customs premises are equipped with scanners that permit non-invasive inspection, substantially reducing customs clearance time. In 2008, Brazil facilitated trade by updating its electronic data

interchange (EDI) system for customs. In 2009, the Brazilian government established a computerised information system that processes all customs procedures, monitors imports and facilitates customs clearance. Known as the Foreign Trade Integrated System (SISCOMEX), it reduces the time needed for export and import procedures by facilitating and decreasing the amount of paperwork previously needed for importing into Brazil. To exempt companies from filling in about 935 fields in different forms before products can enter the country, hindering the import process, the Brazilian government has worked on introducing a Paperless Ports system to reduce the use of forms and harmonise requirements for entry across the country (Moraes 2011).

For LICs, there are particularly useful lessons to be learned from the Brazilian experience with trade facilitation policies for low-value exports. In 1999, Brazil introduced very successful trade facilitation policies for low-value exports, on the basis of the postal network, in order to simplify cumbersome and costly export formalities and address the problem of limited access to an affordable means of transport. The scheme is targeted primarily at small and medium-sized enterprises, helping them to ship their products abroad quickly. More specifically, the Brazilian government implemented a simplified export procedure for exports valued at less than \$10,000 through the ‘Declaração Simplificada de Exportação’ (DSE) and, in so doing, has considerably cut back the number of steps needed to register an export. These types of policies might be appealing for several countries, including LICs (Guasch 2008). The programme has already been rolled out in Ecuador, Peru, Uruguay and Colombia, after being modified to suit local conditions, while Argentina, Bolivia and Chile are in the process of adopting similar schemes and Serbia has implemented its own programme based on the Brazilian model (Universal Postal Congress 2012).

14.6 Lessons: what can we learn from past experiences?

This part of the chapter pulls together lessons from the experiences in China, India and Brazil to promote export success explored in the previous sections. It reviews differences and similarities between the approaches in these three countries with respect to trade-related infrastructure (14.6.1) and trade facilitation (14.6.2). It will also suggest what each of these might imply for LICs.

14.6.1 Lessons for trade-related infrastructure

China managed to build infrastructure ahead of demand that contributed to promoting exports and economic growth. For India and Brazil and other countries that have traditionally underinvested in infrastructure, the need to respond to the worldwide fragmentation of production and new large and extremely competitive economies in the global market is gaining even more urgency. China’s centrally planned economy made infrastructure reforms to some extent less challenging than in India and Brazil, since the central control of the economy enabled the Chinese government to take risks and promoted strong integration between planning and implementation (Leoka and Guma 2012).

Successful infrastructure development involves a number of institutional and policy dimensions, including the way planning and implementation is approached, how the risks are managed and what kinds of incentives and accountability structures are present. In the recent past, the scarce global supply of short- and especially long-term funding has become highly relevant for future infrastructure development. In light of these funding shortages, one goal of this chapter has been to look at how China, India and Brazil have financed infrastructure improvements and what financing alternatives exist for countries that aim to boost infrastructure investment.

It is not possible to finance infrastructure investment on the basis of traditional sources of public finance alone (Kingombe 2011). The financial crisis has further reduced the availability of public investment in infrastructure and there is a need for more private sector finance, but traditional sources of private capital such as banks, have restricted credit growth and may be further constrained in the light of new regulations such as Basel III, which will discourage banks from making long-term loans, traditionally used to finance major infrastructure projects, by demanding that more capital be set aside to cover such loans (Teague 2012). Against this background, institutional investors, such as pension funds and insurance companies, have been considered to help close the infrastructure gap (OECD 2011).

The country cases discussed in this chapter offer some lessons on how infrastructure can be financed using private sector resources. The experiences in China, India and Brazil are very diverse but a number of issues are relevant across the countries reviewed in this chapter. More particularly, the country experiences reviewed above illustrate how overlapping challenges that impede private sector financing of infrastructure finance can be tackled.

Securing sufficient long-term financing for infrastructure investments

Providing adequate long-term financing is essential for infrastructure investments (Walsh et al. 2011). In China and Brazil, bank loans have been helpful to secure such financing: through BNDES in Brazil and through various alternatives in China, including implicit local government guarantees and bond insurance provided by publicly owned banks.⁴ To steer clear of maturity mismatches, banks usually cannot offer loans with tenors of more than five years, except if they receive longer-term funding, for example through long-term loans from development finance institutions (Bond et al. 2012). In India, for instance, banks have dominated infrastructure finance in recent years as well but the RBI has worried about asset liability mismatches and concentration risks and has not permitted similarly high levels of concentration in infrastructure assets to those that Chinese banks have accepted (Rastogi and Rao 2011). Moreover, the Indian government has not agreed to tolerate the contingent fiscal liability that a development bank such as BNDES might take on.

Motivating institutional investors to buy into long-term debt markets

One promising solution is for infrastructure projects to be funded in capital markets. However, encouraging institutional investors to buy into long-term debt markets is not easy in the absence of some form of credit enhancement (Walsh et al. 2011). Against

this background, donors have increasingly made use of official development assistance (ODA) to limit investment uncertainty by guaranteeing future returns, which permits donors to make investment projects more financially viable and mobilise funding from capital markets (ODI, ECPDM and DIE 2013). For instance, special purpose bonds, which are backed by donor commitments to service and repay debt from ODA allocations earmarked for specific purposes, and blended finance mechanisms, which involve the complementary use of grants and non-grant sources such as loans or risk capital, are two ways to tap capital markets on the basis of ODA commitments (Girishankar 2009; Wälde 2012). For example, the fact that sovereign states back special purpose bonds makes such bonds appealing for institutional investors that can offer long-term finance for infrastructure development (Spratt and Collins 2012). In India, for instance, domestic institutional investors offer great potential insofar as their investments are to date focused on government securities and insofar as the development of the Indian New Pension Scheme (NPS) promises considerable growth of assets under management of pension funds. Other countries, for example Chile, have managed to motivate institutional investors to buy bonds issued by fully private companies. Chilean pension funds are permitted to invest only in investment-grade securities, but private insurance companies have insured infrastructure bonds, enabling the pension funds to buy into these markets (Walsh et al. 2011).

Mobilising foreign investment

Foreign savings for infrastructure have been mobilised in a number of ways across different countries (Walsh et al. 2011). In several countries, multilateral lenders have played a significant role, whereas it has been more difficult to motivate foreign private finance. In China, there tends to be little foreign participation in infrastructure. India has relied on multilateral lenders but this source of funding will probably not grow much in the medium term, as infrastructure needs continue to be great, yet securing private financing, on the other hand, remains difficult and would necessitate institutional improvements. For example, Brazil has been open to foreign companies bidding on road projects for which a pro-business environment and transparency in policy administration have been essential. Brazilian energy companies have issued shares and bonds in international markets, having had investment-grade ratings and having indirectly profited from sovereign guarantees. This could be a promising option for some larger corporates or public utilities in LICs but the fiscal risks will have to be cautiously monitored and managed. Brazil has also managed to motivate foreign companies to invest in PPPs.

Another option to support infrastructure development in LICs is to mobilise innovative financing that makes use of the large and increasing savings surpluses of some countries held in sovereign wealth funds (SWFs),⁵ provide those resources to LICs on concessional terms and use them to promote private investments (Kingombe 2011; Noman 2011). Data from historical databases on SWFs' transactions suggest that SWFs can facilitate up to 50 per cent of the investment needs in infrastructure in Africa over the next decade, benefiting from emerging-economy investors and also African home-grown SWFs (Turkisch 2011). ODA might be leveraged to mobilise SWF resources by providing a guarantee for borrowings from SWFs and using ODA to

subsidise the interest payments for sovereign borrowing, and a Low Income Country Infrastructure Fund (LICIF), administered by multilateral development banks, could be established to intermediate the transactions (Noman 2011).

The focus of BRIC financing on infrastructure could have significant positive effects for trade performance by tackling infrastructure weaknesses in LICs (Mwase and Yang 2012). In Africa, China has become by far the most significant source of additional infrastructure financing (Noman 2011). India is also increasing finance for infrastructure projects in Africa. However, some worry about the impact on debt sustainability, subsidised export credits received by some BRIC firms, and labour practices (e.g. Brautigam 2010).

Supporting public–private partnerships

Well-structured PPPs in trade-related infrastructure can help LIC governments to raise the capital required to address infrastructure shortcomings. While investor hesitation has gone down as a limitation to PPPs in many LICs, for example in Africa, policy deficiencies and poor institutional arrangements have arisen as the new major hurdles (Esterhuizen 2012). It is therefore important to support governments to increase the assurance that PPPs are a promising approach to tackle the infrastructure gap. At the same time, it is not enough to merely put into operation an enabling policy framework and institutional arrangements; these frameworks also have to be backed up by sufficient political commitment (Kingombe 2011).

14.6.2 Lessons for trade facilitation

There are two key policy measures to reduce trade transaction costs: the enhancement of trade-related infrastructure, as discussed above, and trade facilitation, above all the rationalisation of trade procedures (ARTNeT and UNNExT 2012). Whereas the former typically demands huge amounts of capital, which tends to be scarce in LICs, the latter can be swiftly implemented once the political will is present. Furthermore, reforming trade procedures enables making better use of existing trade-related infrastructure in LICs. For example, it can allow the customs clearance checkpoints to handle more transactions as traded goods move faster through the facilities. The modernisation of trade procedures can therefore be regarded as key to improving trade performance in LICs. Faster, predictable and transparent customs clearance greatly helps traders to lower costs and enhance their supply chain management (International Finance Corporation 2006).

The political economy of trade facilitation

At the same time, trade facilitation is frequently highly difficult to put into practice, since it often goes against vested interests and is implemented without the ‘ribbon-cutting ceremonies’ that are attractive for politicians and donors (Rippel 2011). One key question is thus how such political economy challenges might be overcome in order to promote trade facilitation and other relevant reforms (Lui and Siziba 2012). In that context, it is essential to first identify the most relevant actors as well as their

motivations and interests. As a second step, it is important to analyse governance relations at the sector level to evaluate the feasibility of reforms and identify what drives or hinders reform as well as the wider context within which reform is supposed to happen. These analyses may lead to a change in focus, for example by moving from an exclusive focus on regional or multilateral trade facilitation protocols to concentrating on the demand-side for policy actions from interest groups or 'showcase' projects that might reduce the opposition to reforms (Lui and Siziba 2012).

Harmonisation and simplification of required documents

The most substantial part of the time needed for an import or export process is taken up by the preparation of the required documents and exchange of information among the relevant different parties (ARTNeT and UNNExT 2012). For LICs, the trade facilitation measure that yields the greatest increases in trade flows is the harmonisation and simplification of documents (OECD 2012). This entails both the harmonisation of trade documents, through reliance on international standards, and the simplification of documentary requirements, through the use of copies and the reduction of the number and complexity of required documentation. For instance, exports to different destinations frequently require different types of documentation, which – more than the mere number of documents – causes delays. Differences in documentary requirements should thus be cut back by aligning national procedures with international standards and conventions, and China, India and Brazil have undertaken successful measures in that regard. For instance, to prepare for the accession to WTO, China Customs amended its Customs Law, which was based on international standards and best practices and incorporated, for instance, the key principles and standards of the Revised Kyoto Convention.

Applying ICT and other modern technology, paperless trade procedures and single window facilities

Results of recent exercises modelling trade costs that are not related to tariff policy - emphasise that enhancing access to information and communication technology (ICT) facilities is essential to reducing trade costs (Duval and Utoktham 2011). China, India and Brazil have successfully applied ICT and focused on paperless trade and single window facilities for submission and processing of information and documents. The implementation of electronic data interchange (EDI) and single window systems enables simplifying documentary requirements and limiting the complexity of documents submission. A single window, for instance, enables data and documentation relating to export or import processes and transit-related regulatory requirements to be submitted just once to a single point, often through one electronic portal, allowing each agency involved to access the information it requires from this single repository in accordance with agreed interagency protocols (Tsen 2011).

Risk management techniques

The Chinese, Indian and Brazilian experiences illustrate the benefits of implementing risk management techniques in order to reduce the need for inspections. Inspection

frequently adds substantially to the time needed for export and import processes and affect their timeliness and predictability, which in turn are highly important for firms that aim to be part of international production networks (ARTNeT and UNNExT 2012). In accordance with key international agreements concerning modernisation of Customs Controls, such as the Revised Kyoto Convention and the World Customs Organization (WCO) SAFE Framework of Standards, many customs agencies are now procuring and employing cargo and baggage scanners which utilise both X-ray and gamma ray sources to augment the control of passengers' baggage and cargoes. Referred to under the generic name of non-intrusive inspection (NII), such equipment, if utilised correctly, can offer an efficient means of detecting high-risk cargoes at the point of import or export without the need to undertake what are often lengthy and costly resource-intensive physical inspections.

Industry- and sector-specific trade facilitation

The duration of the trade processes varies in a way that is strongly conditional on the kinds of goods being traded, as product-specific case studies underline. The trade procedure is especially complex for agricultural goods and food products, which are of high relevance in many LICs, and usually involve complex sampling and testing procedures, which make up almost half of the total export time in some cases (ARTNeT and UNNExT 2012). Another important issue for LICs is low-value exports. As mentioned above, Brazil has had positive experiences with special trade facilitation policies for low-value exports policies, which seek to tackle complex and expensive export formalities and the absence of affordable means of delivery.

Trade facilitation in preferential trade agreements

Preferential trade agreements – be they bilateral or regional in nature – usually lead to added documentary requirements for the trading partners with which they are negotiated. The need for such additional requirements in turn causes considerable trading holdups. Against this background, China and India have taken account of trade facilitation provisions being included in preferential trade agreements.

14.7 Conclusion

14.7.1 Ways forward on trade-related infrastructure

Prevailing large gaps in access to infrastructure services in LICs partly reflect inadequate levels of investment. According to World Bank statistics, LICs are estimated to currently spend about 3 per cent to 3.5 per cent of their GDP on maintenance of and investment in their infrastructure, whereas around 6.5 per cent to 7.5 per cent of GDP is required (Esterhuizen 2012).

New development partners can offer lessons for LICs on how to close infrastructure gaps. The Chinese, for example, have been successful in planning coherent investment, continuously re-examining infrastructure gaps and orienting resources accordingly and

making sure that infrastructure projects are linked, for instance connecting new ports by also building roads and railways that lead to the port (Bredenkamp and Nord 2010).

In the future, the traditional sources of funding for infrastructure, multilateral and official lending institutions, can provide merely a small share of the total funding requirements, deficit funding will cease to be a feasible alternative and the private sector will become ever more central. The key challenge for infrastructure development will be to develop clear financing and pricing policies.

The summary of results provided in the previous section offers a number of lessons for LICs in terms of infrastructure development and financing:

- **Establishing a favourable institutional environment for infrastructure development:** For example, the creation of an independent government body, comprising representatives from different ministries and affiliated agencies who report directly to and are held to account by the head of state, can help to administer infrastructure spending programmes and reduce operational challenges (Wirjawan 2010). A new Development Bank for Infrastructure and Sustainable Development could offer an additional source of funding for infrastructure in LICs (Bhattacharya et al. 2012).
- **Looking for domestic institutional investors:** The main alternative to having banks finance infrastructure, for example if governments are not prepared to agree to enough contingent fiscal liability, is to search for domestic institutional investors. In that context, as mentioned above, a promising source of long-term financing for infrastructure is pre-funded pension plans (Croce 2011; OECD 2011). Pension funds in developing countries have increased from around US\$422 billion in 2001 to \$1.4 trillion in 2010 (J.P. Morgan 2010). Given the rather young population of most developing countries and the recent introduction of pension plans, the assets held by pension funds are growing very quickly in many countries. Since payments from these funds take place over a long term and are highly predictable, they are a suitable source of funding for infrastructure that can provide stable long-term returns (Bond et al. 2012). In order to attract pension fund investment in infrastructure, a number of hurdles need to be addressed (Croce 2011). In many countries, pension funds do not have sufficient skills to invest in infrastructure projects, and governments often restrict the ability of pension funds to invest in infrastructure projects directly (Bond et al. 2012). Motivating institutional investors to move into infrastructure would require regulatory changes, above all by permitting large insurance companies and pension funds to diversify into bonds issued by private insurance companies. In that regard, a significant worry would be the credit risk of infrastructure bonds. Risk-seeking domestic investors might supply capital for bond insurance, especially if bankruptcy proceedings are enhanced to enable better recovery from infrastructure projects. A recent report by the African Development Bank encourages sponsors of infrastructure projects in Africa to turn to domestic institutional investors by issuing infrastructure project bonds (Mbeng Mezui and Hundal 2013).
- **Looking for foreign investment:** In addition to these approaches, LICs could attempt to attract foreign investment. For example, the excess savings in the

global economy, including a growing pool of savings in developing and emerging countries, should be used for infrastructure development by turning them into stable, predictable and scaled finance while providing investors with a safe, high-quality asset (Bhattacharya et al. 2012). To support the search for foreign investors, credit guarantees should be provided by the public sector, either directly through loan guarantees or indirectly through regulatory forbearance at public sector banks. The process of the public sector issuing credit guarantees raises fiscal risks, which should be managed well. For example, Chile has introduced a refined technique for approximating contingent fiscal liabilities owing to infrastructure investment (Walsh et al. 2011). Developing a comparable approach in LICs would offer enhanced information about contingent fiscal liabilities and shed light on these long-term risks, enabling their better management.

- **Supporting public–private partnerships and private participation in infrastructure:** Private participation in infrastructure has been low in LICs so far. In order to enhance this approach, a number of success factors should be taken into account (Kingombe 2011; Leigland 2010). First, the focus should be on project opportunities with a great probability of success, leaving the rest for funding by government budgets or ODA, which donors and international financial institutions can support by avoiding the pre-emption of potentially bankable projects by ODA (Leigland 2010). Second, a strong business climate – and leadership in easing restrictions on doing business – is critical to the success of private participation in infrastructure projects because it helps facilitate affordable project finance. For example, India’s investment-grade credit rating, achieved while the country was still classified as an LIC, has played a big part in its success in terms of private participation in infrastructure. Last but not least, private participation in infrastructure projects in LICs commonly requires extensive upstream preparation, involving sector, policy and legal and regulatory reforms (Leigland 2010). Moreover, one lesson for LICs to consider might be to begin with lighter forms of PPPs, such as operations and management (O&M) contracts, which are easier to enact, carry lower risks and are more likely to be successful, and then, as the environment for and understanding of PPPs improves, to shift towards more complex forms of partnerships with the build–operate–transfer (BOT) approach (Luthra 2012). Guidebooks and toolkits on PPPs can offer additional guidance (e.g. Thomsen 2005; UNESCAP 2011).

14.7.2 Ways forward on trade facilitation

Rationalising trade procedures need not, of course, be alike across countries, insofar as specific needs and capacities of the different implementing countries should be taken account of, above all in the context of LICs. At the same time, there are a number of trade facilitation reforms that recent research considers to be particularly beneficial:⁶

- **Taking account of political economy challenges for trade facilitation:** From a political economy perspective, one important step going forward includes

assessing the major barriers to ‘unlocking’ reform in trade facilitation in LICs. The question is, for example, to what extent these hurdles are due to a lack of technical capacity, institutional challenges, co-ordination failures or a lack of political will and how incentives can be modified to facilitate reform (Lui and Siziba 2012). Making progress also necessitates assessing who are the main drivers of trade facilitation, who is opposed to reform and why, and what role, if any, external partners can play in driving trade facilitation forward.

- **Supporting the harmonisation of documentary requirements across countries:** According to the OECD, for LICs, the trade facilitation measure that yields the greatest increases in trade flows is the harmonisation and simplification of documents (OECD 2012).⁷ LICs score much lower than other country groups in terms of progress regarding the number of documents necessary for exporting and importing, as well as the time required on average for the preparation of such documents, underlining this area as a priority target in future policy interventions and in technical assistance and capacity-building endeavours (OECD 2012). Moreover, compliance with international standards is relatively low (OECD 2012). There should, therefore, be efforts to make trade facilitation practitioners in LICs aware of existing international standards and increase capacities to implement them. LICs should also be involved in the establishment of new international standards.
- **Prioritising paperless trade, with a focus on EDI and national and regional single window facilities:** In most LICs, IT systems capable of electronic data exchange are in the process of implementation or already functional but only a few LICs offer full-time automated processing for customs agencies (OECD 2012). Many developing countries indicate that a single window is planned but numerous LICs have not yet implemented them; this emphasises the importance of efforts undertaken in this area (OECD 2012). Following the example of China, India and Brazil, it is therefore essential to promote EDI and single window facilities for submission and processing of information and documents and to boost the use of information and communication technology and the realisation of paperless trade. The United Nations Network of Experts for Paperless Trade in Asia and the Pacific (UNNeXT) offers guides and toolkits and an online database of trade facilitation and paperless trade experts, facilitating access to relevant expertise to enhance paperless trade implementation, for instance by implementing single window facilities (UNESCAP and UNECE 2012).
- **Minimising physical inspections, in particular through adoption of risk management techniques:** Few LICs have automated risk management implemented so far (OECD 2012). In the light of the Chinese, Indian and Brazilian experiences, LICs should consider introducing risk management techniques in order to reduce the need for inspections. The focus should be on non-intrusive technologies, such as X-ray scanning, to facilitate the cargo inspection process (International Finance Corporation 2006). At the same time, scanning equipment is costly and may, for example, not make adequate

sense in low-volume ports, as the case of extraordinarily high scanning charges in Maputo, Mozambique, illustrates (Bolnick 2007). However, some of the resulting costs might be transferable to other agencies or stakeholders, and the cost of procurement and maintenance of IT systems and X-ray scanners may be financed through processing fees (International Finance Corporation 2006). Establishing certification initiatives, which guarantee certain characteristics of goods through control of the production process instead of each delivery, are a potential alternative to scanning and could also help to bring down the frequency of inspections (ARTNeT and UNNEXT 2012).

- **Considering industry- and sector-specific trade facilitation initiatives, such as for agricultural products or low-value exports:** Sector-specific delays, for instance in the context of agricultural goods and food products, are often attributable to a shortage of the necessary testing facilities in the exporting country, and this, in turn, is a frequent problem in LICs. Industry- or sector-specific challenges should therefore be tackled through industry- or sector-specific initiatives, which may also have to take account of providing the testing facilities that are required for a smooth export process. In addition, trade facilitation policies for low-value exports offer potential for many LICs, inspired by their introduction in countries such as Brazil and the lessons learned from these experiences.
- **Including trade facilitation issues in bilateral and regional free trade agreements:** In order to speed up the process of fulfilling the additional requirements in preferential trade agreements, trade facilitation provisions should be included in such agreements, be they bilateral or regional in nature. The East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and Southern African Development Community (SADC), for example, already acknowledge the importance of improving trade facilitation in the context of deepening regional integration and have established a Comprehensive Trade and Transport Facilitation Programme (CTTTFP) in the Tripartite Free Trade Area (Lui and Siziba 2012).
- **One-Stop Border Posts (OSBPs) and trade corridors:** OSBPs and trade corridors should also be tried as part of regional integration. Notwithstanding the verifiable benefits that they generate, only a single OSBP has been implemented in all of Africa, established in 2009 at Chirundu (Lui and Siziba 2012).⁸ OSBPs, jointly managed by neighbouring countries, reduce duplication of procedures, allow greater efficiency and improve transit times. They are often connected to other initiatives such as trade corridors and efforts towards more integrated and coordinated border management (Barka 2012).⁹ Trade corridors have been at the centre of considerable discussion over the last years, above all across in Africa. The ability to transit goods and people easily along a well-structured trade corridor, with no delays or hindrances such as borders or any other barrier to trade, is a demanding vision that will need a concerted effort and support from every level of the governments within the recognised economic regions.

In sum, these trade facilitation approaches offer the potential to improve a country's trade performance. At the same time, trade facilitation by itself is not likely to generate substantial progress in LICs. Improvements in trade performance call for an integrated programme of strategic investments to tackle the supply-side constraints that constrain a country's possibility to make use of improved trading conditions. For example, recent research shows that trade facilitation reforms could support export performance in Africa, but other reforms, including the quality of the regulatory environment and the quality of the basic transport and communications infrastructure, as discussed above, are required as well (Tomasz and Kirkpatrick 2009). Moreover, the research indicates that the enhancement of on-the-border and behind-the-border policies leads to a higher increase of manufacturing exports in African countries than in the rest of the world. There is, thus, substantial potential for AfT measures to focus on aiding exports in LICs by promoting trade-related infrastructure and trade facilitation against the background of the experiences of emerging economies such as China, India and Brazil and their successful trade performance.

Notes

- 1 I am highly grateful for the helpful comments I received from a number of experts, including Yurendra Basnett, Andre Coelho, Cao Jianping, Alexandre Nicoella, Abilash Puljal, Ram Singh, Surender Singh, Dirk Willem te Velde and other, anonymous, reviewers.
- 2 Table 14.2 suggests that the efficiency of the customs clearance process is the relevant bottleneck for all three countries that offers most room for further improvement.
- 3 Electronic data interchange (EDI) is the structured transmission of data between organizations by electronic means and is used to transfer electronic documents or business data from one computer system to another computer system, i.e. from one trading partner to another trading partner without human intervention.
- 4 In the future, a proposed BRICS bank is likely to play an important role in cofunding infrastructure in developing regions. See Xiaotian (2013).
- 5 At the end of 2010, total SWF assets were around US\$4,300 billion, and Noman (2011) projects that they will rise to some \$10,000 billion by 2015.
- 6 For an outline of the World Bank portfolio on trade logistic and trade facilitation support, see World Bank (2011). De Wulf and Sokol (2005) have put forward insightful proposals on cross-cutting issues of customs modernization. In 2007, the European Commission (2007) also laid down clear criteria on a modern customs administration, which were described in its Customs Blueprints.
- 7 Across all countries, the most significant trade facilitation measures (i.e. those that have the highest impact on trade volumes) are *information availability*, harmonisation and simplification of *documents*, *automated* processes and risk management, streamlining of border *procedures* and *good governance and impartiality* (see OECD 2012).
- 8 The establishment of the OSBP has led to significant improvements and can be regarded as a success. For example, passengers and commercial traffic stop only once to complete border formalities for both countries, and waiting times for commercial traffic have been reduced from about two to three days to just two hours. In order for comparable initiatives to be established, sufficient political will and adequate budgets are needed (see Kwaranda 2010).
- 9 There is considerable potential for OSBPs in Africa; see Barka (2012). In Africa, the UK Department for International Development and Japan International Cooperation Agency have been working with EAC, SADC and COMESA to develop the OSBPs that underpin the North–South Transit Corridor. In Southeast Asia, the Greater Mekong Subregion's Cross-Border Transit Agreement (CBTA) entails implementation of single-stop inspection (SSI) and single window inspection (SWI) points. Joint processing initiatives also form part of the multidonor CAREC (Central Asia Regional Economic Cooperation) programme managed by the Asian Development Bank.

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PART III. FUTURE DIRECTIONS

Chapter 15

The Right to Trade: Rethinking the Aid for Trade Agenda

Joseph E Stiglitz and Andrew Charlton

15.1 Summary

The link between aid and trade has been an important nexus in the global development framework since the World Trade Organization (WTO) launched its 'Aid for Trade' initiative at the 2005 Ministerial in Hong Kong.

Proponents of Aid for Trade declared at the time that its purpose was to recognise the disadvantage of developing countries participating in the global trading system, and to bolster the effectiveness of aid disbursements.

Yet Aid for Trade was also a creature of pragmatic politics. The trade community was motivated to give alms to the poor countries, which felt duped by the undelivered promises of the Doha Development Agenda. After the walkout in Cancun, Aid for Trade was a libation intended to induce developing countries back to the negotiating table. At the same time, the aid community was seeking a bulwark against growing criticism that development assistance was ineffective. By linking development aid with trade outcomes, donors and recipients could point to long-term poverty-reduction impacts of their projects.

Seven years later, Aid for Trade has become a fixture in the development landscape, accounting for no less than 25 per cent of total official development aid (ODA) (OECD and WTO 2011). Aid for trade is being positioned as a building block in the future development agenda beyond the 2015 expiry of the Millennium Development Goals.

This chapter analyses whether Aid for Trade has delivered on its promise. Has it delivered incremental resources to developing countries? Has it been a complement to pro-development liberalisation, unlocking genuine progress in multilateral trade reform? And has the focus on trade made aid more effective? As we show, considerable doubt remains on each of these questions. The Aid for Trade initiative may well be primarily a reallocation rather than an increase in assistance, and constitute a relabelling rather than a fundamental reform of the global trade and development framework.

This chapter also considers alternative means to improve trade outcomes for developing countries. We propose that a 'right to trade' and a 'right to development' be enshrined within the WTO's dispute settlement system. These rights would give developing

countries increased opportunity within current and future trade agreements to expand their trade and safeguard their development.

In addition, we propose that Aid for Trade funds should be consolidated into a more coherent and predictable framework. Dedicated funds should be committed by rich countries to a Global Trade Facility and dispersed through a transparent and competitive process.

Together these proposals would go some way to creating a genuinely pro-development trade liberalisation agenda, giving developing countries greater scope to eliminate the international trade barriers and domestic capacity constraints that limit their ability to pursue export-led development pathways.

15.2 Introduction

The World Trade Organization's 'Aid for Trade' initiative was launched at the 2005 Ministerial in Hong Kong to recognise the disadvantage of developing countries participating in the global trading system, and bolster the development dividend of the flailing Doha Round. Seven years since the birth of the Aid for Trade initiative, huge resources have been mobilised. Fully 25 per cent of total ODA is now channelled, or at least labelled, as Aid for Trade (OECD and WTO 2011). Yet questions remain as to whether the coming together of aid and trade has delivered on the promise of additional resources for developing countries. If Aid for Trade has not been truly incremental to existing aid commitments, there is the further question: has the changed focus made aid more or less effective, resulting in stronger growth or reduced poverty?

Perhaps the greater concern is that Aid for Trade was initially offered as a complement to additional market access to be provided through the Doha Development Agenda – it was supposed to enhance, rather than replace, pro-development liberalisation on the part of the advanced countries. Unfortunately, as advanced countries' commitment to Doha has faded, Aid for Trade is beginning to seem more like a pecuniary pay-off for undelivered promises.

This chapter outlines an alternative path for Aid for Trade as part of a pro-development, multilateral liberalisation agenda. First, the World Trade Organization would enshrine a 'right to trade' and a 'right to development' operational within the dispute settlement system. This right would give developing countries legal recourse against advanced countries whose policies materially impact the development of poor countries by restricting their ability to trade. Second, dedicated funds committed by rich countries to a Global Trade Facility would be administered by the UN Conference on Trade and Development (UNCTAD) and dispersed through a transparent and competitive process based on need and impact.

15.3 From 'Trade Not Aid' to 'Aid for Trade'

The institutions of the modern multilateral trading system were established at a time of relative, albeit far from uniform, consensus about the relationship between trade

liberalisation and development. Tariff reduction was widely understood to have a clear and positive effect on trade flows. Trade flows were deemed to be positively associated with economic growth. And trade-induced growth was believed to enhance general welfare. Armed with these supposed certainties, developed and developing countries were emboldened to embrace the liberalisation of global trade. The Uruguay Round was struck and the World Trade Organization was born.

The Uruguay Round was by far the most ambitious trade liberalisation in history. After effectively sitting out the first four decades of multilateral trade negotiations, developing countries' participation in the Uruguay Round led them to accept substantial liberalisation of their trade regimes. It covered tariff and non-tariff barriers in industrial and agricultural goods and extended multilateral rules to new areas, including services and intellectual property. International organisations including the World Bank and the Organisation for Economic Co-operation and Development (OECD) strongly supported the round. They published estimates of large projected welfare gains in the order of US\$200–500 billion per year. A large share of these gains, it was argued, would accrue to the poorest countries and, on that basis, the international financial institutions (IFIs) urged developing countries to sign up.¹

Almost as soon as the ink dried on the Uruguay deal, it became clear that the agreement was unbalanced. The final terms reflected, in large part, the priorities of the advanced countries. Market access gains were concentrated in areas of interest to developed countries including services, intellectual property and advanced manufacturing. Far less progress was made in areas of interest to the poor countries such as agriculture (including subsidies to agriculture) and textiles. The effect was to concentrate tariff reductions on products exported by the rich countries. Laird (2002) estimated that after the implementation of the Uruguay Round Commitments, the average OECD tariff on imports from developing countries was four times higher than on imports originating in the OECD.² Developed countries had also maintained non-tariff barriers and other protectionism including agricultural subsidies and phytosanitary conditions, which effectively limited the competitiveness of farmers and some other producers in poor countries.³

Even where the exchange of market access had been *de jure* reciprocal, it was *de facto* unbalanced. Exporters in rich countries were able to quickly take advantage of greater market access, but the poor countries found their ability to export to rich countries was limited by a range of constraints including non-tariff barriers, weak infrastructure and supply constraints.

To make the 'Uruguay hangover' worse for developing countries, they rapidly realised that as well as receiving only a small share of the gains from the Uruguay Round,⁴ they were now subject to a remarkable range of additional obligations and responsibilities. Finger and Schuler (2000) estimated the implementation costs of just three areas (customs valuation, Trade Related Aspects of Intellectual Property Rights [TRIPS] and sanitary/phytosanitary measures) would cost each developing country around US\$150 million – a huge sum for many least-developed countries. Overall the agreement was not only unbalanced, it was unjust. Some estimates suggested the 48 least-developed

countries had actually lost a total of US\$600 million a year as a result of the Uruguay Round (around 5 per cent of their gross domestic product [GDP]).

There was increasing concern too about the high developmental and health costs of some of the obligations undertaken under the Uruguay Round and the Financial Services Agreement. For instance, access to lifesaving generic medicines was restricted; countries' health budgets were hit badly and/or access to life-saving medicines was diminished; and newly flourishing generic drug companies in developing countries saw their prospects wane. Local financial firms found it difficult to compete with large multinationals, and local small businesses often seemed unable to gain access to credit from these multinationals. A growing body of literature suggested that financial market liberalisation (as pushed by the Financial Services Agreement) did not promote growth, but did enhance instability (Detragiache et al. 2008).

Even after the results of the Uruguay Round were clear, the international financial institutions continued to advise the developing countries that liberalisation was in their best interests. Developing countries were encouraged to address their concerns through a fresh round of liberalisation. The acting European Trade Commissioner, Sir Leon Brittan, said 'the only way to address the issue is through a new round of negotiations. Indeed, I would ask all WTO members, including developing countries, whether they are entirely happy with the present trading system. If the answer is no, it is clear that the only way of improving upon that system is in a new round' (see Stiglitz and Charlton 2005: 39, and references cited therein). The answer to the problems of liberalisation was more liberalisation. But developing countries' experiences had made them wary of a repeat of the unfairness of Uruguay. Fresh from what they felt was a betrayal,⁵ developing countries were cautious about signing up to another round. The first attempt to establish a new round of trade talks in 1999 in Seattle was a debacle. Sceptical developing countries torpedoed the meeting. Outside on the streets some 40,000 people protested the injustices of the global trading system.⁶

To restart trade talks, in 2001 at Doha the advanced countries made a string of promises to put the poor at the centre of the new round – even naming the talks the Doha Development Agenda. The Ministerial Declaration acknowledged the unfairness of the past and promised to 'place (the developing countries') needs and interests at the heart of the work program' for the new round. These assurances soothed the concerns of many developing countries. Ever hopeful, they signed up to a new round.

The goodwill lasted less than two years.⁷ When developing countries walked out of the 2003 meeting in Cancun, the Doha Round stumbled into a deadlock from which it never recovered. By July 2005, the negotiations had reached an impasse. Recognising the crisis, WTO Director-General, Pascal Lamy, made a decision to suspend negotiations. The stalling of the Doha Round and the implacable sense that the world trading system was manifestly unfair to developing countries led the WTO, its members and civil society to search for alternative avenues to promote trade, bring development closer to the centre of the WTO's work programme and mollify the concerns of developing countries. In this context, Aid for Trade – an obvious carrot for the developing countries – was an idea whose time had come.

15.3.1 Questioning the benefits of liberalisation

At the same time that developing countries began to fear that the trading system was unbalanced, they also began to more critically question the benefits of trade liberalisation. This provided a second impetus for Aid for Trade.

The welfare impacts of free trade were formalised in modern economics by Paul Samuelson (1938).⁸ However, the underlying assumptions that yield this conclusion are highly restrictive and often fail to reflect many of the relevant characteristics of developing economies.⁹ Moreover, neither Samuelson nor subsequent analyses provided a strong analytic basis for the notion that trade liberalisation would lead either to stronger development or faster growth. Nonetheless, during the 1980s, neoliberal policy prescriptions based on the positive welfare impacts of trade liberalisation gained support among the international financial institutions.

Import substitution policies and managed trading regimes fell out of favour and developing countries were encouraged to rely more on market mechanisms.¹⁰ Developing countries were told they must reduce their own tariffs if they were to reap the benefits of engagement in the global economy. Influenced by advice from the international financial institutions and cajoled by aid conditionality, whereby aid was extended on the condition of trade liberalisation, many developing countries shifted their strategy to participate more actively with the WTO.

In the last decade, there has been a significant reappraisal of the Washington consensus, and especially the relationship between trade liberalisation and economic development (Chang 2002). Although some research in the 1990s appeared to confirm that trade liberalisation promoted economic growth, several subsequent studies cast doubt on these results on the basis that the key 'openness' variables employed in earlier empirical studies poorly reflected trade liberalisation (Rodriguez and Rodrik 2000). Recently, successive studies have emphasised the heterogeneity in developing countries' experience with liberalisation and economic growth. For instance, Wacziarg and Welch (2008) found that roughly half of the countries in their survey experienced zero or even negative changes in growth post-liberalisation. Other studies have questioned the direction of causation – it may be possible that rather than being caused by liberalisation, successful development leads to integration into the global economy.¹¹ Estevadeordal and Taylor (2008) agree that most of the prior literature is weak, but find some support for positive effects on growth of liberalising intermediate goods and imported capital tariffs.

While there remains controversy about the relationship between trade liberalisation and growth, what is clear is that the simple and clear link asserted by liberalisation advocates has not been verified by the data. It may be that under certain circumstances (for instance, when the economy is fully employed and when financial markets work well – circumstances applicable in few least developing countries) trade liberalisation, at least of intermediate goods, could enhance growth. Trade liberalisation might lead to growth when accompanied by certain other policies. However, trade liberalisation, as practised, has often had adverse effects on growth, for reasons that are explained shortly below.

If there are strong doubts about the relationship between trade liberalisation and growth,¹² there is even less consensus on the causal link between liberalisation and poverty. The evidence is at best weak (see Bannister and Thugge 2001; Winters et al. 2004) with many studies finding that trade liberalisation, even when it is associated with economic growth, also leads to an increase in inequality (World Bank 2005; Topalova 2010).

Earlier theoretical literature had explained why results suggesting that trade liberalisation might not lead to an increase in well-being should not have come as a surprise. Dasgupta and Stiglitz (1977) and Newbery and Stiglitz (1984) had noted that trade liberalisation increased risk, so much so that everyone could be worse off. These concerns were especially relevant in developing countries, where risk markets were imperfect. Second, the process of adjustment to liberalisation was costly. Neoclassical theory (upon which most of the pro-liberalisation analyses were based) simply presumed that workers would move from inefficient protected sectors to efficient unprotected sectors, without cost. What often happened in reality was that they moved from inefficient protected sectors into unemployment. Output decreased rather than increased. It should have been obvious that the neoclassical model did not describe economies in which there were, even before liberalisation, high levels of unemployment. In these cases, trade liberalisation simply added to the ranks of the unemployed. Again, this was a concern especially in developing countries, where financial markets often didn't work well and where there was a scarcity of entrepreneurship. It was harder to create new jobs than to destroy old jobs. Moreover, trade liberalisation took away one of the most important sources of government revenue. Most countries found it difficult to replace tariffs, say with a value added tax (VAT) (Aizenman and Jinjark 2009). The constraints in government revenues forced cutbacks in investments in education and infrastructure, thereby impairing development.

At first, the impacts on inequality came as a surprise, since the conventional model (the Samuelson–Stolper theorem)¹³ predicted an increase in unskilled wages in developing countries.

However, three factors contributed to the increase in inequality typically associated with liberalisation:

- i. As we have already noted, it often was done in a way that resulted in increased unemployment. This had adverse effects directly on poverty and inequality (in particular, since it is typically those at the bottom who suffer the most from unemployment [Furman and Stiglitz 1998]). But it also has an indirect effect: higher unemployment puts downward pressure on wages.
- ii. Liberalisation was often asymmetric, with capital and goods liberalisation outpacing labour market liberalisation.¹⁴ This adversely affected workers' bargaining position, and put pressure on governments to cut taxes on capital and, correspondingly, programmes for those who were less mobile – unskilled workers. Thus before taxes and transfers, income became more unequal, and after taxes and transfers it was even worse.

- iii. The unskilled didn't benefit from the creation of new export jobs, and they were often in agriculture, which could be hurt by subsidised agriculture exports from developed countries.¹⁵

The reappraisal of the main tenets of the Washington consensus in economic literature was an inevitable consequence of the mixed experience among the developing countries that had embraced trade liberalisation. Many countries that had, according to the neoliberal prescription, done the 'right things' (that is, not only had liberalised, but followed other policy dictates of the Washington-based international institutions) subsequently stagnated. And many countries that had not followed the Washington consensus had achieved considerable success. Rodrik (2001) argued that the three primary models of successful development in the twentieth century all relied on managed trade regimes: import substitution, as practised by a number of countries in the 1960s; outward-orientated industrialisation, as practised in East Asia in the 1980s; and the state-directed capitalism of China in the 1990s. Chang (2002) showed that almost all of today's rich countries used tariff protection and subsidies to develop their industries, and 'Britain and the USA, the two countries that are supposed to have reached the summit of the world economy through their free-market, free-trade policy, are actually the ones that had most aggressively used protection and subsidies'.¹⁶

The ultimate refutation of the trade-not-aid mentality came with the introduction of highly favourable market access preferences for least-developed countries, including the EU's Everything but Arms initiative (EBA) and the United States' African Growth and Opportunity Act (AGOA). These initiatives, though a positive and important step, have had limited impact on beneficiary countries' exports. Sub-Saharan Africa's share of world exports decreased dramatically between 1980 and 2006, falling from 3.9 per cent to 1.9 per cent. African least developed countries (LDCs) did even worse, seeing their average share fall from 0.06 per cent to 0.02 per cent over the same period. Multilateral tariffs, it turned out, were not the binding constraint on the ability of these countries to trade. Their capacity to export was hindered by a range of non-tariff trade costs and barriers, as well as supply constraints.

These three factors – the historical unfairness of previous trade agreements; the high adjustment costs and disappointing results from trade liberalisation; and the broader reappraisal of the relationship between trade, trade liberalisation and development – changed developing countries' approach to multilateral trade liberalisation and their engagement with the WTO. If the gains from trade were not automatic, as the Washington consensus had implied, and the relationships were complex and contingent and the outcomes were heterogeneous, developing countries would (and should) be significantly less sanguine about further trade liberalisation.

At the 2003 WTO meeting in Cancun, UNCTAD Secretary-General, Rubens Ricupero, spoke for many when he acknowledged the shifting mood: 'Trade liberalization is no panacea for developing countries. For many of them, it involves considerable adjustment and social costs. There is a need for synergy and proper sequencing – between the capacities of the developing countries, the level of

obligations they are to take on, the cost of implementation, and the adequacy of financial and technical resources available to them' (Ricupero 2003: 3).

15.3.2 Birth of Aid for Trade

Aid for trade was born in this context. Once the developing countries began to lose faith in the prospects for multilateral liberalisation, the rich countries had to put something else on the table. Aid for trade was a salvo. Some saw it as a recognition that previous agreements had been unfair, others said it was recognition that developing countries faced adjustment costs associated with trade liberalisation, others still saw it as a means to increase the benefits of market access. It was all of these things, but the fundamental driver of the Aid for Trade initiative was that the trading system was in crisis. If the developing countries walked away from the round, the WTO's agenda for expanding trade would grind to a halt.

In early 2005 at the International Monetary Fund (IMF) – World Bank spring meeting, the Development Committee put Aid for Trade firmly on its agenda and resolved 'to work with others to develop proposals to help developing countries adjust to and take advantage of the round, for consideration by our next meeting' (International Monetary Fund and World Bank 2005: 2). A few weeks later at the Gleneagles G8 meeting in May, Heads of Government committed 'to increase our help to developing countries to build the physical, human and institutional capacity to trade, including trade facilitation measures',¹⁷ and called 'on the IFIs to submit proposals to the annual meetings for additional assistance to countries to develop their capacity to trade and ease adjustment in their economies'.¹⁸

By late 2005 the WTO had rallied behind the proposal. At the WTO Ministerial Conference in Hong Kong in December 2005, the 'Aid for Trade Initiative' was officially launched. The Hong Kong Ministerial Declaration reflected the interests and objectives of both the WTO and donors: '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'.¹⁹ Shortly thereafter, Aid for Trade moved toward the centre of the WTO's work programme. Director-General, Pascal Lamy, said in 2006: 'We cannot ignore the costs of adjustment, particularly for the developing countries, and the problems that can arise with the opening up of markets. These adjustments must not be relegated to the future: they must be an integral part of the opening-up agenda. We must create a new "Geneva consensus": a new basis for the opening up of trade that takes into account the resultant cost of adjustment' (Lamy 2006).

It is noteworthy that Lamy emphasised only the adjustment costs. The term 'adjustment costs' suggested that the costs were a short-term problem: they didn't recognise that trade liberalisation might actually impede longer-term development. Advocates of trade liberalisation never fully understood that even in equilibrium, trade liberalisation might have adverse effects, and especially so if it was pursued in an asymmetric way.

Yet even if liberalisation did not have these adverse effects, and even if the multilateral trade agreements (the Uruguay Round in particular) had been 'fairer', there would be a need for Aid for Trade. Symmetric agreements can have asymmetric effects, as we have already noted, because of the asymmetries of different countries. (That was part of the rationale for special and differential treatment.) Market failures are especially pervasive in developing countries and there is, accordingly, need for government interventions. Trade requires resources – infrastructure and finance – that developing countries often cannot provide on their own. Aid for trade can be seen in part as filling in these lacunae.²⁰

15.3.3 Questioning the effectiveness of aid

Aid for trade was born at least in part as a result of a crisis in the global trading system. But it would not have got off the ground with the support of the trade community alone. Aid for trade received additional impetus from the aid and development communities, which were faced with a parallel series of challenges to significantly scale-up disbursements and to demonstrate the effectiveness of development programmes. At the United Nations Millennium Summit in 2000, world leaders came together around eight goals for the poorest countries, which came to be referred to as the Millennium Development Goals. Two years later at the financing for development conference at Monterrey in Mexico, leaders recognised 'dramatic shortfalls in resources required' to achieve these goals.²¹ In subsequent years, major advanced economies made significant commitments to increase their aid budgets. Several major countries committed to a collective foreign aid target of 0.7 per cent of gross national product (GNP) by 2015, these targets have not for the most part been reached.²²

At the same time the aid community faced a challenge to its legitimacy from those who questioned the benefits of aid. In the last two decades, researchers have scrutinised the conditions under which aid is effective. William Easterly argued that the US\$568 billion spent on aid to Africa over the last 40 years has not lifted average African incomes.²³ Other recent cross-country analyses also conclude that the relationship between aid and development is weak and often ambiguous (Rajan and Subramanian 2008; Easterly et al. 2003; Hubbard and Duggan 2009). Clemens et al. (2012: 590) do find that it is 'plausible [...] that aid causes some degree of growth in recipient countries, although the magnitude of this relationship is modest, varies greatly across recipients and diminishes at high levels of aid'. In a recent meta-analysis of the literature, Doucouliagos and Paldam (2011) conclude that the overall finding on 'aid ineffectiveness' has not been overturned, though there are some results suggesting certain components of aid *may* be effective.

It is perhaps not surprising that the links between aid and development are often difficult to discern. Aid has frequently been provided for with non-economic objectives, such as emergency assistance following disaster relief, or for political or geostrategic reasons. During the Cold War, billions of dollars of aid supported corrupt and tyrannical dictators such as Joseph Mobutu of Zaire (now the Democratic Republic of the Congo) and Jean-Bédél Bokassa of the Central African Republic. Many well-intentioned aid projects were rendered ineffective through poor conception and

execution, or fettered by tenuous and sometimes counterproductive conditionality. In other cases, aid may have had a negative effect on growth through 'Dutch Disease' effects – where inflows of capital reduce the competitiveness of the export sector through the appreciation of exchange rates.

Moreover, because the effects of aid (such as education) often take years to be realised, it is hard to assess with contemporaneous data the effects of aid. More generally, the cross-section 'aid and growth' literature is bedevilled by all the econometric problems associated with the 'trade and growth' literature, to which we referred earlier. The effectiveness of aid clearly depended on circumstances.²⁴

Critiques of the impact of aid have become more vociferous as the global campaigns to increase aid have gained momentum. Policy-makers and researchers have responded, both in a commitment to make aid more effective and in analyses to enhance understanding of what is required to do so. At Monterrey donors wanted to know that aid would be used as effectively as possible before they agreed to increase their ODA budgets.

In 2003 aid officials and representatives met in Rome for the High-Level Forum on Harmonization, where donor agencies committed to work with developing countries to better co-ordinate their activities. Two years later, the Paris Declaration on Aid Effectiveness was endorsed – a comprehensive attempt to establish principles to improve the effectiveness of aid.

Aid for trade has been a beneficiary of these trends. It has been presented as an effective channel through which significantly increased aid can be disbursed. At the same time linking aid to trade has enabled the development community to point to longer-term impacts of assistance programmes on growth and economic development.²⁵ This became especially relevant as many in the development community shifted attention away from just poverty to growth, in the belief that it was only or mainly through growth that there would be long-term, sustainable reductions in poverty.

Moreover, if Aid for Trade did enhance trade, then a stronger case could be made that it was in the self-interest of the developed countries to provide such assistance. Exporters in developed countries knew that their exports could only increase with the enhanced trading capacity of developing countries.²⁶

15.4 Has bringing aid and trade together helped?

The concurrent challenges facing the aid and trade communities led to a marriage of convenience from which Aid for Trade ensued. As the development promises of the Doha Round crumbled, the trade community had an urgent need to mollify developing countries by demonstrating a tangible development agenda. At the same time, the aid community of multilateral institutions, bilateral donors and non-governmental organisations (NGOs) were caught between the challenge to ramp up their disbursements to absorb growing national ODA commitments and increasingly strident critiques of the effectiveness of existing aid programmes. 'Aid for trade' enabled the trade and aid communities to leverage one another. The World

Trade Organization could point to significant development-focused activity. The aid community accessed an expanded mandate to invest growing aid resources in productive capacity.

That Aid for Trade was an expedient product of circumstance is neither especially surprising, nor necessarily concerning – many positive initiatives have been born of pragmatism. As we wrote (Stiglitz and Charlton 2006), Aid for Trade had the potential to complement trade liberalisation and increase the ability of developing countries to take advantage of market access opportunities delivered through multilateral trade negotiations.

Yet from the start there were immediate fears that Aid for Trade was merely a semantic façade. After all, the concept of aid programmes focused on trade was not new. The International Trade Information Centre was established in 1964 under the General Agreement on Tariffs and Trade (GATT) to provide trade-related assistance. In the post-Uruguay era, trade-related assistance was stepped up through the Integrated Framework (IF) for Trade-Related Technical Assistance to Least-Developed Countries established in 1997 and the Joint Integrated Technical Assistance Program (JITAP) for Africa established in 1998. More broadly, to the extent that Aid for Trade covers wider assistance to developing countries to develop their supply-side capacity, much development aid over the last 20 years – including assistance in developing infrastructure and institutions and other support for integration into the global economy – has been trade-related.

Simply renaming this assistance ‘Aid for Trade’ would not deliver incremental benefit.²⁷ There were many warnings at the time of the launch of Aid for Trade that it would only be beneficial if it was additional, predictable and responsive to the needs of recipient countries (including the private sector), and increased the coherence of poverty-reduction assistance. Without these qualities, Aid for Trade would be little more than a repackaging of existing commitments – another *legerdemain* on the part of the rich countries.

Evaluating the impact of Aid for Trade involves two questions. First, have Aid for Trade projects been effective at promoting trade and development? This is the question that most of the analysis of Aid for Trade has focused on, and is relevant to the design and delivery of aid programmes. But this question goes to whether Aid for Trade is a good way to deploy bilateral development assistance, not whether it is the best way. The second question poses a tougher test: has the emergence of Aid for Trade increased the overall effectiveness of global aid programmes? This question incorporates issues of additionality and opportunity costs in overall development assistance.

15.4.1 Have Aid for Trade programmes helped to promote trade and development?

One would have hoped that Aid for Trade would have begun with an analysis of the major impediments facing developing countries with respect to trade, and then systematically gone about reducing those impediments. That kind of systematic analysis has not, for the most part, occurred. Had it occurred, it would have been

realised that there are policies (such as escalating tariffs [see Stiglitz and Charlton 2005] of the advanced industrial countries) that impede developing countries' trade and development and which could be easily altered, in some cases with net positive benefits to the developed countries. It would have been realised too that the absence of small business finance has been a major supply constraint, and again there are low-cost policies and programmes that might have facilitated the flow of credit to local small enterprises.²⁸ Finally, a major barrier to trade (supply constraint) is lack of infrastructure.

Nonetheless, we believe that trade-related programmes funded by bilateral donors *can* be effective. Indeed it is possible that Aid for Trade, by being more focused on removing supply constraints on trade, could have leveraged effects on growth.²⁹ Several studies have demonstrated that aid spent on promoting trade is positively associated with global trade, particularly in poor countries with weak infrastructure (Portugal-Perez and Wilson 2012).

Trade facilitation projects in particular have demonstrated considerable benefits. Trade facilitation covers a range of behind-the-border actions including institutional and regulatory reform, infrastructure, and customs and port efficiency. The total value of trade facilitation funding has increased considerably in recent years. Funding by the World Bank has risen five-fold in the last seven years and trade facilitation projects make up around half of all trade-related development assistance. Helble et al. (2011) used 16 years of trade and aid data for 40 donor countries to analyse the impact of trade facilitation on trade. Their results suggest that a 1 per cent increase in Aid for Trade facilitation is associated with about US\$290 million of additional exports from the recipient countries.

15.4.2 Has the emergence of Aid for Trade increased the overall effectiveness of aid?

The key problem in evaluating the 'Aid for Trade initiative' is that it is difficult to ascertain the counterfactual, i.e. what would have happened in its absence? Without evidence of additionality and a clear distinction between projects that would have occurred anyway under development programmes, it is challenging to assess whether the initiative has delivered *incremental* benefits to developing countries.

The promise of Aid for Trade was that it would prove to be more than new nomenclature. When UNCTAD Secretary-General, Rubens Ricupero, called for Aid for Trade at the 2003 Cancun WTO meeting, he specified that trade assistance must be additional, 'developing countries need aid for trade, and such aid must not come at the expense of aid for development'. The WTO Ministerial Declaration in Hong Kong also called for 'appropriate mechanisms to secure *additional* financial resources for Aid for Trade' [emphasis added] (WTO 2005).

However, in the seven years since the initiative was launched, there has been scant evidence that Aid for Trade has been additional. Certainly the volume of Aid for Trade has increased. According to the OECD and WTO's 2011 review, *Aid for Trade at a Glance*, Aid for Trade commitments reached US\$40 billion in 2009, a 60 per cent

increase over the decade. The report claims that much of this increase is incremental to regular development assistance. But these claims are not fully convincing. While the OECD and WTO have invested significant resources in building an inventory of information on Aid for Trade flows, there remains no comprehensive analysis of Aid for Trade quality or its effectiveness (either in its direct mission of promoting trade or its more fundamental goals of promoting growth and poverty reduction) or the extent to which it represents additionality. For the most part, the measurement and evaluation framework relies on self-assessment. As donors provide their own financial and other reporting, there is little independent verification of additionality or impact.

Indeed, there is no clear framework for how additionality is measured. Many of the commitments made by governments in the last decade have been opaque and the amounts are re-announced several times in successive packages. Worse, the line between more general aid for development and Aid for Trade is arbitrary (how close to a port does a road need to be in order to be Aid for Trade?). This blurring of categories means that it is easy for donor countries to count development projects as Aid for Trade projects (Page 2007).

Since most countries have not reached their commitment to reach 0.7 per cent of GDP in aid, it is hard to see Aid for Trade as additional. It is certainly not additional to what they had previously promised to deliver.

If Aid for Trade is not additional to existing aid commitments, then donors must answer some fundamental questions about its purpose and utility. Development assistance reclassified as Aid for Trade obviously cannot fulfil the compensation motive arising from the unfairness of the Uruguay Round. And developing countries will hardly feel better about the collapse of the Doha Round knowing that assistance that they would have otherwise been receiving is now labelled Aid for Trade.

Assessments of the effectiveness of Aid for Trade have been equally problematic. External measurement of the results of Aid for Trade is challenging. Many projects do not have defined baselines against which impacts can be assessed.³⁰ There is only a weak framework to evaluate the impact of Aid for Trade projects and programmes on welfare, growth and inequality.

Indeed, despite evidence of success in case studies in specific areas, structural features of Aid for Trade as it has emerged give cause for doubts about its *overall* effectiveness. The model of bilateral disbursement (which has been *de facto* adopted by donor countries) has meant that Aid for Trade comes with all the challenges of traditional development aid. Priorities may be skewed toward the interests or preferences of donors, and there may be limited country ownership and a range of explicit or implicit conditions.

Earlier, we argued that if Aid for Trade has not resulted in additional resources, then it certainly can't perform the role intended as providing partial compensation for the unbalanced nature of the trade agenda or the failure of developed countries to live up to their promises that the Doha Round would be a Development Round. Yet developing countries might be even more concerned: if Aid for Trade is less effective at poverty reduction than unrestrained aid, then the Aid for Trade movement could have been counterproductive, at least as far as that critical goal is concerned.³¹ If aid

for trade has not lead to more assistance, then it may create a high opportunity cost. By imposing an additional constraint on the way aid money is spent, Aid for Trade has the potential to have a negative impact on developing countries.

15.5 A proposal to support pro-development trade liberalisation

Aid for trade has failed to live up to its promise of additional, predictable and effective finance to support developing countries' integration into the global economy. More importantly, Aid for Trade may not be addressing the fundamental concerns with the global trading system and aid system that gave rise to it, and instead has become a means for both the aid and trade communities to paper over their weaknesses without doing much for the fundamental concerns of poor countries.

This chapter proposes a novel approach to Aid for Trade that would go some way to address the underlying unfairness of the global trading system and deficiencies in aid arrangements. Our proposal is to make aid and trade liberalisation work for poor countries and tied directly to specific development objectives.

15.5.1 The 'right to trade'

There are significant parts of industrial countries' trade policy that materially restrain the development of poor people and constrain the ability of developing countries to participate in international trade. In fact, perversely, the global trading system is still stacked against the poorest – the areas of trade where barriers are the highest (agriculture, textiles etc.) are also the areas of most importance to developing countries. As a consequence, as we have noted, the average tariff in OECD countries on imports from other OECD countries is significantly lower than imports from non-OECD countries. For example, import tax collected by the United States from the imports originating in Bangladesh and Cambodia amounted to US\$1 billion in 2008, which is more than the total amount collected on imports from the United Kingdom and France (Centre for Global Development 2010). In addition, it is not just the average level of tariffs that matter; it is their structure. Escalating tariffs are an impediment to development. And perhaps even more important than tariffs are the non-tariff barriers faced by developing-country exporters.³²

Aid for trade cannot be a substitute for removing these inequities – it must be a complement rather than a replacement for fundamental change to the trading system. This was recognised in 2005 in the Hong Kong Ministerial Declaration 'Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the [Doha Development Agenda] DDA, particularly on market access. However, it can be a valuable complement to the DDA' (WTO 2005).

As the development promise of the Doha Round has faded away – only to be replaced by concerns that what remains may even have an adverse effect on some of the poorest countries – it has become clear that there is no imminent prospect of a pro-development reform to the trading system through formal rounds of multilateral liberalisation. Instead, it is imperative to install alternative

mechanisms to rebalance the global trading system and make trade work for poor people. To achieve this, we propose that members of the World Trade Organization should adopt a general 'right to trade' and a 'right to development' operating within the dispute settlement body.

Article 20 of the GATT provides for certain exceptions to the applicability of trade commitments, e.g. for matters of national security, health and the environment. So too, TRIPS included a provision for compulsory licences for health – the breadth of that provision was a major subject of controversy prior to the Cancun meeting. The Shrimps–Turtle case provided an important set of exceptions in the enforcement of import restrictions (based on technology) on the basis of the environment.³³

We have seen that trade liberalisation (especially if the rules are unbalanced and there is insufficient accompanying support) may not lead to growth; but worse, trade agreements and the obligations they impose may impair development, e.g. through the inability to develop new industries or through devastating effects on existing industries, through the inability to acquire technology and knowledge, or through impacts on public health or public budgets.

The 'right to development' would limit the applicability of WTO obligations when the enforcement of such obligations would have a significant adverse effect on development.³⁴

Faizel Ismail has suggested the adoption of such a right to development for the least-developed countries:

...a mechanism should be established in the WTO in the course of the Doha negotiations that provides small, weak, and vulnerable economies with 'flexibility' to avoid implementation of a specific discipline, if such non-implementation is properly justified for development interests.

(Ismail 2006: 64)

We would argue, however, that such a right be extended not just to the most vulnerable economies, but to any of the least developed.

The 'right to development' is, in a sense, a right not to be harmed by the imposition of trade rules. It recognises that in the formulation of the trade rules, the voices and concerns of the least-developed countries were not given sufficient weight; that provisions on special and differential treatment were not adequately 'hard wired' into the international trading system; that development itself is a complex matter; and that trade ministers have neither necessarily the competence nor interests to design a global trading system that promotes development. Rather than specifying a long list of ways in which developing countries might be adversely affected, and how developed countries might offset these adverse effects (e.g. through Aid for Trade), it enunciates a broad *enforceable* principle, the details of which would have to be fleshed out in the WTO dispute resolution process.³⁵

We argue further that if, as advocates of trade liberalisation claim, trade is good for growth and development (with its strongest advocates claiming that it is necessary and almost sufficient), then actions taken by developed countries to impede trade are,

themselves, a violation of the 'right to development'. A corollary, then, of the right to development within the international trade regime is the 'right to trade'.

The right to trade would give developing countries the ability to bring an action against any advanced country where three conditions are satisfied:

- i. a specific group of poor people within a developing country (or the country or group of countries as a whole) can be identified as being significantly and directly affected by a specific trade or trade-related policy (or policies) of an advanced country;
- ii. the effect of the policy acts to materially impede the economic development of those poor people (or the country or group of countries as a whole); and
- iii. the impediment operates by restricting the ability of the people (or the country or group of countries as a whole) to trade, or gain the benefits of trade.

This right would enable any developing country to bring an action against an advanced country on the basis that a specific policy materially impedes the development of an identified community in a poor country by restricting its ability to trade.

Remedies

Subject to appropriate safeguards, this right would transcend existing agreements and apply to all trade-related policies of advanced country member states. A developing country (or countries) bringing successful actions under the right to trade could access a range of remedies:

- Elimination or change to the offending policy as a result of mediation between the advanced country and the developing country.
- A range of bilateral sanctions including an increase in tariffs against the advanced country (a remedy that would be available to all affected developing countries). This right to sanction would be tradeable (see Stiglitz and Charlton 2005). Rather than merely raise tariffs, sanctions should also be able to include suspension of other WTO commitments of interest to advanced countries, including the TRIPS agreement.
- Compensation from the offending advanced country or support from a multilateral Aid for Trade fund (outlined in the next section).

Any dispute between a rich and a poor country is never a fair fight. Setting aside the differences in their ability to bring suit, even when a developing country prevails, enforcement is difficult. Existing remedies under the WTO dispute settlement system suffer from a range of asymmetries, which weaken the position of poor and small countries and often make those remedies ineffective. For example, raising tariffs against the larger country can be counterproductive if the bigger country represents a large share of imports. The effect on the bigger country may be small, while the population of the small country may face higher prices on imported goods. That is why it is important that the sanctions be 'tradeable' and that they include the suspension of other WTO commitments.

Who can bring an action?

Poor countries may furthermore find themselves subject to coercion, as the larger countries make implied threats to reduce aid or other benefits. This will reduce the likelihood that actions will be brought, eviscerating the force of the 'right to trade'. To address this problem, we propose three alternative mechanisms:

- i. Developing countries should be able to club together to impose joint sanctions, where they are mutually affected by a developed country policy.³⁶ Also, developing countries should have recourse to funds (described further in the following section) to support themselves in the action and provide compensation for any reduction in aid or other losses resulting from retaliation by the developed country.
- ii. Bilateral investment agreements have recognised the right of private parties to initiate actions against states, when they are harmed. The private parties that bring suit under investment agreements are corporations. The rights of poor people should be equally enshrined under the law. Indeed, the rule of law is supposed to be directed at protecting those who otherwise could not fend for themselves. Any group of poor individuals harmed by a trade policy of another country should therefore have the right to bring a case before the WTO.
- iii. There should exist an office ('Defender of the Right to Trade'), potentially located within UNCTAD, that would have the right to bring suit against any country seen as violating the right to trade as defined above.

Breadth and specificity of the right to trade

Most advanced industrial countries have, effectively, recognised the right to trade on the part of least-developed countries. They have recognised that opening up their markets to these countries would have little impact on their own economies (indeed, to the extent that trade restrictions are distortionary, benefiting producers at the expense of consumers, overall welfare would probably increase), but could be of enormous benefit to the least-developed countries. That is why Europe adopted its EBA initiative and the US similarly passed AGOA. However, the implementation of the principle has fallen far short of the aspiration, partly as a result of non-tariff barriers (like rules of origin and phytosanitary conditions).

In a sense, the proposed right to trade does nothing more than formalise the obligations that developed countries have already broadly taken upon themselves, helping immunise trade ministries from the pressures that are brought by special interests within their own countries that would be adversely affected by such a provision.

A number of concerns have been raised about this 'right to trade'. One is the lack of specificity. What exactly is embraced within this 'right'? We are of two minds. On the one hand, specificity may help reduce trade uncertainty. Precisely defined rights give guidance to countries concerning what is and is not allowed. On the other hand, in today's world of regulatory arbitrage, a high degree of specificity is likely to give rise to 'circumvention': attempts to devise policies that are consistent with the letter of the law (regulation), the specifics of the provision, but against its spirit. This is evidenced

by the considerable ingenuity that has been exhibited in trying to circumvent existing liberalisation and anti-subsidy measures. This helps explain why in other contexts, countries have moved toward 'principles-based' regulation.³⁷ Both within the WTO and elsewhere, legal and regulatory systems with broadly defined rights and obligations have worked reasonably well. South Africa's constitution, for instance, includes a broad array of rights (such as the right to housing), which have proved effective in fulfilling the intention in ways consistent with the country's resources and without imposing undue uncertainty.³⁸

We believe that the 'right to development' and the 'right to trade' should be enshrined at a high level of generality, partly because trade negotiators from developed countries will try to impose restrictions on its applicability that will create large 'carve outs' that will eviscerate the effect of the provision.³⁹

For the least-developed countries, we believe that the 'right to trade' and 'right to development' should be enforceable within the WTO dispute resolution mechanism, partly because as we suggested the principle has already largely been accepted.

Emerging markets (middle-income countries) present a more difficult problem, as they have grown to the point where the trade restrictions that they do or could adopt can impose real costs on developed countries. Still, these countries have per capita incomes that are far below those of the more developed countries; they typically have large fractions of the population in poverty, and development and poverty eradication remain an imperative.

If the multilateral trading system is to flourish, those in these emerging market countries must see it to be not only fair, but consistent with their developmental aspirations. For these countries, a 'softer' version of the 'right to development' and 'right to trade' may be appropriate, whereby such a country (or a group of countries or groups within a country) may bring an action, asking for a declaratory judgment that the practices of a given country (or group of countries) has an adverse effect on trade or development, perhaps with a suggestion concerning alternatives that might have less adverse effects. Hopefully, such judgements would put pressure on the offending parties to change their policies or practices. At the very least, an accumulation of such findings should spark discussion within the WTO for the need for reform of existing disciplines and rules – and Aid for Trade – so that the multilateral regime can be pro-development and pro-trade.

Some concern has been expressed too about the broadening of the private rights to bring action. Many look at the provisions of the bilateral investment treaties that give the right to private parties to bring actions against states as misguided; and while our proposal might be seen as counterbalancing this asymmetry, they argue that a preferred remedy is to withdraw the right of private parties to bring actions. We believe that the arguments presented here are, in fact, more compelling than in the bilateral investment agreements: as we noted, states can be put under pressure by the developed countries violating these rights not to bring action, so action will be taken in some cases only if the right is extended more broadly.

If there are worries about these rights to private action, then we suggest that such complaints be filed through the office of the Defender of the Right to Trade described

earlier. Such an office would vet the claims, ensuring that only those that have a reasonable chance of success would go forward. If (and only if) private rights of action by corporations are restricted, then it might make sense to restrict the private rights to action proposed here; in which case the office of the Defender of the Right to Trade would bring suit directly.

15.5.2 Global Trade Facility

In addition to the right to trade, we propose the creation of a Global Trade Facility – a dedicated fund established at the global level, to which all donors would contribute resources that would be allocated to developing countries based on their needs.

This new fund would retain the concept of the Integrated Framework – where international organisations effectively co-operate on Aid for Trade – but concentrate its management within one institution. Dedicated funds for Aid for Trade should be allocated to a special facility to be administered by UNCTAD, much as the Global Environment Facility is administered by the World Bank and supported by a small secretariat operating within but independent from UNCTAD.⁴⁰

This body would oversee the Aid for Trade programme, support the allocation of funds according to an agreed set of principles, create and monitor a common set of performance criteria and report on effectiveness. (The aid projects themselves would be carried out by a variety of national and international institutions and organisations.)

This organisation would not directly manage the assistance programmes, but would allocate resources based on proposals from a wide range of development organisations, which could include multilateral institutions (including the World Bank and regional development banks), NGOs and countries themselves. (It would necessarily also have to have some responsibilities for oversight and evaluation.) This would encourage transparency, needs-based allocation and competition among aid recipients and deliverers to develop the most effective and efficient Aid for Trade projects and programmes.

The Global Trade Facility (GTF) would support the right to trade by providing resources to support developing countries' actions and fund genuine Aid for Trade – including assisting countries to maximise the benefits of new market access won through the dispute settlement system. The facility could also compensate developing countries for any losses – such as reduced aid or other retaliation⁴¹ – associated with any right to trade dispute. It would also provide some adjustment assistance and even ongoing support to developing countries that may be negatively impacted as a result of changes to advanced countries' trade policies – for example, where a developing country was receiving preferences whose value is eroded by liberalisation.

As we have proposed (Stiglitz and Charlton 2006) the GTF should be supported by a funding commitment along the following lines:

- i. The advanced industrial countries would contribute 0.05 per cent of their GDP to the GTF. This means that the aid to trade facility would comprise approximately 7 per cent of the total commitment (of 0.7 per cent of GDP) to developing countries, an amount that seems balanced within the framework of overall development needs.

- ii. There would be an *additional* commitment of a small percentage of the value of the advanced countries' exports to least-developed countries. One can think of this as a partial substitution of the revenues that would have been received as tariffs; but it takes advantage of the greater administrative capacity of the developed countries, and avoids all of the distortionary and political economy 'costs' associated with tariffs. The advanced industrial countries need not actually levy the amount as a tax on exports, but simply pay the amount (small relative to GDP of the advanced industrial countries) out of general revenues.⁴²
- iii. There would be an *additional* commitment of 5 per cent of all agricultural subsidies and 15 per cent of all arms sales to developing countries, partially reflecting the costs that these impose on developing countries.

These mechanisms would give Aid for Trade an annual flow of more than US\$40 billion. This is around the quantum of ODA currently labelled Aid for Trade (OECD and WTO 2011). However, under the GTF framework this flow would be more secure, predictable and genuinely additional.

15.6 Conclusion

Aid for trade was a pragmatic response to challenges facing the global trade and aid system. By 2005 the trade community faced pressure to increase the development focus of its agenda and provide tangible benefits to developing countries. At the same time, the aid community was looking for avenues to efficiently and effectively disburse growing aid budgets and demonstrate greater long-term impacts from funded projects. Aid for trade suited the political economy in which both groups found themselves.

Nonetheless, behind the Aid for Trade movement has been recognition that trade liberalisation by itself is not a sufficient condition for an increase in trade, economic development or societal welfare; and in the short run at least, trade liberalisation can have serious adverse effects on developing countries, and particular groups within those countries. There has been a significant and welcome step forward by the international community towards a greater understanding of the complex relationship between trade liberalisation and economic development in poorer countries.

However, while there is considerable promise in Aid for Trade, so far it has not delivered on that promise. It has not proved to be additional, predictable and effective. Indeed without additionality, Aid for Trade is just another form of conditionality, and may actually impair the overall effectiveness of assistance programmes. Worse still, Aid for Trade has become a substitute for meaningful reform of the global trading system.

The multilateral trading system is at risk. As progress on the Doha Round has slowed, with many giving up hope that it will be completed any time soon, bilateral trade agreements (including international 'partnership' agreements) have proliferated. Bilateral bargaining is even more asymmetric than multilateral bargaining, and the agreements that are emerging often reflect these asymmetries. 'Divide and conquer' has sometimes proved to be an effective strategy for the more developed countries.

These bilateral agreements are replacing the multilateral system with a distortionary 'spaghetti bowl' set of trade provisions, undermining the functioning of the global market economy.⁴³

The proposals we have made for a 'right to trade', a 'right to development' and a 'Global Trade Facility' would help ensure that international trade works for poor countries and the poor within those countries, and will help preserve the multilateral trading system.

Notes

- 1 The importance of their doing so was even then becoming increasingly obvious, as their share of global GDP was increasing. Today, it is unimaginable for there to be a global trade regime without, for instance, China.
- 2 Sub-Saharan Africa was estimated to have lost US\$1.2 billion as a result of the Uruguay Round (UNDP 1997).
- 3 In some cases, setting standards has positive effects on trade, as it provides assurances of the safety of imported products. On the other hand, there are numerous instances in which phytosanitary conditions have been used to effectively bar products that were safe. In any case, the imposition of these standards may impose large costs on developing countries, in order for them to meet the standards. One of the objectives of Aid for Trade should be to provide the requisite assistance.
- 4 As we show below, many African countries (and others among the least developed) were actually worse off as a result of the Uruguay Round.
- 5 As Stiglitz and Charlton (2004) explain, there was an understanding that in return for giving the developed countries what they wanted – a financial services agreement and an intellectual property rights agreement – the developing countries would get what they wanted – a marked reduction in agricultural subsidies and an end to the multi-fibre agreement. The developed countries got what they wanted; the developing countries did not. As we note, many were actually worse off as a result of the agreement.
- 6 The protestors also included those concerned about adverse effects of trade agreements on the environment and labour rights.
- 7 The spirit of global co-operation that pervaded after 9/11/2001 also probably played a role in the ability to reach an agreement.
- 8 He did not, however, consider the effects on development, or even growth. In later work, he noted that even if both countries were in a sense better off, there were distributive consequences. There were losers as well as winners. Even if the winners could in principle compensate the losers, they seldom did.
- 9 In particular, he made all the assumptions of what has since come to be called the neoclassical model – perfect competition, perfect markets, perfect information, no transactions costs, no frictions – which implied, in particular, that there was no unemployment. He also ignored risk. The neoclassical model underlies much of the neoliberal policy. It is increasingly realised that what separates developed from developing countries is a disparity in knowledge, and that an essential element in development is closing the knowledge/technology gap. Thus, the neoclassical model (and neoliberal policies based on that model) assume away a central issue in development (see Greenwald and Stiglitz forthcoming).
- 10 Latin America's lost decade, the 1980s, was often blamed on its pursuit of failed import substitution policies. More recent rethinking of the lost decade (and the subsequent lost half-decade under the influence of the Washington consensus policies), has shifted the emphasis away from failed import substitution policies towards excessive debt obligations undertaken in the 1970s, and the flaws in the handling of the resulting debt crisis, both by Western creditor governments and institutions and by the developing countries (Bértola and Ocampo 2012). The World Bank, especially in the work of its chief economist, has in recent years been actively arguing for industrial policies, some of which involve trade interventions (Lin 2012).

- 11 The debates continue both in the interpretation of the cross-country data, as well as the experiences of individual countries. For instance, Rodrik and Subramanian (2004) argue that India's growth dates not to the period of trade liberalisation in the early 1990s, but much earlier, to the 1980s, when it engaged in internal liberalisation, taking on a more pro-business stance.
- 12 That trade liberalisation *by itself* would not ensure growth should have been obvious from the large disparities that exist within developed countries: there are no trade barriers between north and south Italy (no barriers even to the movement of capital), and yet there have been persistent large differences in income. So too for the United States, until the federal government undertook actions (including assistance) that led to the narrowing (but far from eliminating) the gap in income between the north and the south.
- 13 Stolper and Samuelson 1941. This theorem was based on the same assumptions that underlay Samuelson's earlier analysis of the welfare gains from free trade. At the extreme, Samuelson showed that if there was free trade, factor prices would be fully equalised between countries with the same technologies. That that has not happened should be obvious. Nonetheless, Samuelson and Stolper did identify an important force that was at play: trade in goods was a (partial) substitute for the movement of factors.
- 14 The political economy of this asymmetric liberalisation was understandable, especially given the impetus for liberalisation came from developed countries where capital was in abundance. However, this means that it may not be likely that future trade agreements will be associated with significant increases in symmetry. To the extent that labour market liberalisation is included, it focuses on skilled workers.
- 15 The problems just described arising from trade liberalisation were often exacerbated by other liberalisation measures that often accompanied them. Capital and financial market liberalisation and banking deregulation often led to an increase in instability, with adverse effects on inequality and growth (see Stiglitz 2008, 2010, 2011, 2012).
- 16 While the Doha 2001 agreement clearly put development at the centre of trade negotiations, the link between development and trade liberalisation was even more ambiguous than that between growth and trade liberalisation. And trade ministers, especially from the developed countries, were ill-prepared to analyse the implications of alternative proposals for development. Under GATT, developing countries were somewhat protected by the commitment towards Special and Differential Treatment. The obligations undertaken by the developing countries as part of the Uruguay Round significantly reduced the policy space for developing countries. It made, for instance, the imposition of infant industry/economy protection more difficult, even though many developed countries had used such instruments in earlier stages of their own development, and even though advances in economic theory had shown the desirability of such policies, e.g. in the context of 'learning by doing' (see, for instance, Greenwald and Stiglitz 2006 and Stiglitz forthcoming). Development, it was increasingly recognised, required a transformation of the economy (see, e.g. Stiglitz 1998), a structural transformation that market forces were unlikely to accomplish on their own, and which could be facilitated by well-designed trade interventions. Developing countries began to demand greater flexibility for policy space, including greater freedom to pursue industrial policies and to address supply-side constraints via government interventions, preferential market access and support for institution and capacity building.
- 17 The Gleneagles 'Africa' Communiqué.
- 18 G8 Finance Ministers, 'Final Communiqué'.
- 19 Doha Work Programme, Ministerial Declaration, WTO, adopted on 18 December 2005.
- 20 See International Lawyers and Economists Against Poverty (2006).
- 21 See the final text of agreements and commitments adopted at the International Conference on Financing for Development, Monterrey, Mexico, 18–22 March 2002.
- 22 ODA from development assistance countries was US\$79.9bn in 2004, and it rose to US\$133.5bn in 2012, around 0.31 per cent of GNI (and an average country effort of 0.46 per cent). If it had increased to 0.7 per cent for all Development Assistance Committee countries, net ODA would have been US\$430.7bn. The shortfall between promised and delivered is some US\$297bn.
- 23 Easterly (2006). He has since been joined by a host of critics (cited below) making similar observations.

- 24 In the last decade, significant resources have been devoted to understanding and improving the effectiveness of aid. In an early study, for instance, Burnside and Dollar (2000) showed that aid has no impact in countries with 'poor' institutions and policies, but can support GDP growth in developing countries with 'sound' institutions and economic policies. More recently, Rajan and Subramanian (2008) found that aid flows have very little impact on economic growth.
- 25 This was partly because, at the time, the prevalent belief in the development community was that increasing trade would lead to more growth, and more growth would lead to less poverty (both directly and indirectly because the increased growth resulted in more resources for poverty alleviation.) We have explained why those presumptions may not necessarily be correct. Aid for trade may still, however, promote growth and development (and poverty reduction) if it, for instance, offsets the loss of tax revenues from trade liberalisation or increases the pace of job creation through supply-side measures.
- 26 Though developed country exporters were more interested in expanding imports into developing countries; firms in developed countries that competed with developing country exports were not so interested in increasing the capacity of developing countries to compete.
- 27 At the same time, it should be recognised that much of the broader 'trade' agenda has for the past two decades consisted of cramming issues like investment and intellectual property into trade negotiations. TRIPS actually embraced virtually all of intellectual property rights.
- 28 Yet ironically many trade agreements have included provisions (such as those relating to financial market liberalisation), which have systemically resulted in a diminution in credit flows to small and medium enterprises (SMEs). See Detragiache et al. 2008.
- 29 And, indeed, doing so in ways that are consistent with poverty alleviation, through positive impacts on employment. Note that trade liberalisation by developing countries was often associated with increased imports and job destruction, while the Aid for Trade is associated with increased exports and job creation.
- 30 Thus the critique is far more fundamental than that there have not been appropriately designed 'random trials'.
- 31 That is, in this case the 'counterfactual' is that there would have been the same amount of aid in the absence of the Aid for Trade movement, but the Aid for Trade movement has imposed an additional constraint, diverting money that was more targeted at poverty reduction to other uses.
- 32 The existence of these impediments, which lowers exports from LDCs to developed countries, heightens the imbalances in tariffs: if they had been able to export more, the tariff revenues collected from developing countries would have been even larger.
- 33 WTO dispute cases numbers 58 and 61, for more information see www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm
- 34 The right to development has emerged in a number of different contexts. It was first recognised in 1981 in Article 22 of the African Charter on Human and Peoples' Rights which states, 'All peoples shall have the right to their economic, social and cultural development with due regard to their freedom and identity and in the equal enjoyment of the common heritage of mankind'. The United Nations subsequently recognised the right to development in 1986 in the 'Declaration on the Right to Development', which was adopted by the United Nations General Assembly Resolution 41/128. Article 3.3 states: 'States have the duty to co-operate with each other in ensuring development and eliminating obstacles to development. States should realize their rights and fulfil their duties in such a manner as to promote a new international economic order based on sovereign equality, interdependence, mutual interest and co-operation among all States, as well as to encourage the observance and realization of human rights'. See, for example, Fukuda-Parr 2012.
- 35 One of the details which should, however, probably be pre-specified is the 'breadth' of the set of actions that might fall within the scope of the provision, i.e. the trade rules as a *whole* might be pro-development, even if a specific set of rules (e.g. relating to access to knowledge) impaired development. There should, however, be a presumption against actions that impair exports from least developed countries to either emerging markets or developed countries, or from emerging markets to developed countries.
- 36 Additionally, they should be able to freely agree among themselves on the allocation of sanction rights (some countries within the group may be better able to impose effective sanctions). Note that such collective action is akin to class action suits, which have proved to be one way that countries

- like the United States have responded to the asymmetries between large corporations and the many individuals with limited economic resources that may be affected adversely by the actions of those large corporations.
- 37 Some of America's recent economic problems have been attributed to its rules-based accounting systems, where corporations complied with the rules, to provide a grossly distorted picture of the firm's financial position (see, e.g. Stiglitz 2003). However, there are numerous other examples (cf. transfer pricing; the shadow banking system).
 - 38 In the *Grootboom* case, the South African Constitutional Court, 'made it plain that the right of access to housing could not be separated from the right to human dignity' (Sachs 2005: 147). Such issues are largely a matter of degree: within the current WTO framework, there are agricultural subsidies that are described as 'trade distorting' and forbidden, while others are permitted. The United States claims that its subsidies are not trade-distorting; most economists say that they are. Whether they are, or the extent to which they are, depends heavily on the 'model' of the economy. The WTO, in effect, left such matters to be resolved by the dispute resolution process.
 - 39 A notorious example is the US offer to open its markets to 97 per cent of the products of the least developed countries. However, the 3 per cent 'carve out' embraced essentially all of the exports from some of the least developed countries. Still, there may need to be some specificity, such as discussed in footnote 35 above.
 - 40 The reason for choosing UNCTAD is explained more fully in Stiglitz and Charlton (2006). One wants an institution in which the developing countries have more voice than say the World Bank, and one wants an institution that is less committed to the neoclassical model (in which there is no unemployment) and more committed to development.
 - 41 The adjudication of the magnitude of the aid required to compensate might of course be a complex matter, but no more complex than the assessment of the value of compensation associated with any other trade violation. The GTF could also compensate developing countries in the case of other trade violations (including for already existing rights) where it is determined existing enforcement mechanisms are inadequate, e.g. because the implementation of such sanctions would impose significant costs on the developing country.
 - 42 The tax could be thought of in part as a 'benefit tax' – exporters to developing countries are among those benefitting most from changes in the global trading regime that results in enhanced trade. The gains in 'equity' from such targeted taxation have to be balanced against the resulting distortions, which given the proposed rates are likely to be very small.
 - 43 Even strong advocates of trade liberalisation have been highly critical of these bilateral and regional trade agreements. See Bhagwati (1995) who coined the term 'spaghetti bowl'.

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Annex to Chapter 15

A Summary of Commonwealth Roundtable with Joseph Stiglitz, on *Aid for Trade – Perspectives on Progress and a Way Forward*, held at Marlborough House, Commonwealth Secretariat, London, 29th August 2012

Emily Jones

15A.1 Introduction

The roundtable provided an opportunity for Professor Joseph Stiglitz to present the main arguments and findings of an ongoing study that he was undertaking in collaboration with Dr Andrew Charlton entitled 'The Right to Trade', and to receive comments and suggestions from participants. Their study examines the emergence of Aid for Trade (AfT), evaluates its performance to date, and then outlines an alternative path for AfT as part of a pro-development multilateral liberalisation agenda. They propose two new initiatives. First, the World Trade Organization (WTO) would enshrine a 'Right to Trade' operational within the WTO dispute settlement system. This right would give developing countries legal recourse against advanced countries whose policies materially affect the development of poor countries by restricting their ability to trade. Second, dedicated funds committed by rich countries to a 'Global Trade Facility' would be administered by the United Nations Conference on Trade and Development (UNCTAD) and dispersed through a competitive and transparent process based on needs and impact.

This report provides a summary of the presentation by Professor Joseph Stiglitz (further details can be found in his draft paper). It then presents in detail the feedback from participants. These took the form of short presentations by five discussants, questions and comments from other participants, and some additional written comments. The designated discussants were Professor Alan Winters, University of Sussex; His Excellency (H.E.) Wayne McCook, Ambassador and Permanent Representative of Jamaica to the WTO in Geneva; H.E. Faizel Ismail, Ambassador and Permanent Representative of South Africa to the WTO in Geneva; H.E. Anthony Maruping, Ambassador Extraordinary and Plenipotentiary Permanent Representative of Lesotho in Geneva; Dr Richard Kozul-Wright, Director, Unit on Economic Cooperation Integration among Developing Countries UNCTAD, Geneva.

15A.2 Presentation by Professor Joseph Stiglitz: 'The Right to Trade: a report for the Commonwealth Secretariat'

Professor Stiglitz's presentation was structured in three sections. First, he analysed the history of AfT, and this set the scene for understanding why it has become so significant, and helped provide a framework for evaluating its successes and failures. Second, he presented an evaluation of the extent to which AfT has succeeded in

meeting its core objectives. Third, he made two bold proposals that were designed to stimulate a critical discussion on how to move forward.

15A.2.1 The emergence of 'Aid for Trade'

Examining the history of AfT, Stiglitz argued that it was the product of challenges faced in both the trade and aid communities. In the trade community, the AfT discussion emerged from a period of crisis in multilateral negotiations. By the end of the 1990s, there was a realisation that the previous rounds of trade negotiations, particularly the Uruguay Round, had not been really fair in some fundamental way, as the greatest share of benefits accrued to rich countries (and some studies even suggested that the least developed countries would be significantly worse off). Although the Doha Round was launched with a promise to put development at its centre and redress some of the imbalances of the past, rich countries reneged on their promises, prompting developing countries to walk out of the negotiations, a move from which the round never fully recovered.

During the same period, there was a rethinking of the trade agenda itself and its impact on development. The Washington Consensus began to break down as researchers questioned whether or not trade liberalisation increases trade, increases growth and reduces poverty. Moreover, some arguments suggested that trade liberalisation, as it had been carried out, might impair poverty reduction. Together, these factors reduced developing countries' willingness to participate in the institutions of global trade. In parallel, the aid and development community was facing challenges: donors were under pressure to increase aid, and to show stronger results from aid programmes.

AfT was a convenient response to the simultaneous challenges facing the aid and trade communities. For the trade community, it was a means to deliver a 'development dividend' to entice poor countries back to the negotiating table; for the aid community, it was a channel to absorb growing aid flows, while also potentially showing greater development impacts. In effect, AfT was the product of a 'marriage of convenience' between the trade and aid communities.

15A.2.2 An evaluation of AfT

Professor Stiglitz posed two questions to evaluate whether or not the AfT initiative has lived up to its promise: Has it delivered *additional*, *predictable* and *effective* resources for developing countries? Have these resources been a *complement* to pro-development multilateral liberalisation?

On both counts, he argued that there have been serious shortcomings. Although a significant proportion of aid is now labelled 'Aid for Trade' (approximately 25% of total official development assistance), it is not clear that it is additional. Indeed, donors have failed to deliver on their overall aid commitments. In terms of the ways in which funds have been used, although some AfT initiatives have been successful (including some infrastructure projects), aid continues to be disbursed through bilateral channels according to the priorities of donors, not recipients. Most importantly, AfT was supposed to be a complement, not a substitute, for a pro-development round, but this has not happened. The promised pro-development Doha Round liberalisation

never occurred, and so AfT is coming to be seen as a pecuniary payoff to compensate for undelivered promises.

Overall, he concluded, AfT has been a disappointment.

15A.2.3 Proposals on the way forward

Professor Stiglitz made two proposals for the way forward: establishing a 'Global Trade Facility'; and enshrining the 'Right to Trade' in the WTO's dispute settlement system.

Global Trade Facility

This would be a dedicated AfT fund established at the global level, to which countries would contribute an agreed amount of resources. Advanced industrialised countries would contribute 0.05 per cent of their GDP, about 7 per cent of their total aid commitment (0.7 per cent of GDP). There would be an additional commitment of a small percentage of the value of advanced countries' exports to developing countries, as a partial substitution of the revenues forgone as the result of liberalisation. Finally, countries would make an additional commitment of 5 per cent of agricultural subsidies, partially reflecting the costs that these impose on developing countries. It would be administered by an organisation that can speak forcefully for developing countries (perhaps UNCTAD). Resources would be allocated to development organisations for disbursement, based on a process of these organisations competing to offer the most efficient AfT programmes and projects. They would be distributed to developing countries based on need and impact.

The 'Right to Trade'

Professor Stiglitz advocated enshrining the 'Right to Trade' into the WTO, enabling developing countries to bring an action against any advanced country if three conditions are satisfied:

- A specific group of poor people within a developing country (or the country or group of countries as a whole) can be identified as being significantly and directly affected by a specific trade or trade-related policy (or policies) of an advanced country.
- The effect of the policy is to materially impede the economic development of those poor people (or the country or group of countries as a whole).
- The impediment operates by restricting the ability of the people (or the country or group of countries as a whole) to trade or to gain the benefits of trade.

Professor Stiglitz noted that a challenge with sanctions is that poor countries do not have resources to bring action. In addition, poor countries worry about rich countries retaliating. To help address these problems, he made three proposals. First, developing countries should be able to club together to bring joint sanctions where they are affected, with the 'Global Trade Facility' providing them with the financial support to bring cases. Second, any group of poor individuals, such as a group of African cotton farmers, harmed by a trade policy of another country should have the right to bring a

case before the WTO. (This would be a mechanism similar to the right of private parties to initiate actions against states under investment agreements.) The advantage is that such groups may be willing to bring a case in instances where developing-country governments are intimidated by imbalances in political and economic power. Third, an office 'Defender of the Rights of Trade' located, potentially within UNCTAD, would have the right to bring suit against any country seen as violating the Rights to Trade as defined above.

With regard to the remedies that would be available to a developing country (or countries) that brought a successful action under the right to trade, Professor Stiglitz proposed three types: *elimination or change* to the offending policy; *bilateral sanctions*, including increase in tariffs against the advanced country; and *compensation* from the offending advanced country. He noted that bilateral sanctions are often a problem for developing countries, as a small country imposing sanctions against a larger country can be hurt most. For this reason, Professor Stiglitz argued for tradable sanctions. So, for instance, if a country were granted the right to impose US\$100 million of tariffs, it would be able to trade them, so they are used by another country that is less dependent.

15A.3 Feedback from participants

A rich discussion followed the presentation by Professor Stiglitz. Overall, participants felt the report is timely. They noted that a critical evaluation of AfT is invaluable, and has not been adequately carried out to date. Moreover, as the multilateral trading system is in crisis, this is an opportune moment to take a step back, look at the ideological underpinnings and put forward new concepts and proposals.

In general, participants welcomed the thrust of the report, noting that it raises pertinent issues, including ones regarding the opportunities and challenges faced by the AfT, and makes bold proposals. Words used to describe the report included 'eloquent', 'stimulating', 'excellent', 'a bit mischievous' and 'fairly persuasive'. The main comments are presented below.

15A.3.1 The emergence of 'Aid for Trade'

Participants made a number of comments on the way that the report captured the history of AfT, and these can be divided into three themes: the role of developing countries in WTO negotiations over AfT; the dynamics in the aid community; and the wider global context in which AfT emerged.

Developing country participation

- Several participants noted that developing countries were strong *advocates* of AfT, and there was concern that the report does not recognise this sufficiently.
- One participant noted that AfT was, and still is, a progressive idea, as it acknowledges the need to build the capacity of developing countries to trade if they

are to benefit from the multilateral trading system. Many OECD (Organisation for Economic Co-operation and Development) countries had strongly opposed including AfT in the WTO texts, and the fact that it has become part of the architecture of the WTO is significant progress. It needs to be recognised as the result of sustained advocacy by developing countries and some development organisations.

- To this end, it was suggested that the report reflect to a greater extent the process through which AfT was integrated into WTO texts, including the creation of a dedicated work programme and taskforce during the Hong Kong Ministerial in 2005. It was noted that, although specific AfT monitoring responsibilities were assigned to the WTO, the WTO has no mandate for managing AfT, which limits its ability to assist with increasing aid flows, or assessing effectiveness. Moreover, some progress was made in integrating capacity-building support into the negotiating process. In the negotiations on trade facilitation, it was agreed in July 2004 that any obligation undertaken by least developed countries would be justiciable by the WTO dispute settlement mechanism only if adequate support had been provided for implementation.¹
- There were significant divergences and differences among developing countries, which the report does not adequately acknowledge. For instance, one participant observed that it was the advanced developing countries that were dissatisfied with the Uruguay Round and wanted the Doha Round, whereas the least developed countries were ambivalent.

The aid dynamics

- One participant suggested that the report address the ‘schizophrenia’ in the aid community to a greater extent. In particular, the donor community has channelled the majority of funds into social activities (education, health etc.) and has paid little attention to supporting the development of productive capacities, yet, at the same time, donors claim that they want to end aid dependence.
- Related to this, several participants suggested that AfT is a welcome corrective to the recent neglect of productive activities by the aid community (rather than a possible additional conditionality as the draft report suggests).

The wider context

- One participant requested that the paper situate the historical account of AfT in the wider context of a crisis in multilateralism, rather than just the collapse of WTO negotiations. Moreover, he suggested that the paper recognise that trade is a minor part of the current globalisation story; finance is the major driver of globalisation and it has distorted trade. These links between finance and trade could be elaborated in the report.
- Another participant noted that the report focuses exclusively on AfT in the context of WTO negotiations. However, related discussions are taking place in the context

of the numerous negotiations on preferential trade agreements and these could be included. In general, greater mention could be made of regional trade integration initiatives, both North–South and South–South, and their links with AfT.

15A.3.2 Links between trade, growth and development

A number of comments questioned the report's analysis of the reappraisal of the Washington Consensus.

One participant suggested that the authors are overly optimistic in suggesting there has been a rethink about the trade–growth–development links. He noted that advanced countries are still promulgating Washington Consensus policies, including through the recent Economic Partnership Agreements and the Trans-Pacific Partnership.

Several comments referred to the need to update the analysis of the academic literature on the links between trade liberalisation, growth and poverty, providing greater detail and citing additional sources. Particular comments included:

- *The impact of standards:* The report suggests that sanitary and phytosanitary standards are making it harder for producers in developing countries to export. Although this may be the case in some instances, surely standards are needed and legitimate? What is the alternative? Moreover, there is some evidence that standards have the opposite effect, and boost exports by reducing information asymmetries.
- *The outcome of the Uruguay Round:* The report states that 'some estimates suggested' that least developed countries lost 5 per cent of gross domestic product (GDP) as a result of the Uruguay Round. What are the sources for this figure?
- *The link between trade liberalisation and growth:* One participant noted that Rodriguez and Rodrik (2000), cited in the report, correctly criticised the literature before 1999. However, the science has improved since then and more recent studies need to be incorporated. Moreover, he argued that, on balance, studies show that increased trade is associated with increased income (except perhaps for the very poor).
- *The link between aid and growth:* The paper suggests the evidence is weak and ambiguous. However, recent work by Finn Tarp shows that, although the impact of aid is not as large as was hoped, it is there; aid induces some degree of growth.

15A.3.2.1 Response by Professor Stiglitz

During the discussion, Professor Stiglitz replied to some of these concerns. He argued that, although aid can be effective and trade sometimes promotes growth, it is clear that the combination of aid and trade liberalisation ('Aid for Trade') has not led to the kind of export diversification and growth in developing countries that people had hoped for. One of the reasons for this is the problem of pervasive market failures in developing countries, which AfT should address. Although there is the need for adjustment assistance in terms of loss of revenue, there are far greater and more general needs resulting from the fact that developing-country markets do not work

effectively. As a result, when countries liberalise and jobs are often destroyed, if the financial sector does not function properly and the government does not provide support, then people move from unproductive jobs into unemployment. He agreed that the literature is mixed and remains controversial.

With regards to the role of finance he noted that, in the WTO financial services agreement, there are many restrictions on finance, which run counter to the interests of developing countries. They were adopted in an era when people believed that financial markets worked well, yet there is growing evidence that financial market liberalisation and opening to foreign banks has weakened domestic financial markets and reduced lending to small firms. Paradoxically, this is exactly the type of finance needed to support adjustment to trade liberalisation.

15A.3.3 The evaluation of AfT

In his presentation, Professor Stiglitz posed the question: Has AfT delivered *additional*, *predictable* and *effective* resources for developing countries? Participants had several responses:

Additionality

- Most participants who commented agreed with the report's scepticism that the AfT initiative had raised significant additional funding. They noted that the evidence was 'opaque at best' and that there had been lots of relabelling. One participant suggested that the argument could be made more robust.
- Another participant noted that the WTO is doing little to mobilise additional funds for AfT.

Effectiveness

Participants made several observations about the shortcomings of AfT, and suggested ways in which it can be made more effective:

- *Structural transformation*: AfT has focused on the provision of infrastructure and trade facilitation, and participants agreed that this has been useful. However, several participants raised concerns that AfT not paid sufficient attention to supporting countries to diversify their exports. This gap could be emphasised in the report.
- *Support to firms*: On a related note, several participants noted that AfT has provided too little support at the firm level, yet this is needed if developing countries are to become competitive. However, two participants questioned if developed countries really have an incentive to see AfT used in this way: if firms from developing countries become more competitive, does this not pose a threat to firms in developed countries?
- *Adjustment*: Although one of the main rationales for AfT was to support the adjustment of developing countries to trade liberalisation (including the erosion of preferences), very little financing has been provided for adjustment. It was proposed that the report highlight this gap.

- *Value chains, services and emerging markets:* Although the implicit focus of the report is on boosting exports of goods to developed country markets, participants noted the importance of using AfT to foster the production of goods that can be plugged into the more dynamic supply chains in emerging markets. In addition, AfT should be used to improve the competitiveness of domestic services sectors, which in turn bolster export competitiveness.

Governance

- *Ownership:* Whereas donor countries are fully engaged in AfT initiatives, there is still little awareness in developing-country capitals. Related to this, there is a need for AfT projects to be better tailored to the needs of individual countries.
- *Allocation:* Concern was raised that the allocation of AfT across developing countries is highly skewed.
- *Paris Principles:* One participant advocated that AfT initiatives should be evaluated against the Paris Principles on Aid Effectiveness.
- *Lead institution:* Participants noted that the WTO should not be the focal institution for the evaluation of AfT. The WTO secretariat lacks the skills and capacity, and, more importantly, whereas it interfaces with Ministries of Trade, it is Ministries of Finance that make the key decisions on aid.

Public goods and market failures framework

- One participant noted that both the justification of AfT and its evaluation could be based around a public goods and market failure framework.

15A.3.4 The Global Trade Facility

The proposal for a 'Global Trade Facility' (GTF) was welcomed. Participants had a series of comments on how it might be operationalised:

- *Multilateralisation:* There was general agreement that a move towards greater multilateralisation was to be welcomed, particularly as bilateral aid can be manipulated. (This said, multilateral organisations are not 'beacons of efficiency'.)
- *Widening recipients:* The proposal to make all developing countries potential recipients was welcomed (the Enhanced Integrated Framework focuses exclusively on least developed countries).
- *Institutional home:* There was general agreement that the GTF should not be housed with the World Bank or International Monetary Fund, and no objection was raised to the proposal of UNCTAD.
- *Enforcement:* The report suggests that aid commitments should be made enforceable. Does this not run the risk of *reducing* aid, as donors will be reluctant to make commitments? Moreover, is it politically feasible – would developed countries ever agree to this?

- *Fundraising*: One participant raised concern about the idea of levying a fee on exports to developing countries, as this implies that import trade imposes costs. Similarly, he raised the concern that the proposal to levy a charge on agricultural subsidies ignores the fact that many developing countries are net food importers and benefit from subsidies.
- *Size of the fund*: One participant suggested that the size of the GTF could be specified. In making the case for the fund, analogies could be made to the US domestic trade adjustment facility (approximately US\$2 billion).

Response by Professor Stiglitz

During the discussion, Professor Stiglitz responded to some of the questions raised. He agreed that the main point of the proposal was that AfT should be multilateralised. On the question of where the GTF should be located, he agreed with participants that oversight should not be with the World Bank or WTO. In terms of funding, he responded to the concern about placing a tax on exports to developing countries, noting that this would be a very small levy (a fraction of 1 per cent) so it would not distort trade.

15A.3.5 The 'Right to Trade'

The 'Right to Trade' proposal prompted a series of questions and significant debate over its viability. Some were strongly opposed to the proposal; others broadly welcomed it. Indeed, one participant noted that, whereas the WTO legal framework has a general exception (GATT Article 20) that covers health, security and the environment, there is no 'escape clause' for development. As drafted, the 'Right to Trade' could help address this gap.

A series of specific questions and concerns were raised.

Defining the right

- What does the 'Right to Trade' constitute? Is it merely declaratory, or is it actionable? For instance, in the UN Declaration on Human Rights, there is the 'right to development' but there have been no court cases on this right. One participant noted that second- and third-generation rights can be made actionable. For instance, the South African constitution includes the right to housing and health, and, although the country does not have the means to provide these for all, South Africa has found a way to make it justiciable.
- How should it be circumscribed or limited? The WTO dispute settlement mechanism only enforces commitments that countries have entered into. One participant raised the concern that, as proposed, the 'Right to Trade' appears to be the right to complain about, and change, everything. He emphasised the need to be careful about establishing a precedent of the WTO being able to march into a national capital and demand that a policy be changed, even if a parliament passed it.

- Another participant raised concern that this proposal has the potential to undermine certainty and predictability, which are central to the functioning of the multilateral trading system. Moreover, it could adversely affect the WTO bargaining process. In trade there are always winners and losers, and bargaining allows countries to bargain across issue areas in order to reconcile this: countries lose in one area, but gain in another. If countries can come back and challenge the terms that were negotiated, this could undermine the political bargaining process.
- How would causation, responsibility and liability be determined? Would we have to show that these communities/countries were ready, willing and able to trade? How would we adjudicate on whether a standard caused more harm to poor producers than benefit to rich consumers?

Links to existing international law

- How would the 'Right to Trade' relate to existing WTO jurisprudence? How would it link to international human rights law?

Empowering individuals or communities

- Concern was raised that investor–state dispute settlement is not a model to emulate, and that it might not be wise to empower communities or private individuals in this way.

Possible unintended consequences

- Is there a risk that this initiative could come back to haunt developing countries? What obligations would the 'Right to Trade' confer on developing countries? Could cases be brought against developing countries under the 'Right to Trade', either by communities in advanced countries or by communities in other developing countries?

Tradable sanctions

One participant noted that there is already a precedent of a country 'carouselling' its sanctions. The USA created havoc in European trade by moving its sanctions across products. The implications of enabling countries to transfer sanctions would raise serious implications for trade law and would have to be carefully thought through.

Another participant raised the concern that, in a world with vast income inequalities, monetary sanctions have clear limits. For instance, Antigua can impose all the sanctions it likes on the United States, but the United States will not feel it. One option is to adopt a system that links the size of sanctions or fines to the income of the country reneging on its commitments.

Response by Professor Stiglitz

During the discussion, Professor Stiglitz responded to some of the questions raised. On the question of whether the 'Right to Trade' would be a declaratory or actionable right, he pointed out that, even as a declaratory right, it could have an impact. However, he

argued that the right could be made actionable, and acknowledged that one option might be to add the 'right to development' as an exception under current WTO laws. With regards to the many questions on how the right should be defined, Professor Stiglitz accepted that the current articulation is too broad and needs to be narrowed, but noted that in all legal structures there is ambiguity to start with: the challenge is to define it in keeping with the spirit of the proposal.

15A.4 Conclusion

Overall, the roundtable prompted a rich and thought-provoking debate, and generated a series of comments, questions and suggestions for refining the proposals tabled by Professor Stiglitz. There is a general sense that, although AfT could be extremely valuable for developing countries, it is underperforming, in terms of both the amount of resources allocated and the ways in which resources are used. Although the momentum in multilateral negotiations has dissipated, the needs of developing countries remain acute. Now is an opportune moment to stimulate fresh debate and new actions on AfT; judging from the response at this roundtable, the report by Professor Stiglitz and Dr Charlton will do just that.

Note

- 1 See WT/L/579. (2 August 2004). 'Decision Adopted by the General Council on 1 August 2004' (Annex D).

Chapter 16

Future Directions in Aid for Trade

Dirk Willem te Velde

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 *broad*er 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.

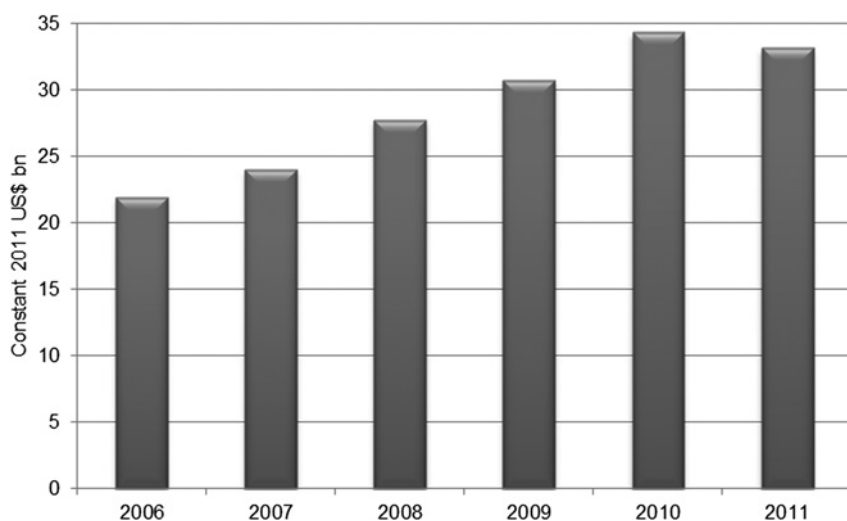
However, with the Doha negotiations grinding to a halt by 2008, the Task Force had already argued that 'AfT is a complement to the Doha Round' (Page 2007) and aid experts established the case for AfT as a normal aid tool that was decoupled from deadlocked trade negotiations. In this second-generation 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.

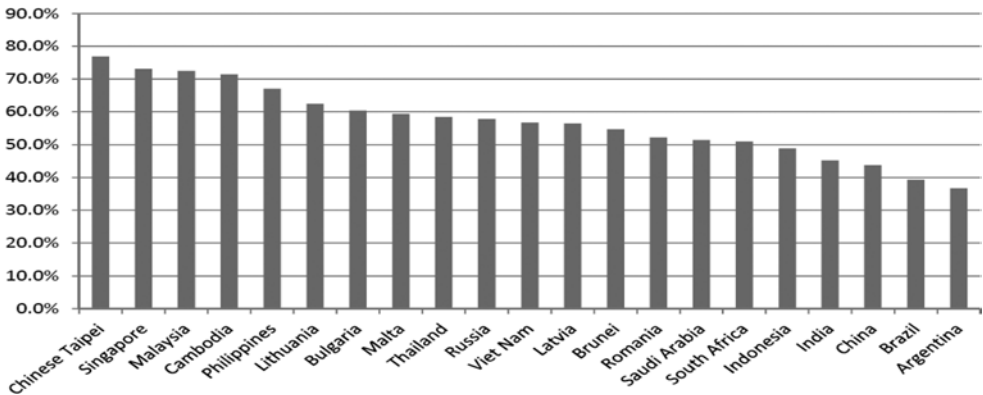
In the future we cannot consider AfT in isolation of other financial flows and we shall need to examine the leverage effect and examine 'investment for trade'. For example, the currently ongoing DTIS for Cambodia is planned to include an investment chapter. Trade diagnostics remain important but the 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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