Aid for Trade

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Many poor countries have been unable to use trade as an engine for growth. Some lack the necessary infrastructure—roads, ports, telecommunications—to link their producers to global markets. Others have inefficient institutions—for customs, tax, and product standards—that drive up the costs of trading. Or producers may lack knowledge about market opportunities and how to access them. For countries that have such problems, market access is not the major challenge; many are unable to use their existing—and often preferential—access to large markets for lack of transport facilities or the ability to meet high standards in export markets.

A second set of constraints is rooted in the political economy of domestic policy. Some poor countries are reluctant to undertake trade-policy reforms that may be in their long-term interest because of concerns about short-term adjustment costs. They may be reluctant to cut tariffs, for example, for fear of losing government revenue. Trade reforms typically create winners and losers, and many poor countries face considerable challenges in providing safety nets, retraining, and other means of adjustment for affected groups.

More recently, the potential costs of adjusting to liberalization by *other* countries have raised similar concerns. Some countries fear the erosion of their preferential market access as trading partners reduce their tariffs on a nondiscriminatory basis. Some net food importers are concerned about the impact of rising food prices following reform of agricultural subsidies in rich countries.

Against this background, many poor countries see more threats than opportunities in the current trade talks. With little confidence that they will be able to benefit from further market opening, and amid concerns about the potential adjustment costs of their own and others' liberalization, many of the poorest countries have adopted a defensive position across the board in the Doha Round, thereby threatening the success of the talks.

There is thus a compelling case, from the perspectives of development and trade, for helping countries overcome the constraints that prevent or discourage them from taking advantage of new market openings. The development case is the most important: countries that are unable to integrate into global markets miss out on important sources of sustainable growth and poverty reduction. But the trade case is important, too: additional assistance is essential to encourage the poorest countries to support an ambitious outcome from the Doha Round, and thus to maintain a strong and effective multilateral trading system—both very much in the interests of poor countries. Additional assistance is thus a key complement to, but not a substitute for, ambitious trade liberalization under the Doha Round.

This is the reasoning behind the current push to increase "aid for trade."

What is "aid for trade"?

In practical terms, aid for trade encompasses five main activities:

- *Technical assistance*: the provision of technical assistance, advice, and expertise to assist countries confronted with the complexities of modern trade.
- *Capacity building*: building the capacity of developing countries to deal with trade issues, for example, through the training of government officials.
- *Institutional reform*: helping to create a framework of sound and well-functioning institutions for trade—in customs, quality assurance, and other areas.
- *Infrastructure*: improving roads and ports to link the poor and the goods they produce to markets through investment in infrastructure.
- *Assistance with adjustment costs*: fiscal support and policy advice to help countries cope with any transitional adjustment costs from liberalization.

Successful aid-for-trade projects generally combine most of these elements. For example, the World Bank is working with Vietnam on a project for comprehensive customs reform, encompassing capacity building, simplification of clearance procedures, modernization of the legal framework, and improved information and communication technology. Likewise, the Standards and Trade Development Facility, initiated by the World Bank and the World Trade Organization (WTO), uses a mixture of financing, technical assistance, and donor coordination to build the capacity of developing countries to meet international standards in food and agricultural exports.

In this sense, aid for trade is not new—mechanisms aimed at increasing the supply-side capacity of developing countries and easing adjustment concerns have been part of development programs for some time (box 1).

The purpose of the current push on aid for trade is to significantly scale up this aid and to make it more effective. This is timely for a number of reasons:

- First, annual development aid is expected to increase by $50 billion by 2010, if recent promises are kept. The increase will bring greater scrutiny of the extent to which aid contributes to sustained growth. Important new agreements have also been reached on increasing aid effectiveness through a greater focus on country ownership, donor coordination, and harmonization of aid policies.
- Dealing with the real currency appreciation from increased aid will require greater attention to trade liberalization, facilitation, and international competitiveness.
- Recent international initiatives on debt relief should be complemented by action to increase the trade capacity of the poorest countries if they are to avoid future unsustainable debt.

Box 1. Rwandan coffee: challenges, opportunities, and the role of aid for trade

Coffee is a key export crop in Rwanda. In 2003, an aggressive strategy was developed to increase total exports of coffee and move the industry into the high-quality, specialty end of the market. The strategy will require an estimated investment of $69 million: $24.75 million from donors and NGOs, $23 million from the private sector, and $21.25 million from the Rwandan government.

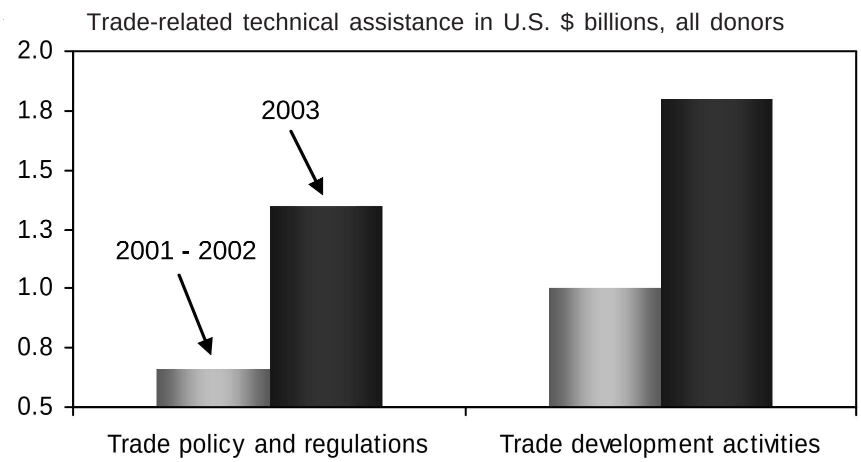
Major efforts are needed to achieve a reputation for Rwanda as a quality producer through international exhibitions, demonstrations, and contests—and strict quality control. Two long-term, donor-funded projects have been assisting producers in developing buyer–seller relationships and helping growers raise quality. Aid projects have also helped farmers to form cooperatives to meet the requirements of “fair trade” coffee and to experiment with organic and shade-grown coffees, all of which command a substantial premium over ordinary coffee.

Increased access to washing stations has increased farmers’ incomes by up to 55 percent. Washing and grading the coffee cherries has made it possible to obtain higher prices for products of higher quality, giving farmers an incentive to increase quality. At one aid-for-trade project, washing stations track the output from individual farmers so that if a particular batch is sold at an exceptional price, part of the revenue flows back to the individual farmer. Regulatory reform has also allowed individual Rwandan cooperatives and private owners to negotiate directly with specialty roasters in the United States and Europe, enabling them to sell to specialty markets at more than twice the market rate.

The quality and the image of Rwandan coffee have improved markedly as a result of these efforts. However, the industry still faces challenges, for which further aid for trade is needed. Those challenges include: *access to finance* (donors are already providing some help in steamlining rural finance among producers’ organizations); *access to low-cost transport* (the cost of transporting coffee from the farm gate to the port is 80 percent of the amount received by the coffee farmer, and major upgrading of transport infrastructure is needed); *access to training* (half a million Rwandan farmers need extensive training in all aspects of coffee production, but there are few agronomists); and *developing associations and cooperatives* (technical assistance is needed to strengthen coffee farmers’ cooperatives and to form an overall industry association, along with reform of unclear government regulations).

Source: World Bank-IF 2005.

Figure 1. Trade assistance is expanding…



Source: OECD-DAC/WTO database.

- Finally, the critical juncture of the Doha Round provides a political focus for aid for trade. Global, nondiscriminatory trade liberalization under the WTO has some of the characteristics of a global public good—that is, a good from which everyone benefits but to which not everyone has sufficient incentive to contribute. All countries benefit from one country's trade reforms and trade-related investments, and benefits are increased when undertaken by several countries concurrently. However, the full benefits of reform are not necessarily captured by the country itself, which may lead to underinvestment in reform. Aid for trade is one way to ensure the provision of this global public good.

Steadily increasing aid for trade

Recent trends form a strong basis on which to build. Data compiled jointly by WTO and the Organization for Economic Cooperation and Development/Development Assistance Committee (OECD/DAC) indicate that resources devoted to trade-related capacity building and technical assistance increased significantly in 2003, after being static between 2001 and 2002 (figure 1).

Commitments for *trade policy and regulations* increased from about $660 million per year in 2001–02 to almost $1 billion in 2003. These sums support effective participation in multilateral trade negotiations, analysis and implementation of multilateral trade agreements, trade-policy mainstreaming, development of technical standards, trade facilitiation (including tariff structures and customs regimes), regional trade agreements, and human-resource development in trade.

Commitments for *trade development activities* increased from $1.35 billion per year in 2001–02 to $1.8 billion in 2003. This covers business development and activities aimed at improving the business climate, access to trade finance, and trade promotion in the productive sectors (agriculture, forestry, fishing, industry, mining, tourism, services) including at the institutional and enterprise level. The OECD/DAC database does not include *activities to enhance infrastructure* necessary for trade (roads, storage, communications, energy) due to difficulties in assessing the extent to which they are related to international trade, as opposed to the general economic climate of the country.

The World Bank has been rapidly expanding its support for trade through enhanced investments in infrastructure and support for trade facilitation. (Details of the Bank's activities, projects and lending related to trade are outlined in chapter 5.) Additionally, the Bank has a major program of trade research and a growing program of trade capacity building. It also is committed to incorporating trade-expanding projects into its country programs as a crucial step toward higher long-term growth. To that end, the Bank has been deeply involved in the Integrated Framework for Trade-Related Technical Assistance (box 2).

But despite these and other initiatives by donors and international organizations, demand for aid for trade continues to outstrip supply, and many poor countries have the capacity to absorb significantly more assistance. More needs to be done, and there is presently a window of opportunity to move forward.

What more can be done?

In February 2005, the G-7 Finance Ministers called on the World Bank and International Monetary Fund to develop proposals for additional assistance to countries to ease adjustment to trade liberalization and to increase their capacity to take advantage of more open markets. The call was reinforced by the Bank's 184 shareholders in April and again by the G-8 in July. Following extensive consultation, the Bank and Fund put forward a package of three proposals that received strong endorsement from ministers at the joint Bank-Fund annual meetings in September 2005. Work is now under way on their implementation.

Consultations held by the Bank and Fund revealed a sharp difference over the best way forward. For some, aid-for-trade needs would be best met by the establishment of a dedicated multilateral fund, as the only way to ensure that sufficient, *additional* resources were made available. Trade, they argue, is never likely to rank high enough among a country's priorities to receive funding via regular channels—particularly for poor countries with pressing demands in basic services such as health, and education. Countries should not have to choose between meeting basic needs now and investing in future growth; the "market failure" on trade should be addressed by a separate fund.

Box 2. The Integrated Framework and the least developed countries

The Integrated Framework for Trade-Related Technical Assistance (IF) brings together multilateral agencies (the International Monetary Fund, International Trade Centre, U.N. Conference on Trade and Development, U.N. Development Programme, World Bank, and WTO) and bilateral donors to assist least developed countries (LDCs). It has two objectives: (i) to integrate trade into national development plans such as poverty reduction strategies; and (ii) to assist in the coordinated delivery of trade-related technical assistance in response to needs identified by the LDC. The IF is built on the principles of country ownership and partnership.

The first step in the application of the IF to a given country is preparation on a diagnostic trade integration study (DTIS). The DTIS specifies the main elements of a policy framework for national trade integration and an action matrix that maps out the delivery of trade-related technical assistance while identifying trade-related investment needs. A special facility created in May 2003 finances small, priority technical assistance and capacity building projects of up to $1 million per country.

By the end 2005, DTISs will have been completed in 21 countries; seven more LDCs have started the process and nine more have applied to join the IF. At the end of May 2005, 22 projects had been approved in 12 countries, amounting to $8 million, covering many areas—among them building capacity for trade negotiation (Cambodia, Ethiopia, Madagascar), export-related information gathering and dissemination (Yemen), and sector-specific institutional and technical support (Burundi, Ethiopia, Senegal). Some 17 donors had pledged $30.2 million to the trust fund that finances the IF.

Notwithstanding the mismatch between its highly ambitious objectives and very modest resources, the IF has produced some good results. It has provided concrete capacity building projects (with just $8 million); made solid progress in the difficult task of coordinating donors and international agencies; contributed to greatly increased understanding of the constraints facing poor countries; and brought IF governments to the table on trade.

For others, such dedicated funds interfere with countries' ability to set their own priorities for donor financing; an ability that is a cornerstone of internationally agreed principles of aid effectiveness. Dedicated funds, it is argued, risk skewing priorities toward areas where external funding is available. Programs determined simply by the availability of funding tend to be insufficiently owned, and thus less likely to succeed. And, in any case, it is very difficult to know when funding is truly additional; creation of a new multilateral fund is no guarantee that funds have not been reallocated from other areas. The debate will continue.

So what's on the agenda for aid for trade?

Enhancing the Integrated Framework (IF)

The key initiative is enhancing the IF. Built on sound principles—country ownership, donor coordination, and mainstreaming of trade into national development strategies—the IF already has shown achievements to date, but it has lacked the scale to bring about real transformations at the national level. Challenges have included weak in-country capacity, lack of systematic follow-up at the country level, insufficient and uncertain financing, and variable donor response to priorities identified in the diagnostic trade integration study that provides the road map for national action under the IF.

Recent enhancements to the IF address those issues. They include a significant, multiyear expansion of resources for technical assistance and capacity building, and for strengthened governance and increased ownership at the country level. The main objective is still to mainstream trade into national development strategies to ensure policy coherence, increase donor coordination, and maximize financing of trade-related projects through bilateral and multilateral channels. Key features of the enhanced IF are:

- *Increased resources*: predictable, multiyear financing on the order of $200–$400 million, to be disbursed to participating LDCs over an initial five-year period, and taking the form of grants, not loans. Additional resources are also required for more effective governance at both the country and global levels.
- *Strengthened in-country structures*: increased up-front resources to help countries implement the IF at the national level—for example, by establishing implementation units within or closely linked to key economic ministries and developing coherent trade strategies. Involvement of the private sector and civil society in consultative bodies and project delivery has increased. Ongoing funding allocations are subject to performance.
- *Strengthened governance*: a lean and effective governance structure to ensure rapid and accountable disbursement of funds, with a professional, fully funded secretariat.
- *Improved links to donor processes*: stronger links between identified large-

scale needs (such as trade-related infrastructure) and donor funding through project-preparation studies in areas of priority. An essential corollary to the increased resources of the IF is increased donor willingness to fund aid for trade in the poverty reduction strategy (PRS) process. Several bilateral donors have already indicated their intention to devote more resources to aid for trade.

- *Multiyear programs of technical assistance and capacity building*: related to, for example, trade policy and strategy, strengthening of core trade-related institutions and functions, administrative and regulatory reforms, intragovernmental coordination, and private sector capacities and initiatives.[1]
- *Possibility of extended coverage*: while the IF has traditionally been a program for LDCs, consideration could be given to extending it to other low-income countries on the understanding that benefits for LDCs should not be diminished.

With thorough and meaningful implementation, the enhanced IF should address most aid-for-trade needs through countries' increased capacity to build trade needs into the PRS process, and through donors' increased willingness to make funds available for aid for trade in that context. This approach provides greater certainty that funds will be available to meet key needs, while preserving the centrality of country priorities determined in the PRS process, in line with agreed principles of aid effectiveness.

Regional and cross-country issues

While country priorities should be taken into account by the enhanced IF, some trade-related issues may not be sufficiently addressed in the PRS process—for example, regional issues. Cross-country issues may be particularly important for small, very poor, or landlocked countries that are dependent on action by neighbors for whom the issue may not be a high priority. For example, the roads that Rwanda requires to reach the ports of Mombasa and Dar es Salaam require the cooperation of Kenya, Tanzania and Uganda, but for those countries, roads in the hinterland may be a low priority. With 20 landlocked countries in the low-income group, there is a need to ensure that these issues do not fall through the gaps.

Small, very poor, or landlocked countries are also likely to face competing demands for existing resources. It may make sense for them to consider cost-effective regional machinery for trade, such as regional laboratories for standards testing or even regional infrastructure or regulatory frameworks to support liberalization in services such as electricity or telecommunications.

In the coming months, the Bank and Fund will examine the extent to which regional and cross-country needs are being met by existing mechanisms and whether there is a need for new ones. Possible new mechanisms to be explored include the opportunities offered by the enhanced IF, the scope for extending existing World Bank instruments, and a dedicated multilateral fund to provide grant cofinancing for regional projects in close coordination with other multilateral development banks and relevant agencies. Rather than cutting across country priorities, a fund in this instance could fill the gap left by the country-focused PRS process, addressing public goods among countries where all stand to gain.

Smoothing adjustments to trade liberalization

Trade liberalization creates adjustment problems for some countries; in some cases, the adjustment can be considerable. Countries suffering adjustment shocks from trade liberalization, including the Doha Round, need to be assured of transitional support from the international community.

A first step is identifying the countries affected. The Bank and Fund plan to assess the nature and magnitude of adjustment needs of countries that present a *prima facie* case of significant adjustment shocks. That group is likely to include, for example, countries negatively affected by the end of textile quotas and by preference erosion, net food importing countries, and countries undertaking major programs of trade reform.

Assessing the impact of adjustment shocks requires consideration of a wide range of factors, including: the possibility of offsetting lost tariff revenue through customs reform and more efficient collection of tariffs; the likely time frame for adjustment; the extent to which existing preferences were used (theoretical access does not always translate into actual exports because of strict rules of origin); the extent of liberalization undertaken by trading partners on products subject to preferences; and the characteristics of affected industries and groups.

On the basis of these assessments, the international agencies will work with countries to design policies to help manage adjustment impact. They also will identify opportunities to provide assistance through instruments such as structural adjustment loans from the World Bank and the IMF's Trade Integration Mechanism.[2] Where a country is suffering particularly severe adjustment costs, they will coordinate with other donors to marshal additional assistance.

An investment in the future

Implementation of these initiatives, coupled with increased aid-for-trade resources in bilateral assistance programs, form a sound basis for exploiting the development potential of trade. The investments required now may seem large, but aid for trade is an investment in the future—one that promises a high rate of return by supporting higher growth in poor countries. Aid for trade should thus be seen as another component of stepped-up international efforts—greater overall aid, debt relief, and trade liberalization under the Doha Round—to help the poorest countries achieve the Millennium Development Goals.

Notes

1. Projects depend on country needs and priorities but may include: trade policy capacity, customs (computerization, risk management), standards (training, surveillance, and accreditation), development of export and investment promotion agencies, sectoral support (product development, supply chain upgrading), and development of regulatory frameworks to support services liberalization.

2. The Trade Integration Mechanism is designed to assist member countries to meet balance-of-payments difficulties that might result from trade liberalization by other countries. Two countries have taken advantage of it to date—Bangladesh ($78.03 million) and the Dominican Republic ($32.03 million).

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Further Reading

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