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# Aid for Trade: An Action Agenda Looking Forward

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*The current postcrisis environment–and fragile economic recovery–increases the importance of aid for trade. Global rebalancing and tightened fiscal budgets in the short to medium term also place renewed emphasis on aid effectiveness. This note identifies four options to enhance the effectiveness of the multilateral aid for trade initiative: (i) expanding market access for least-developed countries (LDCs) through leadership by middle-income G-20 members;(ii) creating a mechanism to identify good practices in domestic regulation of service markets and other "behind-the-border" trade-related policies; (iii) leveraging the dynamism and knowledge of the private sector to improve trade facilitation and build capacity; and (iv) making a concerted effort to expand data collection and monitoring and evaluation (M&E) of aid for trade.*[1]

The Hong Kong Ministerial meeting of the World Trade Organization (WTO) in 2005 called on members to allocate more development assistance to trade-related projects and programs. This reflected a recognition that firms in many developing countries are unable to benefit from market access opportunities (Njinkeu and Cameron 2008). Poor quality infrastructure and high trade and other operating and transaction costs block many of the advantages of reduced barriers to trade. By focusing on boosting investment in infrastructure and complementary measures to improve access to higher quality, lower cost public and private services, "aid for trade" can help countries to capture more of the benefits of existing market access opportunities.

## Challenges and Priorities Looking Ahead

Since the early 2000s, the overall amounts of aid for trade have increased, albeit at a slower pace than official development assistance flows overall (OECD and WTO 2009), and greater attention is being given at the national level to identifying trade-related priorities. In LDCs, this process is now supported by the Enhanced Integrated Framework, through a secretariat in Geneva, and a dedicated grant funding mechanism. Although progress has been made in delivering on aid-for-trade commitments, there are a number of strategic areas where action can be taken to enhance the effectiveness of aid for trade as an instrument to promote inclusive and sustainable growth.

### *Leveraging investments in infrastructure: the services "software" agenda*

Infrastructure is the largest category of aid for trade: infrastructure projects account for about 54 percent of the global aid-for-trade portfolio. While improved infrastructure is clearly a priority in many countries, investment in infrastructure must be accompanied by measures that reduce trade costs and by appropriate regulation—for instance, policies that promote competition in transport services and improvements in border management. The quality of public and private services can be an important determinant of the size of the payoffs to improvements in hard infrastructure. In addition, the efficiency, variety and costs of services inputs are critical for the competitiveness of firms and farmers because they represent an important share of the total costs of production. Being able to compete in international markets is increasingly determined by access to low-cost and high-quality producer services such as telecommunications, transport, distribution, and finance.

Developing countries tend to have more and higher barriers to international trade and investment in services, as shown by the negative correlation between gross domestic product (GDP) per capita and the restrictiveness of services trade and investment policies as measured in Gootiiz and Mattoo (2009; figure 1). Policy reforms that revolve around increasing the contestability of services markets and facilitating new business entry and the supply of new service products can be very beneficial to the performance of the national economy. They may also be cheap in financial terms—they often do not require massive investments in hardware. An increasing body of research demonstrates that reforms in services sectors have a positive effect on the productivity of both foreign- and locally owned manufacturing firms that use services inputs (see Francois and Hoekman [2009] for a recent survey of the literature).

A noteworthy feature of the pattern of services trade and investment policies is that landlocked countries apply more restrictive policies than coastal countries. This appears particularly true in the air transport and telecom sectors, in which landlocked countries have no inherent disadvantage (Borchert et al. 2010). While there are many reasons why being landlocked might lead to lower availability of services and higher prices, restrictive policies contribute to the poor performance in services sectors beyond the handicap imposed by geography. This suggests that supporting policy reforms to enhance the contestability of "backbone" services in landlocked countries could be a priority area for aid for trade. To date, however, much of the aid for trade effort has focused on support for hard infrastructure and improving productive capacity. Less has been done to improve the services-related policies and regulations that help determine the efficiency of (cost of using) infrastructure networks.

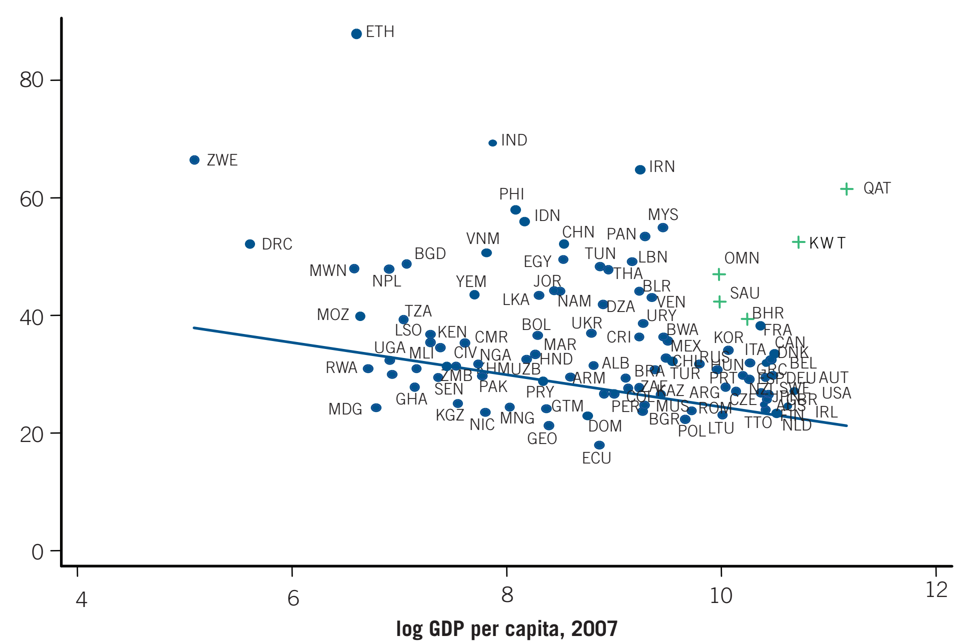
***Expanding south–south integration through trade reform and market access***

South–South trade has been growing rapidly in recent years as a result of high rates of economic growth in many developing countries. However, significant trade barriers remain in many of the dynamic emerging markets. The emphasis in policy forums, such as the WTO, has been on developed countries' market access conditions, including achieving duty-free, quota-free access for the LDCs and addressing key constraints that reduce the value of preferential access, such as rules of origin. This is important, but it represents a missed opportunity for low-income developing countries that confront high barriers against exports in middle-income countries.

Middle-income markets will grow more rapidly than those of high-income countries in the coming years. The emergence of multiple growth poles in the South offers low-income countries an opportunity to diversify both across markets and products, mitigating the risk associated with increased market openness and trade-led growth, while reducing exposure to possible prolonged slow-growth markets in Europe, Japan, and the United States.

If all Organisation for Economic Co-operation and Development (OECD) countries were to offer 100 percent duty-free, quota-free access to LDCs, their exports could increase by some $2 billion more than they would under the 97 percent scenario that was included in the 2005 Hong Kong WTO Ministerial Declaration (Bouët et al. 2010). But export gains would be substantially greater if major middle-income countries were also to offer such access to LDCs—by up to $5 billion, reflecting higher tariffs in these countries. To be effective, such improved market access would need to be accompanied by liberal rules of origin and related administrative requirements.

**Figure 1. Services Trade Restrictiveness Index**




*Source*: Gootiiz and Mattoo 2009.
*Note*: GDP per capita (constant 2000 US$); 102 countries.

*Supporting regional cooperation and integration of markets: capacity building*

Although much (most) of the aid-for-trade agenda is national in scope, there has been a recent rise in the demand for assistance to support regional integration. One factor driving this is a recognition that key constraints to a country's competitiveness may lie outside its borders. This is most often the case for landlocked countries. Much of the agenda here revolves around initiatives to lower transactions and operating costs for firms on both sides of the border.

Lowering such costs does not give rise to the types of welfare-reducing trade diversion that can arise from preferential reduction of tariffs: lower trade costs benefit all trade partners—they facilitate trade with the rest of the world as well as with neighbors.[2] Landlocked developing countries in Africa, in which more than a quarter of the continent's population lives, face a substantial competitive disadvantage due to high trade costs (Arvis, Raballand, and Marteau 2010; Arvis, Carruthers, and Smith forthcoming). For landlocked countries, domestic costs are multiplied by problems prevailing in transit/coastal countries.

The need for regional cooperation to facilitate trade is understood by all stakeholders. However, the range of available instruments to support regional projects and cooperation is limited. This results in inadequate financing and assistance for multicountry trade-related projects. Weak capacity of existing regional secretariats and the diffuse nature of the benefits of existing integration mechanisms for the private sector have also resulted in a poor implementation track record.

Dedicated funds to support regional cooperation, covering both software (regulatory institutions, policy changes) and hardware (infrastructure to support cross-country flows of goods, services, and people) could help to fill the gap that currently exists. A concerted focus on identifying and financing regional projects to address the national priorities could also help overcome resistance to beneficial regional market integration (beneficial in the sense of helping to attain the competitiveness objective).

*Harnessing the private sector as a source of knowledge, capital, and information*

Given the broad nature of the aid-for-trade agenda—encompassing areas from border management to regulatory reform and infrastructure investment—there are many stakeholders involved from both the public and private sectors. As such, there is great scope to make more effective use of public-private partnerships that capitalize on private sector expertise in prioritizing areas for reform, identifying potential solutions, and monitoring progress. Such initiatives can serve as platforms for developing national strategies and action plans for reform, in addition to providing stakeholders with a mechanism for coordination and harmonization of policy measures across industries and sectors. Much more can be done to harness the knowledge and information that exists in the private sector to use as both a source of data on constraints to trade and policies or factors that needlessly increase costs of trading and as a source of potential solutions to specific problems.

*Bolstering monitoring and evaluation of the effectiveness of aid for trade*

Recent research has begun to assess the impact of different forms of aid for trade and the complementarities or synergies between types of aid for trade. For example, Helble, Mann, and Wilson (2009) analyze the effects of various categories of aid for trade—trade development assistance (productive capacity building), trade policy assistance, and infrastructure—on bilateral trade. The findings suggest there are high marginal returns to projects that target trade policy and regulatory reform: US$1 of aid for trade targeted at trade policy and regulatory reform could increase trade by US$700. While there will be diminishing returns, such findings illustrate that the rate of return to some types of aid for trade can be very high. Relatively few such studies have been undertaken, in part as the result of data constraints. More investment in data collection is needed to enable rigorous assessments of the impacts of aid for trade and the channels through which it affects poverty, welfare, and trade.

## Moving the Agenda Forward

The fragile economic recovery—combined with the need to strengthen the international trading system in support of sustainable and inclusive growth and employment—places the aid for trade initiative at the forefront of policy importance. In addition to delivering on the commitments to expand aid-for-trade flows made in 2005 at the Gleneagles G-8 summit and the WTO Hong Kong Ministerial, the above discussion suggests four strategic themes that an action agenda on aid for trade might support:

1. Establish a ***platform for capacity building and knowledge transfer focused on policies and regulatory options to improve the operation of producer services markets and network infrastructure***. A coordinated program of assistance and knowledge exchange that includes active involvement of middle-income G-20 countries could do much to increase the rate of return on aid-for-trade investments in hard infrastructure by creating a mechanism to strengthen capacity to put in place the associated complementary "software" inputs—policies, pro-competitive regulation, and so forth—that are critical to both social (equity) objectives and improving the efficiency of network infrastructure use.

   This is an agenda that goes beyond leveraging investments in infrastructure by encompassing both producer and business services. An important factor that explains lack of progress in negotiations aimed at liberalization of trade and investment in services—whether multilateral or regional—is uncertainty and concerns regarding the possible consequences of making market access commitments. Establishing a forum for substantive discussion and analysis of liberalization impacts and specific regulatory policies and policy changes could enhance understanding of different options and identify where large gains from liberalization can be realized.

2. Complement the financial aid for trade provided by high-income countries with ***market access reform by middle-income G-20 members to lower barriers to exports from poor countries.*** Extending duty-free, quota-free access for LDCs to all G-20 members, with minimal exceptions, would constitute a concrete initiative that would directly promote the trade and development prospects of the poorest countries in the world. Such an initiative is completely at the discretion of G-20 members and can be authorized at the stroke of a pen. It would come at very low cost to the G-20 countries in terms of additional imports because the production and trade structures of the LDCs and the G-20 countries have little overlap and the LDCs are usually very small suppliers. Any such initiative would need to be accompanied with liberal rules of origin and rules of cumulation, because, as has been documented, extensively restrictive rules of origin can greatly reduce the effectiveness of preferential access programs. Concrete solutions to the rules of origin constraint have been developed by several importing countries and can be emulated by other G-20 members (see Elliott et al. [2010]).
3. Create a ***public-private aid-for-trade partnership to leverage the dynamism in the private sector for strengthening trade capacity*** in the countries that are recipients of aid for trade. Given the high payoffs from improving trade facilitation—encompassing areas from border management to regulatory reform and adoption of modern information and communication technologies—such a partnership might focus initially on capitalizing on private sector expertise and information in identifying potential solutions and monitoring progress, while leveraging the coordinating capacities of governments and/or multilateral donor institutions. The private sector is already undertaking numerous initiatives to address concrete problems or to leverage ongoing investments to enhance development impacts. Greater sharing of information on such initiatives and learning about what works and what does not would enhance the visibility of such efforts and boost the role of the private sector in the broader aid-for-trade program.
4. Develop a ***strategic action plan to provide dedicated financial support for a targeted program of M&E of aid for trade*** anchored in systematic data collection and research. The importance of M&E and analysis of trade outcomes and performance are widely recognized. The OECD is leading the efforts to share the results of M&E by donors and agencies and so that they can benefit from lessons learned. There is, however, no dedicated funding to ensure consistent *cross-country* collection of data on trade outcomes and their determinants on a comparable basis.

## Note

1. This note draws on Hoekman and Wilson (2010).
2. As has been discussed extensively in the literature on regionalism, it is important that policy not target an expansion in intraregional trade as a policy objective; what matters is to reduce barriers to trade generally, and regional agreements can help do so—especially for landlocked countries.

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