

Aid for Trade: is cooperation serving trade?⁹⁵

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The European Union is currently negotiating six Economic Partnership Agreements (EPAs) with 77 countries in Africa, the Caribbean and the Pacific. These so-called ACP countries comprise some of the least developed countries in the world. Overall, the EU is treating these EPAs as reciprocal free trade agreements. However, in recognition of the asymmetries between the EU and the ACP countries and likely significant adjustment costs, the EU is engaging in trade-related aid and adjustment programme.

The EU's far-reaching market opening agenda comprises the trade in raw materials, agricultural products, non-agricultural goods, and services and it addresses areas including investment, government procurement, intellectual property rights, customs procedures and development assistance. The reciprocal trade relations envisaged in the EPAs will require significant adjustments from ACP countries as the weaker partner in the negotiations. The likely adverse development impact of reciprocal market access between such highly asymmetric partners as the EU and the ACP countries, in particular the least developed among them, continues to be highlighted by civil society organisations and ACP Trade Ministers alike. (ICCO, 2007).

Adjustment costs

According to a research carried out by the Commonwealth Secretariat the estimated overall costs for a minimum level of restructuring adjustment support required from ACP countries amount to €9.2 billion (at 2005 prices) over 10 years. There is the additional requirement that this support is frontloaded with 60% of the total needed in the first five years, which raises the issue of the timeliness of distribution of this aid. The study identifies four main areas where ACP countries will need support with adjustment costs. These include costs incurred by fiscal reform, made necessary by loss of government revenue due to removal of tariffs; trade facilitation and export diversification costs; production and employment adjustment programmes; and skills development and productivity enhancement support programmes. Among those, the easiest to quantify are the costs associated with revenue loss (Christian aid, Traidcraft, Tearfund, 2007).

⁹⁵ Compiled on the basis of the following documents: ICCO, *The realities of EC "Aid for Trade" support in Botswana, Lesotho, Namibia and Swaziland. Lessons for the Epas negotiations*, 2007. Christian Aid, Traidcraft, Tearfund, *"The real costs and benefits of Economic Partnership Agreements"*, april 2007. IATP, *"Can aid fix trade? Assessing the WTO's Aid for Trade Agenda"*, September 2007. OECD/WTO, *"Aid for Trade at a Glance 2007: 1st Global Review"*, 2007. ECDPM, *"Aid for Trade. Twenty lessons from existing aid schemes"*, Septemeber 2007. Solidarité, *"With teh EPAs the EU derisore aid to ACP countries will not prevent an increased gap in their competitiveness"*, novembre 2007. Christian Aid, *"The opportunities and risks of Aid for Trade"*, 2007. International NGO Principles regarding "Aid for Trade", 2007.

Costs of addressing supply side constraints

Liberalisation will have two substantial effects on the economies of the ACP countries: the contraction of production in non-competitive sectors and the simultaneous expansion of sectors which hold a comparative advantage. It is important to take into account supply side constraints which may hinder either of these effects, thus working against the stated benefits of trade liberalisation. These constraints may include lack of transport infrastructure, limited access to telecommunications, barriers to entry to markets because of lack of economies of scale, and investment (*Ibidem*).

A European Analysis Research Paper examining possible supply side constraints concludes that "liberalisation is not a magic trick to promote development and that it can only work if many other issues are addressed successfully at the same time" (European Analysis Research Series, 1995).

Who will cover these costs?

The EC says that aid to cover the costs of implementing and adjusting to EPAs will come from the 10th EDF. €22.7 billion has been pledged for the 10th EDF. However, before consideration of any EPA related needs, it was estimated that €21.3 billion were needed to fund the costs of the existing aid portfolio and maintain EU contributions at 0.38% GNI. So, if the EDF is to provide new funds for EPAs, it's clearly going to be diverted from other areas such as health and education.

Putting aside problems with the amount of aid available, there are massive process problems with the EDF, not least the time it takes to commit and disburse EDF resources. Even if there was more money in the EDF or it was felt justified to divert EDF money from social spending, the delay in delivering the aid poses major problems for 'time sensitive' EPA related adjustment costs. For example, EC assessments of time frame required for full deployment of existing 9th EDF resources in Botswana, Lesotho and Swaziland show that it will take between 9 and 17.5 years to disburse existing EDF funds and between 7 and 14.66 years to sign contracts for the implementation of specific project activities (Christian aid, Traidcraft, Tearfund, 2007).

On the 16th of October 2006 the EC announce new policy in this regard, reiterating a commitment to provide €2 billion annually in aid for trade support to developing countries and one year later worked out a strategy on the delivery of previously pledged "aid for trade" support. Half of this amount is to be new money drawn from EU member states expanding ODA budgets. Half of it will be drawn from the EDF. It is the part to be drawn from EU member states expanding aid budgets which could potentially contribute to EPA related adjustment initiatives. The EU is still elaborating how precisely it is to live up to these commitments. The best endeavour nature of these commitments, compared to the binding nature of the tariff commitments entered into through an EPA, is a matter of major concern to ACP countries (*Ibidem*).

What is Aid for Trade?

The proposal of an Aid for Trade package developed by the WTO governments arose in the context of negotiations on the Doha Agenda. Aid for Trade was officially put on the WTO agenda at the 6th Ministerial Conference in Hong Kong in December 2005. The Hong Kong mandate is "to help developing countries, particularly least-developed countries (LDCs), to build the supply-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." Aid for Trade remains vaguely defined. Developed and developing countries have differing views on what the package should encompass. Many developing countries, for example, argue that building supply-capacity and trade-related infrastructure includes activities such as improving the productive capacity of agriculture and manufacturing sectors, building roads to link local, regional and international markets, and supporting the development of small and medium enterprises (IATP, 2006).

At the Hong Kong Ministerial Conference, WTO members instructed the WTO Director-General, Pascal Lamy, to set up a Task Force to provide recommendations on how to put into operation Aid for Trade. The first set of recommendations was submitted to WTO members on July 27, 2006.

The Task Force recommended that Aid for Trade cover six broad categories:

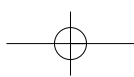
- (a) Trade Policy and Regulations, which includes training trade officials, helping governments implement trade agreements, and complying with rules and standards.
- (b) Trade Development, which includes providing support services for business, promoting finance and investment, conducting market analysis and e-commerce.
- (c) Trade-related Infrastructure, which includes building roads and ports.
- (d) Building Productive Capacity: improving the capacity of a country to produce goods and services.
- (e) Trade-related Adjustment, which includes financial assistance to meet adjustment costs from trade policy reform, including balance of payment problems resulting from lost tariff revenues or from the erosion of preferential market access.
- (f) Other Trade-related Needs.

Categories (a) and (b) cover the traditional forms of aid, namely trade-related technical assistance and capacity building. Categories (c) - (f) expand the Aid for Trade agenda (*Ibidem*).

The Task Force recommended that Aid for Trade build on existing trade-related assistance mechanisms, for example the IF and the JITAP, as well as use existing guidelines for aid delivery, especially the Paris Declaration on Aid Effectiveness.

The Task Force recommended several additional guidelines for the implementation of Aid for Trade.

They include: (1) strengthening country ownership of aid programs and country-based formulation of trade-related needs and priorities; (2) strengthening the donor response to trade-related needs and priorities; (3) strengthening the bridge between country demands



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and donor responses at the country, region and global level; and strengthening monitoring and evaluation. The Task Force also recommended the establishment of various structures to facilitate the implementation of Aid for Trade. These include a system of data collection and analysis at the country level, national and/or regional Aid for Trade Committees, and a global periodic review of Aid for Trade by WTO members (*Ibidem*).

What is the trend?

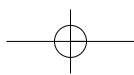
According to OECD/WTO report, between 2002 and 2005 the total aid for trade commitments from bilateral and multilateral donors rose by 22% in real terms, from USD 17.8 billion to USD 21.7 billion. This represents an annual rate of growth of 6.8% and a welcome contrast with the long-term declining trends observed since the mid 1970s. For example, in 1988, spending on building productive capacity reached over USD 16 billion in 2005 constant prices compared with the barely USD 9 billion during the 2002-05 baseline period. This decline was far from being compensated by aid to economic infrastructure which remained around USD 10-12 billion per year since its peak in the early 1990s or by assistance to Trade Policy and Regulation, which entails much smaller financial flows (OECD/WTO, 2007).

The increase in flows during 2002-05 has however been insufficient to reverse the declining trend of aid for trade as a share of total sector allocable ODA. Indeed, over that same period total sector allocable ODA increased by 27%, from USD 51 billion to USD 67.5 billion. Consequently, aid for trade as a share of total sector allocable ODA fell from 35% in 2002 to 32% in 2005. Many factors lie behind this relative shifting of resources. For instance, during the 1990s, political support for the public ownership model for utilities declined in many OECD countries, with a concomitant expansion of public-private partnerships. This development has probably contributed to donors reducing aid for economic infrastructure, on the assumption that private-sector actors would fill the funding gap (an assumption that has, with hindsight, largely proved mistaken) (OECD/WTO, 2007).

Relevance of the ACP-EU partnership for recent AFT developments

The ACP-EU cooperation represents a highly significant case in the context of North-South aid and trade relations. The Cotonou Partnership Agreement (CPA) framework explicitly establishes specific linkages between trade, aid and development. This feature is becoming even more central with the Economic Partnership Agreements (EPAs) currently being negotiated between the EU and the six ACP regions.

The EU - member states plus the EC - is the largest donor in the world and it is increasing both its AFT funding and its overall assistance (pledged to rise to €90 billion by 2015 to meet the United Nations target of 0.7% ODA/GNI). Between 2001 and 2004, the former (including contributions to multilateral AFT schemes) reached an annual average of €840 million for the EC and €300 million for the EU member states. Consequently, aid decisions by the EU, in particular in terms of its assistance to ACP countries (nearly half of the developing



WTO members), will have a major impact on trade and development at the global level (South Centre/ECDPM, 2007).

Quantities

The EU has committed itself to increasing its aid for trade from €960 million in 2006 to €2 billion from 2010. If this total amount is for all developing countries, of which 40% have gone to SSA in 2006, the European Commission has promised that half of the increase will go to ACPs. This would make €884 million for SSA and about €940 million for all ACPs (assuming it would be proportional to the population size, where SSA represent 94% of the total) (Solidarité, 2007).

Assuming that the increase from €940 million in 2006 to €2 billion from 2010 on would be linear, which means it would be €265 million per year, we can estimate the current and the real value of the EU aid for trade during 10th EDF. The nominal value would be €11.205 billion, an average of €1.868 billion per year, and a real value of €10.365 billion or 1.728 billion per year. This would represent a total loss of purchasing power of €840 million or 7.5% in relation to nominal value. Considering the increase in population for the ACP countries (914 million inhabitants by the end of 2010), this represents an aid of €1.89 per inhabitant per year, to be compared with the per capita GDP of \$599 or €477 in 2006 (*Ibidem*).

Effectiveness

Another constructive discussion that aid for trade has facilitated refers to the effectiveness of trade-related assistance and capacity building. It creates the opportunity to make aid more predictable and effective and to put developing countries firmly back in the driving seat of their trade and development strategies. The problems experienced with trade-related aid have been significant and sometimes damaging, but they do not differ in essence from those identified in wider aid debates. Therefore the "Paris Principles" to improve aid effectiveness have been rightly identified by the Task Force as the key to overcome past problems. Although flawed - for example by not tackling the problems of conditionality head-on - application of these aid effectiveness principles can improve trade-related assistance in the following ways (Christian Aid, 2007).

Country ownership

The impact of trade reforms is notoriously diverse and unpredictable. Unintended impacts can emerge unless reforms are carefully managed, paced and locally designed. A recent assessment of World Bank support to trade reforms pointed out the need to pay more attention to local conditions such as health, education, infrastructure, etc., in determining the impact of trade reforms in order to improve their disappointing track record. It also highlighted the need for a "greater understanding of the local political economy. Trade reforms are also particularly sensitive to local political ownership, because of negative impacts for

some groups. Imposing external reforms, for example through conditions, undermines this sense of ownership" (*Ibidem*).

Alignment

According to this idea donors must fall in behind countries' strategies and priorities. One of the major failings of the Integrated Framework (IF), the flagship aid for trade initiative, was due to a lack of application of this principle. Despite attempts to provide holistic, integrated, country-owned diagnostics of the problems of LDCs, the IF failed to achieve its lofty objectives because donors tended to fund those items in the new strategies that most appealed to them, rather than letting LDC governments prioritise policies and spending. There are two reasons to be underscored in order to understand how important the principles of country ownership and alignment in the trade arena are. First, the controversial nature of the reforms themselves - donors tend to prefer reform programmes that favour liberalization policies, although experience of several countries shows that heterodox policies are those that achieve success. Secondly, donors are simultaneously trade and investment partners with their own commercial interests at stake. Thus applying these principles is essential to avoid conflicts of commercial or even ideological interests with the need to support local strategies (*Ibidem*).

Mutual Accountability and Predictability

Predictability is important as the trade reform process is a lengthy one with benefits realized over the long term - even decades. During that period, countries need to be confident that they will receive timely and sufficient assistance to put in place the necessary conditions and accompanying measures to derive the benefits from reforms and maintain support for them. Without this, the value of trade reforms is undermined and even reversed.

Mutual accountability is especially important in the context of trade because of the different weights of aid and trade commitments. Non-binding "best endeavour" clauses pledging assistance for implementation have been ineffective in securing adequate support for developing countries. In addition, there is no strong framework to make donors accountable for their aid delivery - even the Paris Principles themselves have been heavily criticized for the weakness of their implementation and enforcement. On the other hand, developing countries sign up to binding commitments to carry out trade reforms backed up by dispute settlement provisions. They therefore risk sanctions for failing to implement commitments undertaken on the promise of aid never delivered - a far cry from mutual accountability (*Ibidem*).

Aid for trade risks distorting spending priorities

The OECD has stated that aid for trade pledges will not be additional to promises of aid increases made in 2005 - promises that have yet to be delivered on. Ear-marking of aid for trade-related assistance therefore will divert funds from important social spending, unless ad-

ditional money is made available. This is especially problematic if aid for trade is narrowly defined. It risks providing incentives for a limited set of reforms, and not addressing the broad range of factors affecting a country's trading success. Some developing countries have been reluctant to define aid for trade broadly, as there is a risk of any aid commitments being re-labelled "aid for trade" to fulfil public promises. However, there are good reasons for keeping the definition open-ended. Firstly because needs vary. Secondly because if a specific pot of money is associated with a narrow range of reforms, there is a real risk that these are given undue attention by developing countries competing for limited funds (*Ibidem*).

The added value of aid for trade lies in mobilizing new funds and drawing attention to neglected areas of spending. Among donors there has been a reluctance to fund production, although improving the competitiveness of producers in developing countries is a key factor. Patterns of donor spending on aid for trade show that there is a preference for spending on trade policy and regulation. However, UNCTAD has warned that support to the productive sector in least developed countries (LDCs) has experienced a significant decline that must be reversed (*Ibidem*).

Finally aid for trade risks being a double blow for the poorest groups if it is targeted at export-oriented industries only. This money could then bypass the significant proportion of poor producers and traders for whom domestic or regional markets are more important. Poor people will also suffer if social spending is reduced because aid for trade is not new money. This takes on increased resonance, in light of current concerns regarding the effects of increasing inequality (*Ibidem*).

Aid for trade risks distorting trade reform choices

Aid for trade raises the spectre of old, but not yet extinct controversies, of donor activity in the area of economic policy. Grant and loan conditionality in the area of economic policy, especially trade, has been rife and frequently damaging - most notoriously during the 1980s and 1990s period of Structural Adjustment Programmes. Although World Bank studies appear to show economic, especially trade conditions, in decline, countries still face strong pressures to adopt a checklist of donor-preferred reforms through technical assistance, project assistance rankings and bias in research (identified as problematic in a recent assessment of World Bank research) (*Ibidem*).

This runs counter to good development practice according to which the importance of local conditions and political domestic choices dictates that local design and ownership are critical to successful reforms. It also goes against the principles of mutual accountability and alignment already identified as essential to the sound implementation of aid for trade. With respect to formal conditions attention has shifted to "second generation" reforms relating to business and investment regulations and conditions behind the border. These are likely to be key areas of spending for aid for trade, and are no less controversial. For example, preferred reforms often relate to investor protection, fewer and lower taxes for businesses and

more “flexible” labour rules. These kinds of reforms are arguably more politically sensitive than changes to border taxes, as they enter into country choices of how they regulate their domestic economy (*Ibidem*).

Aid for trade risks distorting trade deals

Aid for trade is closely connected with the WTO trade talks held during the Doha Round. It is part of the Hong Kong Ministerial Declaration and the WTO Director General has been assigned an active role. Developing countries were aware of the risks this association would have posed. On their opinion “aid for trade” could only complement and not substitute a good WTO deal. A deal that delivered little in the way of subsidy reform or real market access improvements in rich country markets for developing countries or that used aid for trade to leverage more commitments from developing countries would work against developing countries improving their place in world markets and seriously undermine the usefulness of the initiative. These problems have been evident in Economic Partnership Agreement (EPA) negotiations between the EU and African Caribbean and Pacific (ACP) countries. Rumours of aid bribes and countries competing to sign up first or to the most comprehensive deals have undermined their confidence in reaching the right negotiating outcome.

However, as the ACP have argued, when developing countries sign up the agreements, they would benefit from greater confidence in having the necessary resources and good conditions to implement and capitalize on them. Existing measures in trade deals designed to secure assistance for implementation have had little effect. In addition, flexibilities intended to help countries to coordinate development strategies and trade reforms have not worked properly (*Ibidem*).

A more constructive relationship between aid and trade commitments is possible and could be achieved under the remit of Doha negotiations that includes a mandate to improve special treatment provisions for developing countries in trade agreements.

Principles

Given the concerns listed above, we the undersigned, call upon bilateral and multi-lateral donors to transform existing “aid for trade” programs by applying these principles:

1. Country-driven. Recipient nations should have the greatest say in programming resources. “Aid for trade” should be country-driven, involving local civil society and local small and medium businesses in determining priorities. This means “aid for trade” programs should be structured from the premise of local ownership, knowledge and participation so that trade strategies flow out of locally-developed national development strategies. This also means that developing countries should be free to use funds to enhance their capacities to advance their interests in relation to trade law, regardless of what the donors’ interests might be. Finally, “local ownership” also means that public oversight of national plans and priorities for *Trade Capacity Build-*

- ing Assistance* is ultimately assured through taking such plans to the national Parliament or Congress for final formulation and approval.
2. Poverty-reduction emphasis. In practice, "aid for trade" should be focused on meeting the economic development needs of smallholder farmers and other people struggling to overcome poverty with the understanding that at times it may be premature or inappropriate to emphasize production for international markets.
 3. Aid without detrimental conditions. "Aid for Trade" programs should not demand that recipient nations implement economic policy changes which are harmful to people living in poverty or the environment.
 4. Untied. "Aid for trade" should not require the purchase of donor country products or donor-country businesses, contractors or consultants.
 5. Greater freedom and flexibility in finding technical assistance. Aid for trade programs should enable recipients to choose more independent, objective sources of advice and support, rather than just those employed or endorsed by donor agencies. There is a need for availability of a larger number of different paradigms underpinning technical assistance. As regards these issues, competition among different paradigms will empower the user. Monolithic paradigms or approaches should be rejected.
 6. As opposed to a "quid pro quo" approach in trade negotiations. At times, donor nations have used "aid for trade" as a bargaining chip to achieve desired outcomes in specific trade agreements. We call on donors to de-link "aid for trade" from trade negotiations, and make it an ongoing part of foreign assistance for a more predictable, long-term support for development. "Aid for trade" should be a complement, rather than a substitute for fairer trade rules.
 7. Funding allocated for "aid for trade" should be additional to existing development aid. Donors should not shift resources away from traditional, long-standing commitments to meet basic needs, on-going development projects, or general budgetary support. On the contrary,, financial assistance for enhancing trade should be over and above existing levels of aid.
 8. Disbursement channels for trade capacity building assistance need to be streamlined. At present, current mechanisms are not able to meet the timeline many countries face in order to prepare for negotiations and to gear up particular sectors before implementing a new trade agreement.
 9. Evaluation and monitoring of the impact of TCBA for its social, economic and environmental effects needs to be integrated into all proposals and funding mechanisms.