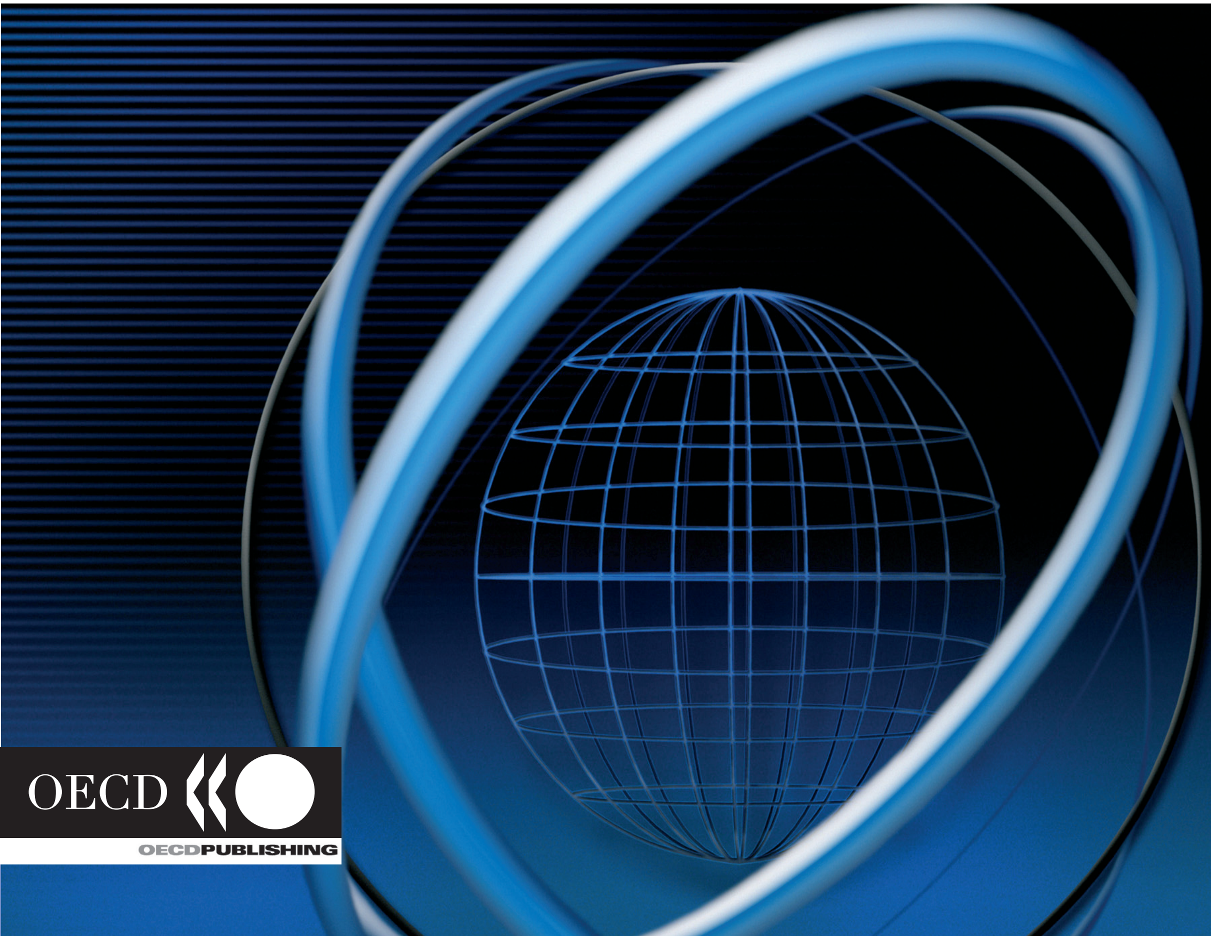
The Development Dimension

Aid for Trade

MAKING IT EFFECTIVE



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Foreword

The 2001 Doha WTO Ministerial Declaration put developing countries' priorities at the centre of the agenda and highlighted the challenge of addressing development concerns in the multilateral trading system. How to help developing countries overcome their trade-related institutional, human resource and supply-side capacity needs consequently became an integral part of the WTO negotiations. Most recently, the 2005 Hong Kong WTO Ministerial Declaration established a task force to provide specific recommendations on how to operationalise aid for trade and invited the Director-General to consult with "…international organisations…on appropriate mechanisms to ensure additional financial resources for aid for trade, where appropriate through grants and concessional loans".

Aid for Trade: Making it Effective contains the OECD's contribution to these WTO consultations. It addresses in particular the following three questions: *i)* how much aid do the DAC donors already provide in support of trade? *ii)* how effective are these assistance programmes? and *iii)* how to make aid for trade an effective tool for helping developing countries, particularly the least-developed countries, to fully benefit from trade liberalisation and the WTO Agreements?

The inclusion of aid for trade in the Hong Kong Declaration offers a real opportunity to re-examine the existing framework for its delivery with the view to strengthen incentives to foster synergies between trade and other economic policy areas, improve the coherence of aid for trade with overall aid strategies as well as enhance the credibility of donors' commitment to increasing aid for trade.

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Acronyms

ACP	African, Caribbean and Pacific Countries
CAPs	Country assistance programmes
COMB	EU Common Organisation of the Market in Bananas
CRS	Creditor Reporting System
DAC	Development Assistance Committee
DDA	Doha Development Agenda
DDA GTF	Doha Development Agenda Global Trust Fund
DFID	Department for International Development, United Kingdom
DoC	The Drivers of Change
DSU	Dispute Settlement Understanding
DTIS	Diagnostic Trade Integration Studies
EBRD	European Bank for Reconstruction and Development
GRM	The Global Review Mechanism
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IFI	International Financial Institution
IF	Integrated Framework for Trade-Related Technical Assistance for LDCs
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation, World Bank Group

ITC	International Trade Centre
IMF	International Monetary Fund
JITAP	Joint Integrated Technical Assistance Programme
LDC	Least Developed Country
LAP	Local Accountability Pacts
MFN	Most Favoured Nation
MTS	Multilateral Trading System
OECD	Organisation for Economic Co-operation and Development
OVOP	"One Village, One Product"
PRS	Poverty reduction strategy
PRSP	Poverty reduction strategy papers
SFA	Special Framework of Assistance for Traditional ACP suppliers of bananas
SPS	Sanitary and Phytosanitary Measures
TBT	Technical Barriers to Trade
TRIPs	Trade Related Intellectual Property Rights
TRTA/CB	Traditionally Trade Related Technical Assistance and Capacity Building
UN	United Nations
UNAIDS	Joint United Nations Programme on HIV/AIDS
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNFPA	United Nations Population Fund
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development
PARPA*	Action Plan for the Reduction of Absolute Poverty, Mozambique
WTO	World Trade Organisation

* Denotes acronym in original language

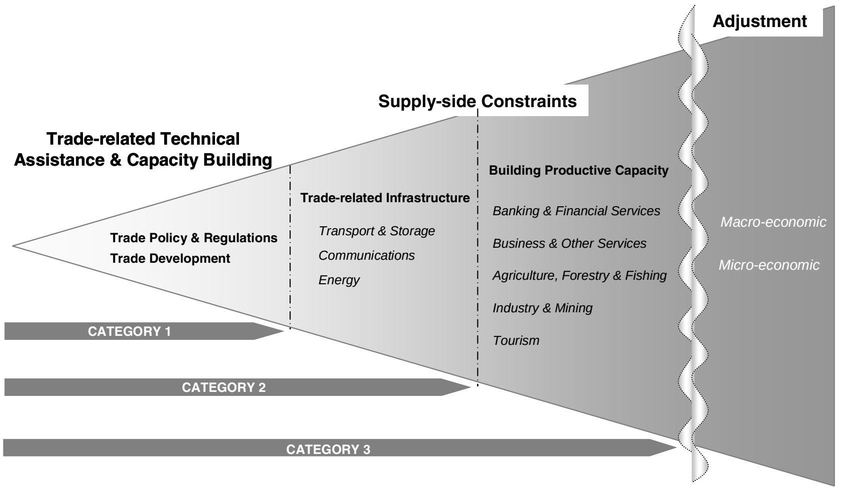
Executive Summary

The 2005 Hong Kong WTO Ministerial Declaration calls for the expansion of aid for trade to help developing countries benefit from WTO agreements and more broadly expand their trade. It is within this mandate that the WTO has asked the OECD to contribute to these efforts, and in particular to examine the following three issues: *i)* how much aid do donors already provide in support of trade; *ii)* how effective are these programmes; and, *iii)* how to make aid for trade an effective tool for helping developing countries, particularly LDCs, to fully benefit from trade liberalisation and WTO agreements.

The agenda is expanding

When attempting to measure the amount of aid spent on trade, the key issue is where to draw the line, *e.g.* how to distinguish between assistance focused on improving trade capacity in particular and support to promote economic growth in general. Technical assistance to build trade negotiating capacity is at one end of the spectrum. At the other end, building supply-side capacity could include expenditures on education, health and environment all of which are critical elements in shaping a country's competitiveness. Infrastructure is clearly essential to build export capacity. While in theory it would be useful to separate trade-related infrastructure, in practice it is not feasible. Not only are data not available but more importantly all forms of infrastructure contribute to productivity and competitiveness. Even assistance that is targeted at boosting domestic productivity will have an impact on imports and thus the balance of trade. Consequently, this paper does not attempt to provide a definitive delineation of the remit of the aid for trade agenda. Instead, it offers for consideration three different categories as shown in Figure 1.

Figure 1. Aid for trade: The expanding agenda



There seems to be an emerging consensus that the aid for trade agenda includes at least TRTA/CB and infrastructure. There is less agreement on whether support to address supply-side constraints should remain confined to reducing trading costs (*e.g.* trade facilitation), or, in addition, should include support to increase the productive and competitive capacity of the private sector. There is even less agreement on whether adjustment costs should be part of the agenda. This paper argues that most of the activities necessary to address adjustment, such as support to export diversification or fiscal reform, are already included in the three aid for trade categories mentioned above, but does not include in the three categories proposed other adjustment-related expenditure such as social safety nets, balance of payments support or compensation for potential costs from multilateral liberalisation such as preference erosion or a reduction in government revenue. Rather, it notes that international financial institutions, such as the World Bank and the IMF have been supporting developing countries' adjustment efforts arising from a host of factors, including trade reforms, and will continue to do so. This adjustment support has been evolving over time and further definition and targeting may be called for in light of the outcome of the Doha Round. In this regard, countries experiencing for example severe preference erosion may require special attention.

The aid volume is not the issue, but …

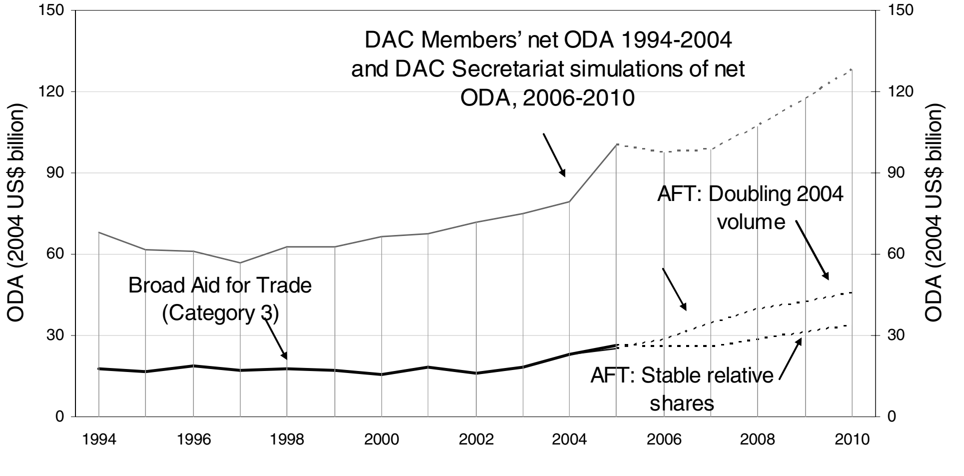
In 2004, assistance to the broader aid for trade agenda included USD 2.5 billion for TRTA/CB, USD 12.9 billion to build infrastructure and USD 7.3 billion to promote productive capacities. This adds up to a total of nearly USD 23 billion and a combined share of over 24% of total ODA, excluding debt relief.[1] In fact, since the Uruguay Round, the share of the broader aid for trade agenda (*i.e.* category 3) in ODA has averaged around 24% of total ODA.

With increased donor attention to trade, infrastructure and the broader economic growth agenda, it seems reasonable to assume that the volume of ODA to help developing countries participate more effectively in international trade could rise significantly. On the basis of the DAC Secretariat's simulations on the scaling-up of aid,[2] two scenarios for additional aid for trade have been developed for the period 2005-2010 (Figure 2):

i) On the basis of the narrow definition of aid for trade (*i.e.* category 1) the projected scaling-up of aid alone – *e.g.* maintaining its share in ODA constant – could bring total spending in 2010 to USD 4.3 billion, an increase of 67% in volume terms. Including infrastructure (*i.e.* category 2) would raise the stakes considerably and bring the total volume in 2010 to USD 30 billion.

ii) Results for the broadest definition of aid for trade (*i.e.* category 3) are illustrated in Figure 2. The scaling-up effect alone could deliver an additional USD 11 billion, a 48% increase over the 2004 levels of USD 23 billion. Doubling the volume would lead to an increase of USD 15 billion and aid for trade would then capture 30% of total ODA.

Figure 2. Scaling-up the broad aid for trade agenda (2005-2010)



Increasing the capacity of less-advanced developing countries to become more dynamic players in the global economy will clearly require a wide range of support. The scaling-up of aid provides room for this, but it is worth keeping in mind that it is the responsibility of these countries to give more priority and clearer definitions to their trade and growth strategies in order to effectively accelerate their successful integration into the world economy, a process which donors are willing to support.

… effectiveness needs to be improved

The process of building internationally competitive economies takes time and is highly country specific, but there are a number of common features for designing comprehensive strategies to promote dynamic and broad-based growth through trade while minimising short-term economic and social adjustment costs. Addressing the barriers that restrict a nation's trade-related capacity has proven to be a challenge stretching the capability of most recipient and donor agencies. In fact, aid for trade will face much of the same challenges inherent to all aid delivery. Harmonisation among donors and efforts to implement common arrangements, simplify procedures, an effective division of labour and collaboration are key aid effectiveness principles. Furthermore, recent evaluations of aid for trade programmes highlight, in particular, the absence of a results-based design in most projects and the poor use of monitoring and evaluation tools.

Local ownership is key

The main challenge, however, remains lack of genuine country ownership towards making trade a key tool of economic development. Trade reform is extremely sensitive to political economy constraints, and in many countries, vested interests are often unwilling to promote the reforms needed. In these cases, national dialogues and mainstreaming trade into national development strategies will remain weak. Donors seeking to deliver development results may want to improve their understanding of the political and institutional constraints to assess the capacity of the private sector and local champions in and outside of existing political and business elites in helping to define country strategies.

The inclusion of aid for trade in the Hong Kong Declaration offers the aid and trade communities the opportunity to establish a framework to deliver aid for trade assistance by providing incentives to recipients and donors alike to:

- Foster integration and synergies between trade and other economic policy areas;

- Improve the coherence of aid for trade assistance with overall aid strategies;
- Enhance the credibility of donors' commitment to increasing aid for trade;
- Support knowledge development in recipient and donor countries, and;
- Strengthen country ownership, align around country strategies, harmonise donor procedures and enhance management for results and mutual accountability.

Local accountability and global review will deliver the Hong Kong mandate

Some commentators are advocating the creation of new institutional mechanisms to secure additional financial resources towards aid for trade, even if this implies establishing a vertical fund. Indeed, specific vertical funds can be a useful mechanism to attract financial resources towards needs that might have been neglected and can be easily de-linked from broader national development strategies. However, it is undesirable, if at all possible, to separate the trade-related agenda from the broader economic growth agenda since this most certainly will compromise aid effectiveness and fail to deliver any real impact on trade performance. Prioritisation of trade capacity gaps can only be achieved effectively and efficiently when trade is mainstreamed into national development strategies. Moreover, a broad interpretation of aid for trade, already representing around a quarter of net ODA, points towards the need to focus efforts on further integrating aid for trade into locally owned development strategies to support the scaling-up process at the country level, rather than creating a completely new parallel aid for trade channel.

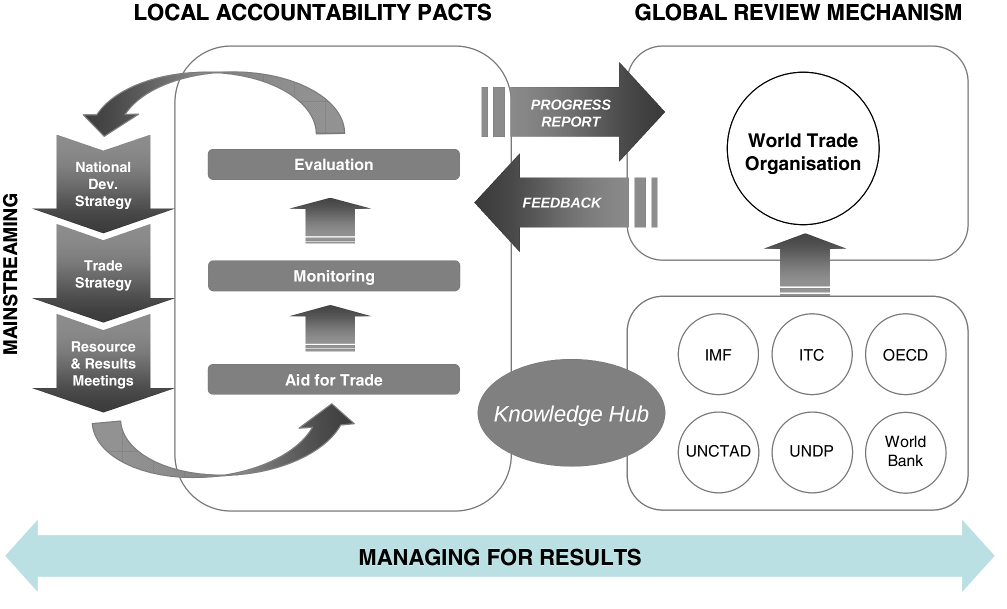
While there are compelling reasons to refrain from creating a new institutional mechanism for the financing and allocation of aid for trade, there is a very clear need to establish the credibility of aid for trade in the context of the DDA. A more structured Aid for Trade Partnership operating at the country level with global review and monitoring would fill the gap that exists at present. In fact, two accountability mechanisms are required: one that should operate at the national or regional level, and the other at the global level.

An aid for trade partnership aligned with existing local partnerships should bring together all the relevant stakeholders, including donors who provide trade-related support. Such a partnership (termed here as Local

Accountability Pacts or LAP) would provide incentives and means to foster country ownership, donor alignment and harmonisation. Its purpose is to provide feedback on the financial and performance-related aspects of the national aid for trade agenda. This would ensure that aid for trade would focus more on outputs instead of inputs. An obligation to report regularly, for example, to the WTO will focus assistance on delivering measurable results.

A Global Review Mechanism (GRM) would provide strong incentives to address needs – whether financial or performance related – identified by LAP and highlighted in the global review process. In turn, this will ensure that the Hong Kong aid for trade mandate is implemented in a credible, sustainable and effective manner, responding to the objectives of both the aid and trade communities. Figure 3 illustrates such an approach.

Figure 3. An Effective Aid for Trade Partnership: Local Accountability and Global Review



More traditional donors' evaluations remain important to ensure that the dissemination of best practices across countries, and increase transparency on pledges and commitments. Given the technical challenges of using aid to improve export competitiveness and the urgent need to improve know-how in both recipient and donor countries, there is a need for a more informal mechanism dedicated at developing tools and methods to build trade capacity where aid for trade practitioners could meet and work jointly free from the donor-recipient relationship present in most other fora. Such a hub should bring together knowledge acquired at the local and global level.

Notes

1. On commitment basis (CRS data), excluding debt relief and 2003 constant prices.

2. These are simulations only. Actual supply of ODA will depend on DAC members approving aid budgets and delivering ODA at the level indicated by their public commitments.

Introduction

The Hong Kong Ministerial Declaration invited the WTO Director-General to consult with "… international organisations … with a view to report to the General Council on appropriate mechanisms to ensure additional financial resources for Aid for trade, where appropriate through grants and concessional loans."[1] Subsequently, the WTO asked the OECD to contribute to these discussions, and in particular to examine the following questions: *i)* how much aid do donors already provide in support of trade, *ii)* the effectiveness of these assistance programmes, and *iii)* how to make aid for trade an effective tool for helping developing countries, particularly the Least Developed Countries (LDC), to fully benefit from trade liberalisation and WTO agreements.

The question regarding how much aid donors provide in support of trade and scenarios for additional resources was addressed in a first contribution to the international debate on aid for trade.[2] A second contribution provided recommendations on improving the effectiveness of aid for trade programmes.[3] This paper consolidates both contributions and takes account of the OECD members' comments. It is structured as follows:

- Chapter 1 describes the origins of trade-related technical assistance and the expansion of its scope in the Doha Development Agenda and highlights the international response.
- Chapter 2 discusses some of the challenges in defining the scope of the aid for trade agenda, in particular, the question on how to address adjustment costs.
- Chapter 3 analyses trends in financial assistance that donors have provided in support of the expanding aid for trade agenda to provide a common baseline.
- Chapter 4 presents scenarios for additional aid for trade in the context of scaling-up aid to USD 130 billion in 2010 and addresses the management challenges with respect to absorption capacity constraints and the potential for Dutch disease.

- Chapter 5 highlights the problems related to identifying market failures that can be effectively addressed by government interventions, and sets out the principles for aid effectiveness against which donor programmes to strengthen trade capacity are reviewed.
- Chapter 6 identifies three main priority areas to improve the effectiveness of aid for trade, *i.e.* establishing a national dialogue to formulate and implement trade policy, mainstreaming trade policy into national economic development and external assistance strategies, and better adapting donor programmes to recipient's characteristics.
- Chapter 7 concludes with a proposal for strengthening the aid for trade framework, and in particular for providing further incentives to apply aid effectiveness principles and increase mutual accountability.

Notes

1. Paragraph 57 of the WTO Hong Kong Ministerial Declaration WT/MIN(05)/W/3/Rev.2
2. COM/DCD/TD(2006)2
3. COM/DCD/TD(2006)3

Chapter 1

THE ORIGINS

Membership in the WTO has often been a key tool for governments seeking to enhance the credibility of trade reform and to provide firms with a more predictable external trading environment. At the same time, successive MFN multilateral liberalisations have highlighted the difficulties that many low income countries are facing in adjusting to trade liberalisation and capturing the benefits of more open markets. In these countries, governments, institutions and enterprises often lack capacities, *e.g.* information, policies, procedures, institutions and/or infrastructure, to compete effectively in global markets and take full advantage of the opportunities that are provided through international trade.

This chapter highlights key elements that have promoted the expansion of the narrow trade-related technical assistance and capacity building agenda that was conceived after the Uruguay Round to the broader aid for trade agenda that is currently being debated in the context of the DDA. This historical background could offer some insights on where to draw the line between the narrow and broad aid for trade agenda, on the one hand, and the general economic development agenda on the other.

Technical assistance in the Uruguay Round Agreements

The Uruguay Round negotiations marked the coming-of-age for many developing countries as full participants in the multilateral trading system. Developing countries agreed as part of the Single Undertaking to submit schedules of concessions and commitments on market access in industrial and agricultural products, as well as commitments on intellectual property rights and in the services sector. This concept of a Single Undertaking underlying the WTO brought to an end the fragmentation of the multilateral trading system in different layers of obligations and rights, while simultaneously responding to increased demands for stronger enforcement of international trading rules. This presented many developing countries with a number of challenges, including putting in place the necessary administrative, institutional and legal machinery to implement their commitments. Difficulties included such factors as the costs of implementation, the absence of adequate skilled manpower, and the time needed to prepare and enact new legislations and regulations.

Although the resources to implement the minimum legal requirements of WTO agreements might be modest, an effective implementation that enables countries to fully benefit from these agreements is more resource-intensive. It typically requires the procurement of equipment, training of people, and the creation of institutional frameworks. Most estimates of implementation costs are derived from technical assistance projects and are thus likely to be biased by donor's preferences on which countries and projects to support. There is a lack of credible estimates of implementation programmes funded through regular government expenditure. The most widely quoted figures come from Finger and Schuler (2000) who extrapolated from a few World Bank projects on customs reform, Trade Related Intellectual Property Rights (TRIPs) and Sanitary and Phytosanitary Measures (SPS) to arrive at an estimated cost of USD 150 million per country – the entire year's development budget of many LDCs – for the implementation of just these three agreements. It is likely that this is on the high end of estimates. For example, while Finger and Schuler used as a proxy the World Bank customs reform project in Tanzania which cost around USD 10 million between 1996 and 2000, Sauvé (2005) estimates the cost of reforming Cambodia's customs at only USD 4 million.

The 1994 Marrakesh Declaration explicitly acknowledged the need to provide trade-related technical assistance to least-developed countries to help them with their implementation difficulties and associated adjustment costs. In addition, a large number of specific agreements, *e.g.* SPS, TBT, Customs Valuation, Pre-shipment Inspection, GATS, TRIPs and Dispute Settlement Understanding (DSU), also contain specific references to best endeavours to provide support to developing country members and in particular the LDCs for implementation of these agreements. Finally, a decision on net-food importing countries was also attached to the Uruguay Round Agreement.[1] In it, WTO members acknowledged that "... *certain developing countries may experience short-term difficulties in financing normal levels of commercial food imports and that these countries may be eligible to draw on the resources of international financial institutions under existing facilities, or such facilities as may be established* … ".

Some developing countries did not fully appreciate the implementation challenges brought by the Round and ascribed that partly to their limited capacity to identify their trading interests and effectively pursue these during the negotiations. The combination of the Single Undertaking and the large number of developing countries accessions (34) during the Uruguay Round negotiations meant that many countries had little experience in trade negotiations, great difficulties in participating effectively in the Uruguay Round negotiations and thus had limited impact on the design of the new rules (Blackhurst *et al*. 1999).

International responses to build trade capacities

Shortly after the signing of the Uruguay Round Agreements, African trade ministers called upon the international community to help strengthen their capacity to formulate trade policy, participate in trade negotiations and implement trade agreements. In response, the WTO, UNCTAD and the International Trade Centre (ITC) established the Joint Integrated Technical Assistance Programme (JITAP) to mobilise expertise and support to help African country partners participate in the WTO, integrate into the new multilateral trading system and take advantage of new trade opportunities arising from the globalisation of world markets.

Furthermore, the first WTO Ministerial Conference in 1996 also recognised the special difficulties LDCs faced in integrating into the world economy. The following year, WTO members adopted an initiative for strengthening LDCs' trade capacities known as the Integrated Framework for Trade-Related Technical Assistance to the Least Developed Countries (IF). It was supported by six multilateral organisations (the IMF, ITC, UNCTAD, UNDP, the World Bank and the WTO) with the OECD/DAC as an observer. Together, these organisations have developed a comprehensive and integrated framework for the provision of technical assistance to the LDCs. The World Bank has, in addition, initiated programmes (particularly in favour of LDCs) where implementation of WTO agreements has become an integral part of development projects.

The IF has been applied on a case-by-case basis to meet the development needs identified by individual LDCs through round-table meetings with donors and international agencies. However, the mandated review of the IF pointed to some shortcomings related to unclear definition of policy objectives, weak administration and co-ordination as well as lack of monitoring capability. Subsequently, the six core agencies expanded their agenda to "mainstream" (integrate) trade into the national development plans such as the Poverty Reduction Strategy Papers (PRSPs) through the preparation of country specific Diagnostic Trade Integration Studies (DTIS).

The Integrated Framework is a significant undertaking for at least two reasons: first, WTO members have come to recognise that despite major efforts at trade reform, several poor countries still face a wide range of supply side constraints that prevent them from reaping the full benefits from the multilateral trading system. And, second, given the enormous challenges facing some of the poorer developing countries and the limited resources available, co-ordinated, integrated and demand-driven responses are critical to the effectiveness of donor support. Where the IF has fallen short is particularly in the implementation process at the country level.

The Doha Development Agenda

Since the WTO Ministerial meeting in Seattle, developing countries, and in particular LDCs and other low-income countries have consistently expressed their reluctance to agreeing on significant MFN tariff cuts and undertaking further trade-related commitments. This is mostly driven by their concerns about preference erosion, loss of tariff revenue, and perceived lack of capacity to capture the gains from emerging market access opportunities and other WTO agreements. The agreement to put developing countries' priorities at the centre of the Doha Development Agenda further highlighted the challenge of how to address development concerns in the multilateral trading system, and in particular how to help developing countries overcome their trade-related institutional, human resource and supply capacity needs became an integral part of the WTO Doha negotiations.

In the run up to the Sixth WTO Ministerial Conference in Hong Kong and in response to a specific request from the G8 in Gleneagles, the World Bank and the IMF jointly proposed an aid for trade framework. This should comprise traditional instruments such as trade-related technical assistance and institutional and supply-side capacity building, including trade-related infrastructure development, but expanded to provide aid to help developing countries adjust to possible revenue losses suffered through cuts in tariff revenues and preferential margins, or, more generally, to smooth adjustment pressure arising from increased international competition. In response, the September 2005 meeting of the Development Committee endorsed the proposals for an enhanced Integrated Framework, stated its support for a strengthened framework for assessing adjustment needs so that IFIs and donor assistance mechanisms can be better utilised, and asked the Bank and the Fund to examine further the adequacy of existing mechanisms and better integrate trade-related needs into their support for country programmes. The World Bank and the IMF are expected to report back to the Development Committee in September 2006.

The Hong Kong Ministerial Declaration agreed that Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO agreements and more broadly to expand their trade. Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the DDA, particularly on market access. However, it can be a valuable complement to the DDA and called for the creation of a Task Force to provide recommendations on how to operationalise aid for trade and how aid for trade might contribute most effectively to the development dimension of the DDA.

In addition, the Declaration asked a task force to provide recommendations on how to improve the implementation of the IF and stated its support for the enhanced commitment of members to address the increased demand for technical assistance, and improve its quality. The task force has formulated draft recommendation on an enhanced Integrated Framework to increase, predictable and additional funding on a multi-year basis; strengthen the effectiveness of the IF and improve its IF governance structure.

Notes

1. See the Uruguay Round Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries adopted by the Trade Negotiations Committee on 15 December 1993 and 14 April 1994.

Chapter 2

THE SCOPE OF THE AID FOR TRADE AGENDA

Traditionally Trade Related Technical Assistance and Capacity Building (TRTA/CB) has been defined as activities aimed at enhancing the ability of recipient countries to: *i)* formulate and implement a trade development strategy and create an enabling environment for increasing the volume and value-added of exports, diversifying export products and markets and increasing foreign investment to generate jobs and trade; or *ii)* stimulate trade by domestic firms and encourage investment in trade-oriented industries; or *iii)* participate in and benefit from the institutions, negotiations (OECD/WTO, 2005).

Two main categories were established to further classify these activities:

i) *Trade policy and regulations* – to help countries negotiate, reform and prepare for closer integration in the multilateral trading system; it covers activities such as analysis and implementation of multilateral trade agreements, trade policy mainstreaming and technical standards, trade facilitation including tariff structures and customs regimes, support to regional trade arrangements and human resources development in trade.

ii) *Trade development* – to help enterprises engage in trade and improve the business climate, access to trade finance and trade promotion in the productive sectors (agriculture, forestry, fishing, industry, mining, tourism and services).

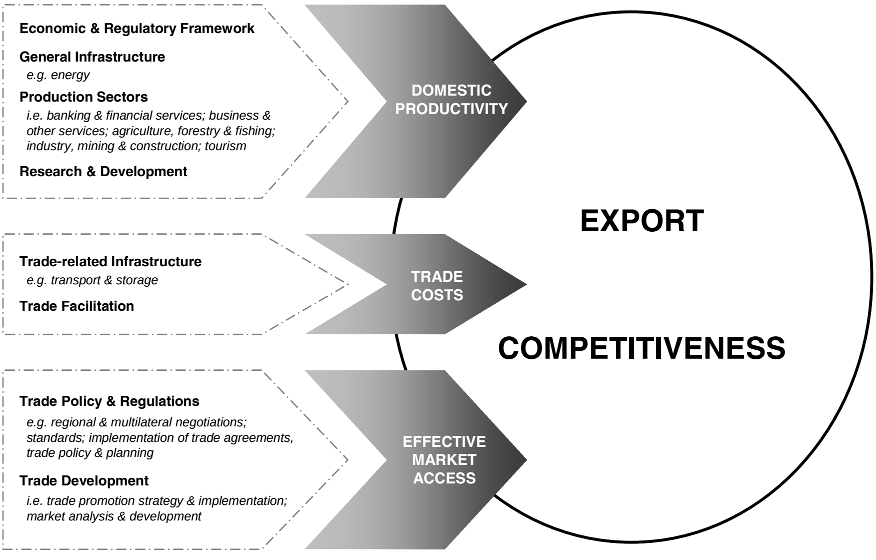
In addition, it was also decided not to refrain from creating a new separate category for assistance to trade-related infrastructure. Roads, telecommunication or 'power' are all part of a network and ascribing the focus of such assistance to trade would always remain arbitrary to ensure consistency among donors. Instead, all assistance reported under the Credit Reporting System on Economic Infrastructure (transport, energy and communications) was deemed, *inter alia,* to assist international trade. Indeed, even the trade-development category - intended to help identify the trade component of activities aimed at increasing the capacity of different productive sectors, or establishing a business environment – continues to suffer from lack of consistency in the reported data. Donors have established different reporting practices with some attempting to isolate the trade component of each category and others reporting the whole activity as trade-related.

These different reporting methods reflect lack of agreement on whether support to address "supply-side constraints" should also include support to increase the capacity of specific productive activities or remain confined to reducing trading costs (be they information on export markets, standards or trade finance) and supporting exclusively exporters. In fact, there is no internationally agreed definition of supply-side constraints. Generally, supply-side constraints refer to impediments to the capacity to produce goods and services competitively and the ability to get them to markets at a reasonable cost. This seems to be the premise of the Monterrey Consensus which called upon donors to gradually remove supply-side constraints, through improving trade infrastructure, diversifying export capacity and supporting an increase in the technological content of exports, strengthening institutional development and enhancing overall productivity and competitiveness (UN, 2002). Others refer to this category of support as economic responsiveness to trade opportunities. Both concepts address a wide range of development needs in public and private sectors from helping governments create a competitive and enabling environment to supporting local enterprises' abilities to identify and produce goods at competitive prices (USAID, 2003).

Export competitiveness

At first sight, a more economically rational definition of aid for trade would be based around export competitiveness. Export competitiveness is determined by three main factors: *i)* domestic productivity, which determines the costs of production; *ii)* trade costs, which determine the cost of moving and/or exporting the good and/or service and, *iii)* the effective level of market access which is determined by the extent of unilateral, regional or multilateral trade reforms and the capacity to meet standards and overcome information gaps on export markets (Figure 4).

Figure 4. Key inputs to improve export competitiveness



Note: Classification according to CRS database categories

The key issue, however, is that this type of definition does not provide further insights on how to differentiate between an aid for trade agenda on the one hand and the general economic development agenda, on the other. It is clear that domestic productivity will be crucial in determining developing countries' capacity to benefit from further trade liberalisation. Building supply-side capacity could extend as far as expenditures on education, health and environment expenditure that may be crucial to competitiveness. (Some countries have indeed built their export capacity around an educated labour force or environmentally-sound tourism). Infrastructure is clearly essential to building export capacity and while in theory it would be useful to distinguish trade-related infrastructure as a category in itself, in practice such a distinction is not feasible both because all infrastructure in the end contributes to productivity and the ability to compete (*e.g.* water for irrigation, sanitation for meeting SPS standards) and because of data and reporting limitations. Finally, not only is export competitiveness the outcome of a broad economic process, but even assistance apparently aimed exclusively at boosting domestic productivity will also have an impact on imports and thus the balance of trade.

Adjustment costs

There is even less agreement on whether, compensation/assistance with adjustment costs should be part of the agenda. Bhagwati (2004), Hoekman and Prowse (2005) and Zedillo *et al.* (2005) have argued that aid for trade should be part of the agenda, a view that is widely supported by developing countries and non–governmental organisations. However, the Development Committee considered that existing assistance mechanisms might be sufficient if better utilised and the issue is not part of the Hong Kong Declaration section on aid for trade. Mention to adjustment needs is made in Annex F on Special and Differential Treatment where the Agreement-Specific proposal 36 amending the Decision on Measures in Favour of Least-Developed Countries which states:

We urge all donors and relevant international institutions to increase financial and technical support aimed at the diversification of LDC economies, while providing additional financial and technical assistance through appropriate delivery mechanisms to meet their implementation obligations, including fulfilling SPS and TBT requirements, and to assist them in managing their adjustment processes, including those necessary to face the results of MFN multilateral trade liberalisation.

The issue of adjustment is particularly complex. Trade liberalisation prompts changes in relative prices that, in turn, trigger structural adjustment, which occurs as more productive firms – especially export-oriented – expand their outputs coupled with a contraction of less productive enterprises in sectors that become subject to greater import competition. As trade patterns change, workers lose their jobs and must seek reemployment in expanding sectors, while capital might also lie idle for a period. In many developing countries, adjustment is constrained by the degree of rigidities in the economy and export patterns (*e.g.* dependence on a few export commodities and markets). Also the costs of implementing new WTO agreements can be disproportionately higher in developing countries where previous practice and regulation might differ substantially from the international standards. From this perspective, facilitating structural adjustment is at the heart of efforts to eliminate supply-side constraints, and as such fully included in the Hong Kong declaration on aid for trade and in the aid categories/activities discussed above.

On the other hand, in the aid for trade context, adjustment is often interpreted as financial compensation for the potential downside effects of multilateral trade liberalisation, such as preference erosion, higher food prices or loss of government revenue. It is this aspect which is most controversial, partly due to its potential systemic effects on future multilateral trade liberalisation negotiations, but also due to the uncertainties regarding the magnitude of these potential costs and to the type of activities that have generally been financed, such as social safety nets, balance of payments support or general budget support – well outside the traditional trade-related assistance framework.

A key issue when considering the treatment of adjustment costs in the aid for trade debate is to distinguish between, on one hand, the possibility of integrating into the aid for trade agenda the activities and type of support necessary to mitigate adjustment and accelerate structural change (*e.g.* TATR/CB, infrastructure, assistance to productive sectors, workers training schemes or even balance of payment support) and on the other hand, the possibility of defining *ex ante* a compensatory financial package to countries seemingly at risk of experiencing overall welfare losses from multilateral liberalisation.

Indeed, it is extremely difficult to anticipate the magnitude of downward risks in complex situations that deal with policy changes in a variety of areas and regions such as those induced by a trade round. For example, although at the time of the Decision on net-food importing countries developing countries expected an increase in food prices brought by agricultural liberalisation in developed countries, the gains in agricultural productivity were considerably larger than any upward pressure brought by a relatively modest reduction in agricultural support. Hence, food prices did not on average increase. It is clear that what is required is a set of instruments in place that, if and when a downside occurs in specific sectors and activities, can be activated to enable the afflicted to cope with the difficulties (Bhagwati, 2004).

For example, the Trade Integration Mechanism launched by the IMF in April 2004 is such an instrument. It has been conceived to bring support to countries that might experience balance of payments shortfalls resulting from multilateral trade liberalisation. It aims at mitigating the concerns of developing countries about the impact on their economy of other countries' opening their markets for goods and services by increasing the predictability and accessibility of resources available under previous facilities. Until now, only two member countries, Bangladesh and the Dominican Republic, have requested and obtained support.

Prospects for refining the definition of aid for trade

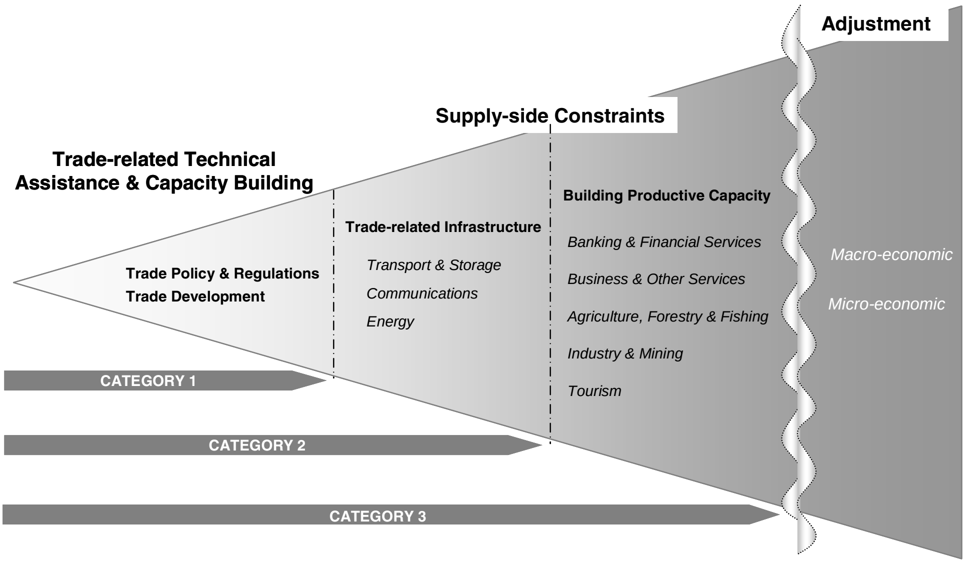
The above makes clear that there are few economically rational criteria to strictly ring-fence aid for trade activities from overall growth promoting ODA. Any definition of aid for trade narrowly based on the type of activities eligible for aid for trade assistance would be unavoidably arbitrary. Moreover, if such a definition was to be used to prioritise financial support to eligible activities, there is a risk that aid for trade programmes would fail to take into account the different characteristics and specific needs of developing countries, and this could lead to a misallocation of resources and reduce the overall effectiveness of aid for trade assistance.

At the same time, there is a risk of re-labelling all growth promoting development assistance as aid for trade. This would run the risk of reducing the impact of the aid for trade initiative and increase scepticism about the potential of this initiative to effectively enhance developing countries' ability to better benefit from WTO agreements. A potential way-forward would be to adopt a definition that is based on the objectives of the aid. That is, define aid for trade by the objectives of the activity to be financed, rather than attempting to define it by the type of activities it is supposed to finance. This seems to be closer to the spirit of the Hong Kong Declaration which defines aid for trade in terms of the supply-side capacity and trade-related infrastructure needed to implement (benefit from) WTO agreements and expand trade. An objective-based definition would also be fully compatible with a results-based management approach to aid for trade as proposed in Chapter 7.

However, for the purposes of this paper, and in particular the next chapter on estimating donor support, only ODA targeted towards trade-related technical assistance and capacity building, economic infrastructure and building productive capacity are considered. Other support to the economic growth agenda such as economic and development policy and planning, legal and judicial developments and government administration to name a few is excluded. This does not imply that the impact of regulation and policy is negligible. On the contrary, the World Bank/IFC's *Doing Business* annual reports show the critical impact that regulations and bureaucracy can have on businesses' costs. However, including such items in the scope of an aid for trade initiative in the context of the DDA could be interpreted as widening the scope of the WTO agenda further into behind-the-border policies as well as raising unnecessary concerns about conditionality and links between domestic policy and trade reforms. Assistance for adjustment, such as social safety nets and balance of payments, is also excluded. This is the case since, first, current databases do not differentiate between assistance to trade-related adjustment and other type of adjustments and second, because past expenditure cannot be considered as an indicator for future expenditure in this area.

Thus, although there is no general agreement on the scope of the aid for trade agenda, in order to provide a magnitude of the current and expected flows of assistance, the possible elements in the aid for trade agenda that are taken into account in this paper are represented in Figure 5.

Figure 5. Aid for trade: the expanding agenda



Chapter 3

DONOR SUPPORT

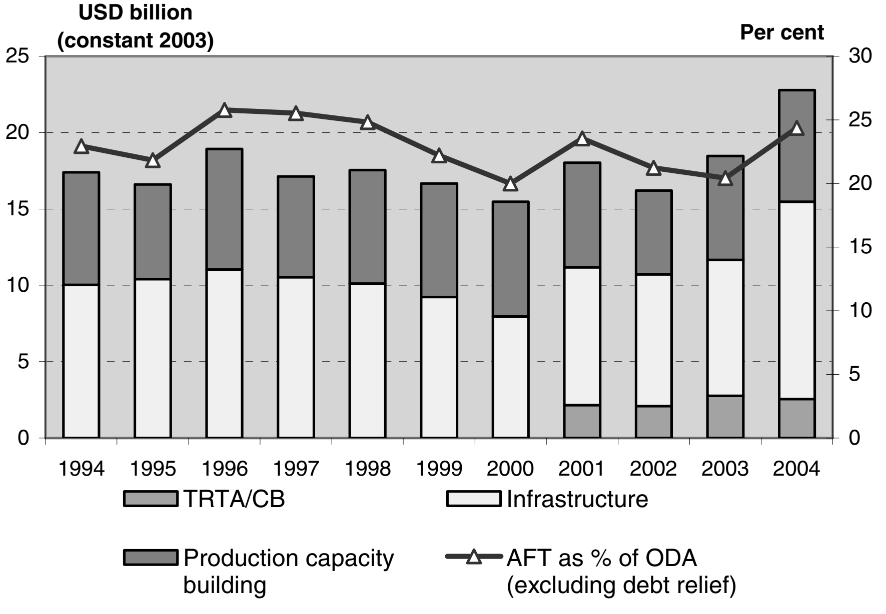
This chapter provides some more detailed trends in bilateral and multilateral donor support to the different categories of the aid for trade agenda, *i.e.* TRTA/CB and supply-side constraints (infrastructure and building productive capacity). A time series for the period 1994-2004 provides a baseline for donor support to the aid for trade agenda. The definitions and methodology are set out in Annex A. The chapter also attempts to reconcile the ODA-restricted country eligibility and the WTO non-discrimination principle.

Volume of aid for trade

At the Doha Ministerial Conference, members recognised the need for more comprehensive data to track and monitor trade related technical assistance and capacity building commitments which are part of the Doha Development Agenda. In response, the WTO and OECD created jointly the trade capacity building database in 2002. The database covers support for trade policy and regulations and trade development provided by 26 bilateral donors and 19 multilateral agencies. TRTA/CB activities have been reflected in the WTO/OECD joint database under two main categories: *i) Trade policy and regulations* and *ii) Trade development.*

According to the figures in this database, overall support for TRTA/CB has declined by USD 200 million to USD 2.5 billion in 2004, following the increase recorded in 2003. However, from 2001 commitments for *trade policy and regulations* have increased from USD 649 million to USD 703 million in 2004, while commitments for *trade development* increased by USD 340 million to USD nearly 1.8 billion in 2004. The level of donor contributions to multilateral trust funds and programmes, *i.e.* the Doha Development Agenda Global Trust Fund (DDA GTF), the Integrated Framework, the JITAP and the ITC trust funds, have increased by almost 70% between 2001 and 2003, but remained stable at USD 45 million between 2003 and 2004. This represents less than 2% of the overall TRTA/CB budget (Figure 6 and Table A1).

Figure 6. Volume of ODA to the broader aid for trade agenda



Source: OECD Creditor Reporting System database and WTO/OECD Trade Capacity Building Database

The reported declines are mainly due to the programming cycles of some of the larger donors and the exchange rate movements between the USD and other currencies, mainly the Euro. To eliminate the influence of these bi-annual fluctuations in donor programmes, the 2005 joint WTO/OECD report on TRTA/CB has combined the amounts of support in 2001 and 2002 and compared the total with the combined support in 2003 and 2004. On that basis, TRTA/CB has increased by 50% in volume terms and its share in total ODA has increased from 2.75% during 2001/2 to 2.9% for 2003/4. Data for 2005, which are still incomplete, suggest that the share will increase again and surpass the 2003/4 level.

Activities to enhance the *infrastructure* necessary for trade are included in the OECD Creditor reporting System under the heading economic infrastructure and reported in the annual joint WTO/OECD TRTA/CB reports. Economic infrastructure consists of a number of sub-sectors:

transport and storage, communication and energy. Water supply and sanitation are classified under the heading social sectors. Therefore, in this chapter, all aid to infrastructure, minus water supply and sanitation, is considered as a proxy for trade-related infrastructure. Since 1994, the total volume of aid to economic infrastructure sector has fluctuated between USD 8 billion and USD 11 billion (2003 constant prices). In 2004, the total volume has risen by almost 50% to USD 13 billion, mainly due to important reconstruction programmes in Afghanistan (transport) and Iraq (energy). Although the sharp increase in 2004 is not a trend in itself, donors are showing a renewed interest in the potential contribution infrastructure and in particular transport can make to economic growth and poverty reduction (OECD, 2006). Against this background, a reversal of the downward trend in support of infrastructure from 15.6 in 1997 to 9.8% in 2003 is probably forthcoming. [Table A1 and Figure 5].

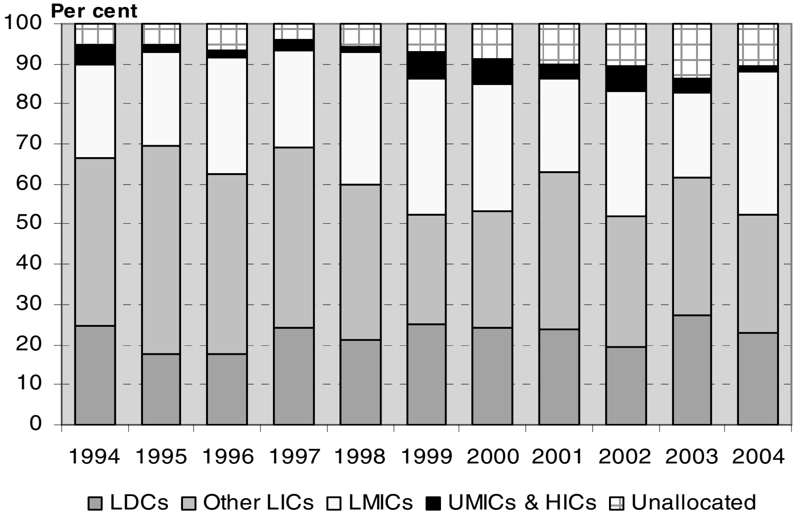
Activities to enhance general *productivity and competitiveness* are neither included in the joint WTO/OECD database nor in the annual TRTA/CB reports. Support to enhance overall productivity and competitiveness is captured in the CRS. Up to 2000, support to these programmes was relatively stable in the range of 8.2% to 10.7% of total ODA. Since 2001, the share dropped and moved in the range of 7%-9% of total ODA. This decrease resulted from the reclassification of trade development as a part of the TRTA/CB category, after the joint OECD/WTO database was created in 2001. Care has been taken to avoid any double counting in all the data presented in this chapter from activities reported in both the trade development and the productivity and competitiveness categories.

During the period 1994 – 2004, most of the aid to improve productivity and competitiveness went to the agricultural sector (50% on average). The share of aid to improve industry productivity and competitiveness of industry averaged around 20%, which in cases of developing countries with an important extractive industry is largely directed at the mining sector. Support to the service sector, *e.g.* banking and other services has on average increased and reached 26% in 2004 (Table A1).

Distribution of aid for trade flows

The breakdown by income groups shows where rising contributions of TRTA/CB, infrastructure and support for building productive capacity are spent. In 2004, the largest beneficiary group was the lower-middle-income group, which includes such major global players as Brazil, China, Egypt and Thailand, which received around 36% of all aid for trade. The share of the non-LDC low-income group has been declining proportionally, while the share of the least developed countries has remained relatively stable at around 24-22% of total aid for trade (Figure 7). It is worthy to highlight that for TRTA/CB, the largest share is unallocated (33%) which is often destined to regional support programmes.

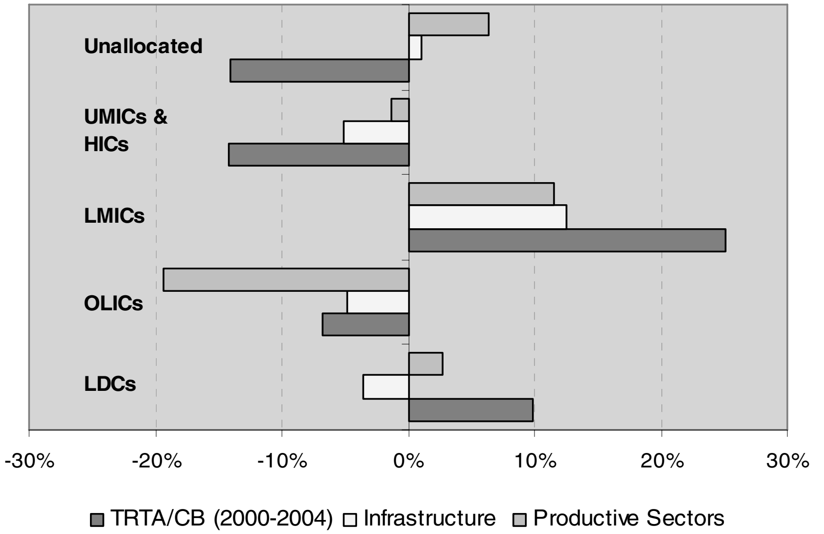
Figure 7. Distribution of aid for trade by income group, 1994-2004
(TRTA/CB, Economic infrastructure and Productive capacity Building)



Source: OECD Creditor Reporting System database and WTO/OECD Trade Capacity Building database

A spotlight analysis of the distribution of aid for trade in 1994 (2000 for TRTA/CB) and in 2004 show some remarkable shifts in the ability of various income groups to capture aid for trade assistance. Middle Income countries have significantly increased their share of the three aid categories, but in particular of TRTA/CB from 10% of the total TRTA/CB commitments in 2000 to nearly 36% in 2004. The groups that have experienced the largest decline in their shares are the upper middle income and high income countries and the group of non-LDC low income countries that used to capture around 40% of total aid for trade in 1994 and are now receiving close to 30%. Figure 8 illustrates in more detail the change in the share of aid for trade assistance in 2004 from 1994 (2000-2004 for TRTA/CB) by category of aid and by income group. For example, it shows that the LDC share of total TRTA/CB commitments has increased by 10 percentage points since 2000.

Figure 8. Shifts in the share of aid for trade in 2004 from 1994 by income group
TRTA/CB, Economic infrastructure and Productive Capacity Building



Source: OECD Creditor Reporting System database and WTO/OECD Trade Capacity Building database

Marrying ODA and MFN: The terms of support

Official Development Assistance is defined as those flows to countries on the DAC List of Aid Recipients (developing countries) and to multilateral institutions for flows to aid recipients which are: *i)* provided by official agencies, including state and local governments, or by their executing agencies; and *ii)* each transaction of which is (a) administered with the promotion of the economic development and welfare of developing countries as its main objective; and (b) concessional in character and (c) conveys a grant element of at least 25% (calculated at a discount rate of 10%). Countries on the DAC list of aid recipients includes all low and middle income countries (*e.g.* with a *per capita* income smaller than USD 10 065 in 2004), except those that are members of the G8 or the European Union (including countries with a firm date for EU admission; *i.e.* Bulgaria and Romania).

Of the current WTO members two thirds are designated as developing countries. Despite extensive references in the WTO agreements to special provisions, rights and obligations accorded to developing countries, there is no official definition of what constitutes a "developing country". Rather, GATT Contracting Parties have self-selected their designation, most recently when the WTO was created. Other WTO members, however, can challenge the self-proclamation as a developing country. This challenge can then lead to negotiations to clarify the position. For countries that have negotiated to join the WTO after 1995, their status is a matter that is taken up during accession negotiations (OECD, 2001b).

The Hong Kong Declaration calls for the WTO Director-General to focus his consultations on mechanisms to secure additional financial resources for Aid for trade, where appropriate through grants and concessional loans. At the moment, around 85% of all TRTA/CB is grant based; assistance for infrastructure is split fifty-fifty between concessional loans and grants, reflecting the resource intensiveness of many infrastructure projects. Does the potential conflict between the different criteria applied to assign developing status according to GDP *per capita*, as practiced by the development community and the WTO approach of self-selection provide compelling reasons to change the current mix of grant and concessional loans in the context of the aid for trade initiative, while taking care that these approaches still adhere to the OECD Arrangement on officially Supported Export Credits?

Any meaningful comparison between the impact and efficiency of grants versus loans needs to keep the total ODA level constant. At a given level of assistance, it is the degree of concessionality that will determine the overall size of the loan, with higher degrees leading to less debt but also fewer resources available for recipients and less or no recycling potential.

Cordella and Ulku (2004) examined whether the degree of concessionality affects aid recipient's growth outcome. They advocate a mixture of grants and loans to optimise assistance. Countries with good policies and a higher absorption capacity will benefit most from loans which release more resources, enabling faster growth while countries with high levels of indebtedness, high poverty levels or bad policies and poor absorption capacity are better off with grants even if this means lower level of assistance.

In terms of efficiency, the available evidence indicates that recipients' financial discipline is negatively correlated with the degree of concessionality; *i.e.* the cheaper money, the less efficiently it may be used. Grants promote government consumption spending and retard investment spending. Moreover, in low-income countries, an increase in grants tends to be completely offset by a decline in domestic government revenues. Whereas official loans with high concessionality level are found to be an incentive for over-borrowing and, thus, encourages unsustainable debt levels (Odedokun, 2004).

Given the possible negative incentives of both grants and concessional loans, Odedokun (2004) argues that the degree of concessionality should be determined by the desirability of subsidising the activity. For example, in case of positive externalities such activities would probably be under invested. This is one of the key arguments some put forward to justify an increase in aid for trade (Hoekman and Prowse, 2005). It is particularly applicable to trade infrastructure with a regional impact. On the other hand, grants are more appropriate to assist poor segments of the population. However, if the transfers are sought for allocation to the recipients' private sector, non-concessional loans are most appropriate, so as not to compromise resource allocation efficiency, particularly if the grace period is sufficiently long for investment to yield compensatory returns.

In general, aid for trade – except in the case of public goods – requires less financing by grants than other sectors such as education and health. Indeed, any worthwhile investment to build a country's export capacity should generate enough foreign currency resources to service the debt and, loans are more likely to be efficiently invested in productivity enhancing activities than grants. However, the available evidence does indicate that the debt factor is sufficiently large in highly indebted and in very poor countries to offset the advantages of loans. In these cases, grants or highly concessional loans should continue to play a major role. More innovative instruments providing recipient countries incentives to strengthen the efficiency of grants and greater choice between grants, concessional loans and market-based loans might have the potential to contribute to the effectiveness of aid for trade and deserve further attention and development.

Chapter 4

THE GLOBAL AID CONTEXT: THE CHALLENGES OF SCALING-UP

An important factor influencing aid for trade financial flows and the design of an effective framework is the overall aid context in which aid for trade will be delivered. Once donors' commitments are met, ODA is expected to reach about USD 130 billion by 2010, an increase of USD 50 billion from 2004 and twice the amount spent in 2000. The challenges for partner countries for managing such a scaling-up of aid inflows are numerous. They include; (1) maintaining a stable macroeconomic framework with an increasing share of the economy – and particularly budgetary resources financed by multiple and volatile sources of external assistance; and (2) improving public financial management while facing increasing disincentives to mobilise domestic resources and rationalise expenditure. In terms of the effectiveness of aid for trade, two issues seem particularly relevant: absorption capacity constraints and the potential for a Dutch disease syndrome.

Additionality or scaling-up of aid for trade

The announced ODA increase by USD 50 billion by the year 2010 is impressive, but needs to be treated with some caution. It implies that aid will be one of the most rapidly rising outlays of public spending. Given the budgetary pressures in many donor countries, it will be a challenge delivering such increases. It is also the case that there will be close scrutiny of the make-up of any additional aid. For example, while the last three years have seen a real increase in aid, much of it has been in the form of debt relief. Important as that is, it does not necessarily result in new money for developing countries.

This chapter assesses the potential effect of the scaling-up of aid on aid for trade financial flows. It is reasonable to assume that with the increased donor attention to trade, but also to infrastructure and the economic growth agenda in general, the volume of ODA to help developing countries participate more, and more effectively in international trade could rise significantly in the period to 2010. The issue of "additionality" requires, however, some clarification in the context of the aid for trade debate. In fact, two types of additionality should be distinguished:

i) The first type is additional new aid money over and beyond the level that has already been projected to 2010.

ii) The second type is additional to what is currently already being provided in the area of aid for trade – *i.e.* increasing the total volume of aid for trade in real terms.

The first type of additionality is unlikely. Most DAC members have already made commitments for their total aid levels to at least the year 2010. Consequently, however large a commitment is made to aid for trade, it can be more or less excluded that any DAC member's overall aid programme will rise beyond what is currently planned, at least to 2010. (The United States, which is virtually the only DAC member without some form of medium-term ODA target, might be the possible exception.)

The prospect for the second type of additionality is more probable. Given the increased attention to aid for trade, it is realistic to expect that its relative share will grow faster than the projected increase in overall ODA. Already the current pledges on aid for trade, and in particular those that have been made during the WTO Hong Kong Ministerial Conference would significantly increase the relative share of aid for trade. (The European Union and its member states pledged to provide Euro 2 billion in trade related technical assistance by 2010, the US announced grants of USD 2.7 billion a year by 2010. Japan committed USD 10 billion over the next three years for trade related infrastructure, production and distribution).

Table 1 shows the additional volume on aid for trade that can be expected assuming that the scaling-up of ODA materialises, but *i)* no change in the relative share of aid for trade takes place and *ii)* the volume of aid for trade doubles. The calculations of these scenarios are based on total ODA (*i.e.* bilateral + multilateral) on commitments basis, *i.e.* USD 93.4 billion in 2004. The projection of total ODA commitments of USD 150 billion in 2010 has been arrived at by applying the same methodology and ratios as those applied by DAC secretariat for the general simulation of scaling-up of net ODA to 2010.

On the basis of the narrow definition (*e.g.* TRTA/CB) the following scenarios apply:

- The projected scaling-up of aid alone, *e.g.* maintaining TRTA/CB share in ODA constant, could bring total spending in 2010 to

USD 4.3 billion, an increase of 67% in volume terms. Doubling its volume as suggested by some donors would increase the share up to 3.4% of total net ODA and yield over USD 5 billion.

Including infrastructure already raises considerably the stakes:

- An increase in line with the projected scaling-up of aid would raise an additional USD 6.4 billion, an increase of 41% on current spending. Doubling the volume would lead to aid for trade absorbing up to a 20% of total net ODA.

The broadest definition of aid for trade leads to the following results:

- A scenario where shares in ODA remain stable would mean that the scaling-up process alone could deliver an additional USD 11 billion to aid for trade, a 48% increase. Aid for trade could represent 30% of total ODA if commitments to double spending are kept.

Table 1. Summary of scenarios (in % and volume)

	Status-Quo		Constant share		Doubling the volume	
	2001-04	2004	2010		2010	
	% Share	USD bn.	% Share	USD bn.	% Share	USD bn.
TRTA/CB	2.8	2.6	2.8	4.3	3.4	5.1
TRTA/CB & Infrastructure	14.5	15.5	14.5	21.9	20.5	30.9
Broader Aid for Trade	22.4	22.8	22.4	33.7	30.2	45.5

Note : Share as % of net ODA

Given the striking implications of broadening the scope of aid for trade and doubling its volume, it is crucial that policy-makers establish urgently consensual and realistic financial objectives. Furthermore, it is evident that there are trade-offs between the scope of the agenda, the scaling-up of aid commitments, and managing these commitments to deliver results. This would become particularly important if the WTO negotiations lead to a substantial increase in commitments and to further widen the scope of aid for trade to also include adjustment costs.

Absorption capacity

Given the probability of significant increases in aid and aid for trade flows, it is critical to consider the capacity of developing countries, and in particular LDCs, to absorb this aid. Absorptive capacity constraints are influenced by the macroeconomic impacts of aid on the fiscal and external deficits and by the capacity of the government to deliver services, select projects, exercise financial control and manage them effectively to satisfy expectations. Many partner countries are in fact already experiencing absorption capacity constraints. Most studies on the relationship between aid and growth show diminishing returns after aid has reached a certain level of GDP. Estimates on the saturation point – the level of aid after which it ceases to have a positive effect on economic growth – vary significantly across countries within a range of 5% to 25% of GDP depending on the quality of institutions (Collier and Dollar, 2002).

Considering that aid to a number of African countries is already above 10% of GDP, the proposed scaling-up of aid will have to be carefully sequenced to ensure that the absorptive capacity of countries is one step ahead of the committed funds. As Heller (2005a) highlights, the sequencing of reforms becomes critical. Certain initial human capital and infrastructural bottlenecks must be tackled if adverse effects from scaling-up are to be minimized. Given the wide scope of the broad aid for trade agenda, it is likely that any substantial increase in assistance will affect capacity constraints and thus, the effectiveness of the whole scaling-up exercise. Indeed, while aid for trade could play a critical role in increasing absorptive capacity through technical assistance and capacity building, economic infrastructure and boosting productivity, the complexities of the agenda and linkages with the domestic economy might also absorb too much capacity, impose the wrong sequencing and undermine other priorities. It is thus crucial that aid for trade is fully coordinated with other aid flows. The obvious tool to coordinate all aid flows are National Development Strategies (PRSs, CAPs).

Dutch disease

The expected scaling-up of aid has renewed concerns about the potential of aid flows to create a real appreciation of the aid recipient's currency – the "Dutch disease" effect – and thereby dampen the export competitiveness of a country. A recent study by Rajan and Subramanian (2005) finds that aid had systematic adverse effects on countries' competitiveness, as reflected in a declining share of labour intensive and tradable industries in their manufacturing sector as a result of real exchange rate appreciation caused by aid inflows.

Inflows of aid, *i.e.* foreign currency, increase the demand — both for tradables (items that are readily exported or imported, such as consumer goods) and non-tradables (items that are not readily exported or imported, such as housing). In theory, greater demand for tradables should be easily satisfied through an increase in imports. But higher demand for non-tradables could encounter production bottlenecks leading to pressures for higher wages and other inputs resulting in a rise of their price relative to tradables, thus pushing up the real exchange rate. This leads to a loss of competitiveness and lower growth of the tradable sector.

Real exchange rates effects on export growth can be significant. In the context of trade policy reforms, this means that the reduction in trade restrictions is not accompanied by a depreciation as large as would otherwise be necessary to trigger a rise in exports; thus, prices for import substitutes fall more. This inflicts pain on producers of import substitutes early in the reform programme and reduces the incentives for exporters. It defers the export supply response and worsens the political economy of trade reform. Moreover, recent studies find that growth accelerations are associated with currency depreciation suggesting that a large appreciation associated with scaling-up could have long term growth costs (Haussman, Pritchett and Rodrik, 2004).

From a development perspective, the benefits of aid in reducing poverty and building long-term competitiveness can often offset the costs of reduced competitiveness in the medium term. However, it is clear that the effectiveness of an aid for trade initiative would be seriously undermined if the additional aid contributed to reducing the recipient country's export competitiveness. At the same time, aid for trade has a strong potential to mitigate Dutch disease effects by improving the underlying competitiveness of the economy and compensating the impact of currency appreciation.

Indeed, there are various strategies available to governments to sterilise this effect for example by building up foreign reserves, but these imply not spending or at least deferring into the future the disbursement of additional resources. The other strategy is to ensure that aid does deliver higher productivity, particularly in the non-tradable sector – such as roads, storage, ports, distribution – that enables the sector to expand supply instead of increasing prices. A key role of aid for trade assistance is to tackle the bottlenecks hampering supply and productivity in the non-tradable sector. In particular, support to intra-regional trade, through improvements of regional trade infrastructure or reduction in other trade barriers, might have a key role in increasing the productivity of the non-tradable sectors. Increasing productivity in the tradable sector might help the sector to cope with an appreciation of the real exchange sector rate but will not mitigate the appreciation effect. In short, while an effective aid for trade programme that lifts productivity in the non-tradable sector is likely to mitigate the potential Dutch disease effects from ODA flows, an ineffective one would exacerbate it and contribute to undermining the recipient country's export competitiveness.

Chapter 5

WHEN IS AID EFFECTIVE?

This chapter discusses key theoretical insights on how to ensure that aid can indeed lift the productivity and export competitiveness of recipient countries. It first explains some key general public finance principles for successful government interventions and then presents in more detail the Paris Declaration principles on aid effectiveness that address the challenges of managing effectively externally financed activities, *i.e.* aid programmes.

Effective government interventions

In general, the economic rationale for government intervention is to improve equity and efficiency. The rationale for aid for trade assistance is based on equity concerns at the global level but on efficiency concerns at the local/country/regional level. The main cause of inefficiency lies where circumstances mean that the private returns that an individual or firm receives from carrying out a particular action differs from the returns to society as a whole. Market failure is a description of a situation where, for one reason or other, the market mechanism alone fails to achieve economic efficiency. This can occur in the case of public goods, externalities, imperfect information, or market power from insufficient competition. Correcting market failures is essential to ensure that government intervention creates a 'supply-side' or 'structural impact' that alters the productive capacity of the economy by for example improving the working of markets and economic institutions or strengthening capacities.

Identifying market failures, however, may not be always straightforward. For example, a well-known supply constraint in many low-income countries is lack of access to credit. The World Bank annual *Doing Business* reports uses as a proxy for quantifying this problem the availability of credit information registries. If banks cannot access information about the creditworthiness of potential clients, they will rely on social and ethnic networks, constraining the expansion of new businesses beyond privileged connections. However, Bigsten and Söderbom (2005) in their review of manufacturing enterprises find that despite the fact that financing is the top constraint cited by company managers in Africa, investment by companies remains unrelated to retained profits and that the desire for formal credit is relatively modest among medium and large businesses. The most likely explanation for why credit (or lack thereof) has not been a major factor in explaining why investment has been low over the last decade is that during this period few firms in these countries could identify strong investment opportunities. In Bigsten and Söderbom's (2005) view, the high level of economic and political uncertainty coupled with the very thin markets for second hand fixed capital are much more important factors than the lack of formal credit. This is why so many of the financial system reforms implemented in Africa in the 90s appeared ineffectual, *i.e.* reforms did not address the binding constraints.

Furthermore, what appears at first sight as a market failure may be in fact caused by a government failure. Indeed, governments, particularly those with weak institutional capacity and low levels of civil society scrutiny might produce inefficient solutions. For example, some argue that under-investment in trade-related administration and infrastructure is partly due to the public good characteristics of such investments on other countries. There is no doubt that the impact of transport infrastructure is an essential determinant of export competitiveness and has significant externalities to neighbouring countries. Limão and Venables (2001) estimate that the median landlocked country faces transport costs about 50% higher than the median coastal country and that as a result its trade volume is 60% smaller. However, Evenett (2005) remarks that it might be misleading to think about the rationale for under-investment in an activity as independent of the levels of investment in other areas that affect the export competitiveness of developing country firms. He argues that sub-optimal outcomes in any one component of a nation's trade-related capacity might reduce the returns expected from investing in other components. For example, one could easily envisage that the investment returns from a new port are greatly reduced by the existence of a corrupt and inefficient customs service – a typical government failure.

Consequently, identifying the binding market or government failures that are constraining a nation's trade-related capacity is a challenging exercise that will stretch the capability of most recipient and donor agencies. Among donor agencies there has been a concerted effort to improve the analysis of capacity gaps in developing countries. For example, the Trade Diagnostic tool of the Integrated Framework helps LDCs to analyse where government intervention will be most helpful. In addition, the World Bank has decided to further develop its capacity to assess trade-related capacity gaps. Integrating economic growth and trade into national poverty reduction strategies will be essential to help in identifying the interplay between different constraints and the most binding ones. However, while these tools are vital to help the poorest countries build a coherent national trade policy and identify priority areas, they are often still too general to provide the detailed analysis necessary to ensure a successful intervention. Identifying a need is not sufficient to ensure successful interventions that will increase productivity. If corruption is the problem, investing in ports without reforming the customs service will allow customs officials to capture a larger rent instead of delivering lower transport costs. Further mechanisms to improve the 'know-how' of aid for trade practitioners from recipient and donor countries seem required.

Aid Effectiveness: The Paris Declaration

Experience in both developed and developing countries' public sectors show that complex assistance programmes have the potential to consume large amounts of administrative resources and tend towards answering the needs of the programme providers instead of the priorities of the targeted population. In the last decade, many OECD countries have focused their public sector reform efforts on improving the delivery of public services through expanding the use of performance and project management tools, such as joint-up government, stakeholders' consultations, outcome-based targets and in-built evaluations. Equally, the development community has developed a vast body of best practices on delivering aid effectively. This chapter sets out these practices and principles that were agreed upon in the Paris Declaration on Aid Effectiveness (OECD, 2005a).

Donors have committed themselves to support such local ownership of development strategies, align development assistance with these local strategies, harmonise donors' policies and procedures, and implement principles of good practice in development cooperation. Furthermore, they affirmed their commitment to foster a global partnership on managing for results, agreed to aligning cooperation programmes with desired development results and to define how aid is expected to contribute to them, and decided to rely on and strengthen partner countries' monitoring and evaluation systems in order to track progress. Together, these international agreements define the principles of the aid effectiveness agenda, which can be summarised in five broad areas:

i) **Ownership.** The development community will respect the right – and responsibility – of the partner country to exercise effective leadership over its development policies and strategies, and coordinate development actions.

ii) **Alignment.** Donors will align their development assistance with the development priorities and results-oriented strategies set out by the partner country. In delivering this assistance, donors will progressively depend on partner countries' own systems, providing capacity-building support to improve these systems, rather than establishing parallel systems of their own. Partner countries will undertake the necessary reforms that would enable donors to rely on their country systems.

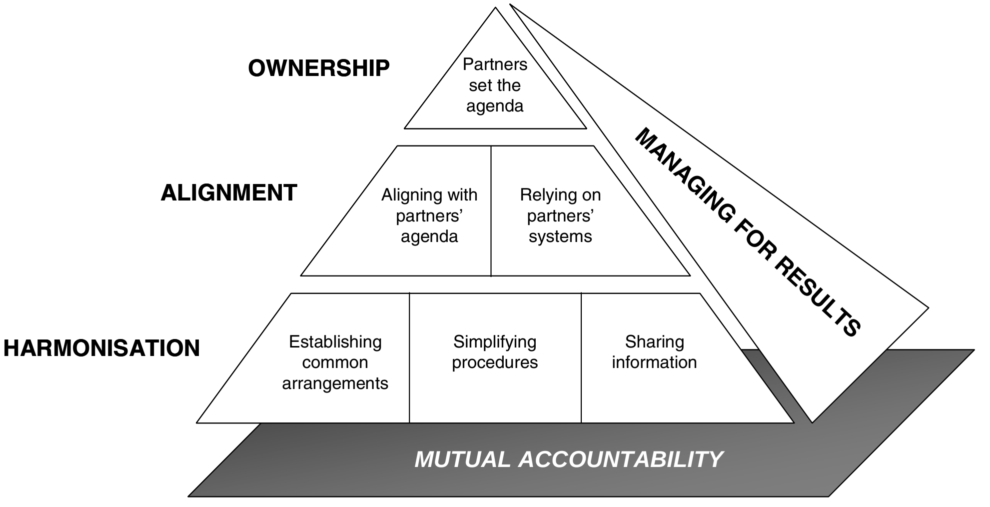
iii) **Harmonisation.** Donors will implement good practice principles in development assistance delivery. They will streamline and harmonise their policies, procedures, and practices; intensify delegated cooperation; increase the flexibility of country-based staff to manage country programmes and projects more effectively; and develop incentives within their agencies to foster management and staff recognition of the benefits of harmonisation.

iv) **Managing for Results.** Partner countries will embrace the principles of managing for results, starting with their own results-oriented strategies and continuing to focus on results at all stages of the development cycle – from planning through implementation to evaluation. Donors will rely on and support partner countries' own priorities, objectives, and results, and work in coordination with other donors to strengthen partner countries' institutions, systems, and capabilities to plan and implement projects and programmes, report on results, and evaluate their development processes and outcomes (avoiding parallel donor-driven mechanisms).

v) **Mutual accountability.** Donors and partners are committed to enhance mutual accountability and transparency in the use of development resources. Partner countries will reinforce participatory processes by systematically involving a broad range of development partners when formulating and assessing progress in the implementation of national development strategies. Donors will provide timely, transparent and comprehensive information on aid flows.

These five broad principles of the Paris Declaration on Aid Effectiveness are schematically depicted in a pyramid (Figure 9). Whether read top-down or bottom-up, the pyramid provides insights about the harmonisation/alignment/managing for results agenda.

Figure 9. Partnership for Greater Aid Effectiveness



Source: An adaptation from Figure 2 of OECD (2004)

Top-down. Partners begin by setting the agenda for achieving development results and donors respond to this lead by aligning their support with the countries' results-oriented strategies and relying on partners' systems. At both of these levels, capacity strengthening and institutional development are essential. At the base of the pyramid, donors initiate the complementary actions of establishing common arrangements, simplifying procedures, and sharing information. At all levels of the pyramid, a focus on results is essential: the country's development agenda must be oriented toward the growth and poverty reduction results it expects to achieve and both recipients and donors are accountable for the programmes outputs.

Bottom-up. Read from bottom to top, the pyramid illustrates the stages of maturity in the aid relationship and the separable, but reinforcing, gains expected at each stage. In almost any circumstance, including in the most fragile country environments, the bottom-tier actions — adopting common approaches, simplifying procedures, and sharing analysis — can improve the impact of aid or at least reduce its costs. The ultimate objective is to move up the pyramid. In the most evolved country situations, partner governments not only establish clear priorities and results-based strategies, but also communicate how they want donors to collaborate and in what forms.

Aid for trade will face the same challenges inherent to all aid delivery. Harmonisation among donors and efforts to implement common arrangements, simple procedures, an effective division of labour and collaboration is a key aid effectiveness principle. Reducing administrative costs which can be extremely high in programmes based on a large number of relatively small activities is essential to enable recipient countries' administrations to increase their absorption and technical capacity. The main challenge, however, will be to implement performance management and use effectively evaluation and monitoring tools. Recent evaluations of aid for trade programmes highlight, however, the lack of explicit targets in most projects and consequently lack of effective monitoring. To be useful, targets need to be decided beforehand, be measurable *ex ante* and *ex post*, agreed upon by all actors, and accompanied by risk management strategies.

Summarising, there are no magical recipes to improve aid for trade projects. There is little specificity in aid for trade assistance that would justify radical changes in aid delivery best practice. Applying the aid effectiveness principles of the Paris Declaration is a prerequisite to improve the impact of aid for trade assistance. The foremost objective of specific projects should be to improve recipient countries' institutional capacity. This is necessary to ensure that recipient countries implement effective government interventions that result in improved trade capacity.

Reality check: Lessons from evaluation exercises

A number of bilateral donors and multilateral agencies have recently reviewed their trade-related technical assistance and capacity building programmes.[1] Most conclude that the direct effects of these assistance programmes on export (growth) volumes have been rather difficult to substantiate. The most widely cited positive outcomes of trade-related donor assistance include improved understanding of the potential contribution trade can have on development, increased awareness and knowledge of trade policy issues (including WTO-related), and strengthened national dialogue. This chapter reviews a number of these evaluations in relation to the aid effectiveness principles.

A recent review of forty-five case studies from economies around the world on how they managed the challenges of WTO participation notes the key importance of country ownership and national dialogue (WTO, 2005). Key domestic stakeholders (government, business and civil society) need to manage the pace and nature of their country's integration into regional and global markets and thus to take full advantage of participation in the WTO. At the same time, the case studies also clearly show that there is a 'threshold' level of institutional capacity and resources that are needed to implement WTO agreements and maintain an effective presence 'at the table' of WTO negotiations. Beyond that threshold, however, the key to successful management of participation in the global trading system is local ownership and dialogue: among government institutions, and between government and private sector institutions. Cases where a high level of interaction, information exchange and collaboration between major stakeholders was realised have been all ‘success stories’. Cases where, for a variety of reasons, this collaboration and information exchange broke down, or where the priorities of the government and those of the private sector were mal-aligned, have derived little benefit from greater integration into the global economy.

Beyond the key requirement of a national ownership and stakeholder dialogue, the case studies also highlight the need for strong political will and leadership from the highest levels as a prerequisite for a country to create a macro-economic policy environment conducive to private sector development and growth and development through trade liberalisation. Local ownership remains, however, rather weak in many low income developing countries. Under multi-donor initiatives, such as the IF, partner countries often failed to demonstrate strong leadership and political will for the reforms needed to underpin an effective trade development strategy, and the trade agenda seemed to have been driven mainly by the donors. Equally, bilateral donors have not always assessed trade-related needs in consultation with all relevant stakeholders, *e.g.* the private sector, while non-governmental stakeholders were not systematically consulted during the design and implementation of bilateral or multilateral programmes (OECD, 2006a).

In general, very few donors have used local institutions and country systems for their programmes. This was mainly due to weak local capacities in trade-related matters. Most of the programmes were not implemented in close consultation with all relevant partner country stakeholders and thus lacked well-defined roles and responsibilities of each entity involved in actual delivery. The exception has been the UK/DFID which channelled some of its aid through direct budget support. While most donors refrained from creating parallel structures for managing their programmes, they did not always use sufficiently local talents and institutions which would have helped strengthen local capacities. Instead most relied on the services of international experts/consultants and firms based in donor countries. Lack of alignment, in some instances coupled with weak project management, has been a serious factor impeding the effectiveness of trade-related capacity development programmes (OECD, 2006a).

In principle, the aim of a multi-donor initiative, such as the IF or JITAP, is to foster and advance a harmonised approach to TRTA/CB. Yet, in practice, donors on the ground have had little success in designing and implementing complementary trade-related interventions through an integrated approach. Many donors often programmed their activities in isolation rather than in the framework of a broader comprehensive TRTA/CB programme. At field level donor co-ordination has been assessed as insufficient to ensure positive synergies between various interventions. For example, there are not many cases of joint project missions or evaluations. Furthermore, there are weak linkages between donors' multilateral activities (*e.g.* the IF and JITAP) and their bilateral activities at field level (OECD, 2006a).

Very few national development plans or poverty reduction strategies contained clearly defined trade-related objectives and/or performance indicators. Correspondingly, few donor-supported programmes were linked (or responsive) to partner countries' development strategies, nor were they assessed against country-owned objectives or indicators. However, donors themselves were not always effective at ensuring a results-based management of their own programmes and often lacked clear and measurable (multi-year) objectives and indicators. A number of reviewed donor programmes lacked information regarding the cost, timing or target per activity. This underscores the need for donors to improve their capacity on results-based management.

Similar recommendations have also been made regarding the operation of the Integrated Framework for Trade-Related Technical Assistance (IF) whose mandated review pointed to shortcomings related to unclear definition of policy objectives, weak administration and co-ordination as well as lack of monitoring capability (World Bank, 2000). Subsequently, the six core agencies (IMF, ITC, UNCTAD, UNDP, World Bank, WTO) revamped the design and expanded the IF agenda to "mainstream" (integrate) trade into national development plans, such as PRS, through the preparation of country-specific diagnostic trade integration studies (DTIS). Even so, the independent IF evaluation that followed noted the high variability in the achievement of concrete trade outcomes in IF countries, and called for the development of a results-based management framework, with measurable goals and outcomes (Capra-TFOC, 2003). The most recent independent review of the IF again substantiates these findings, also noting the divergence in objectives and expectations between the intended beneficiaries and donors that have resulted in insufficient ownership (Agarwal and Cutura, 2004).

Some of these findings have been confirmed in the recent independent assessment of the World Bank support for trade and related policies. It notes that until recently the Bank has not had any formal trade capacity building strategy and that trade mainstreaming in its activities has been slow and uneven, calling for greater collaboration between the Bank's Trade Department and Country Management Units. To ensure that the Bank's advice on trade issues is consistent with its poverty reduction goal, the

Bank's evaluation team recommends a more systematic assessment (*ex ante*) of possible trade-related poverty and distributional outcomes in all of its activities, particularly by drawing on the range of multidisciplinary expertise the Bank offers. Moreover, given the multi-sectoral nature of the current trade agenda the assessment calls for an enhanced cross-fertilisation between the various sector networks within the Bank (*i.e.* financial and private sector development, agriculture and rural development, and environmental issues) and the Trade Department. Finally, the evaluation recommends that the Bank strengthens its knowledge management activities (World Bank, 2006).

Notes

[1] See Annex D for a summary of key findings from selected donor evaluations.

Chapter 6

PRIORITIES FOR IMPROVEMENT

Based on the evaluation of past trade capacity building programmes, there are three main priority areas for improvement that have proven particularly difficult to tackle in the past: (1) establishing a national dialogue to formulate and implement trade policy; (2) mainstreaming trade policy into national economic development and external assistance strategies; and, (3) aligning aid for trade with aid effectiveness principles. These three priorities for improvement are elaborated below.

Dialogue among stakeholders

The formulation and implementation of sound trade strategies and policies require a formal consultation mechanism or dialogue structure involving key stakeholders from the public and private sectors. This is needed to ensure sustainability of the process and linkages with national policy making. The objective of stakeholder consultation is to devise, based on consensus, a country-owned trade (development) strategy and a plan that identifies the priorities, roles and actions expected of national and external actors in implementing the strategy. Finally, a political commitment at the highest level of policy-making to a formal, on-going trade policy dialogue would demonstrate strong country ownership of the process, bolstering the dedication of mid-level officials, executives, and other participants in the policy process. That said, many developing countries, especially the LDCs, are short of business associations with sufficient capabilities to advance the interests of their members at the national policy making process, or in international markets. Often civil society groups are poorly organised and funded, with only limited access to policy-makers. Given the weakness of many business associations and civil society groups, a critical first step toward building effective stakeholder policy dialogue in some developing countries would be to support the development of private institutions that could act as effective interlocutors with government.

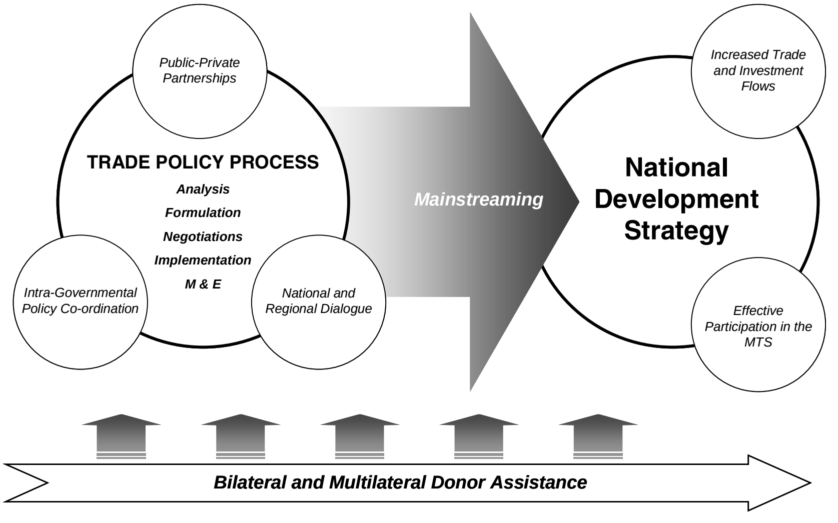
The second step has to be taken by developing countries' own governments. Developments in international trade and investment today frequently have implications for the core work of ministries responsible for finance, infrastructure, social welfare, labour, economic planning, statistics, justice, and foreign affairs. The reverse is also increasingly true: policies formulated well beyond trade ministries have implications for trade. Yet officials in these disparate government departments do not always fully recognise the trade implications of the matters under their jurisdiction. To be effective, all the ministries and cabinet units whose work affects, or is affected by trade must be systematically engaged in trade policy discussions. In most cases, the formulation of trade policy is led by the trade ministry whose limited capacity and prominence *vis-à-vis* more traditional planning ministries often explains the poor reflection of trade as a core aspect of country development strategies.

Cambodia is a good example of a developing country that appreciates the importance of forging effective partnerships with the private sector and dialogue with key stakeholders (policy-makers, business sector representatives, development partners and civil society groups) as an effective driving force to formulate a robust pro-poor trade sector strategy and hence the National Poverty Reduction Strategy (Siphana, 2003). In order to adopt a holistic, participatory and results-based approach to development and poverty reduction, the Government considers these mechanisms as vital in ensuring that both the national and international stakeholders at all times develop and work from a shared vision of objectives and goals. For instance, the Government has institutionalised a formal channel of policy dialogue, known as the Government-Private Sector Forum (chaired by Prime Ministers Office), through which systematic consultations between the public and private institutions are held.

Mainstream trade in national development strategies

The breadth, complexity and continuing evolution of trade development challenges have led to a consensus that one of the principal objectives of trade capacity building should be to help developing countries put in place effective and sustainable trade policy frameworks and processes. Indeed, the record suggests that no country has been able to achieve substantial gains in trade without an effective trade policy framework. There is no single way to structure the trade policy framework, and no two countries will adopt the same approach. Yet every country, regardless of the course it chooses, must master the same four-staged policy cycle: analysis and formulation of trade policy and strategy; preparation and execution of negotiating strategies; implementation of agreements; and monitoring and evaluation of policies and agreements. During all the stages of the mainstreaming process donors assistance can contribute to the effectiveness of the process, but cannot replace it. This cycle and the overall mainstreaming process are illustrated in Figure 10.

Figure 10. Mainstreaming Trade



An effective national dialogue – as explained above – is essential to the formulation of trade policy and preparations of negotiating positions. These must be broadly inclusive, involving significant contributions from the enterprise sector and civil society and based on sound analysis. Governments must have a sophisticated understanding of the principal regional and multilateral agreements to which they are parties and of the international commercial developments that affect their economies. They must have the data collection and analysis capacities to understand the strengths and weaknesses of their economies as a whole, and the particular challenges facing individual sectors. Enterprises must have an understanding of their own competitiveness problems and a sense of the opportunities available to them in international markets. Civil society groups need a capacity to monitor the economic and social impact of trade-related policies and developments. A minimum level of joined-up government is necessary to assess the implementation costs from trade policy agreements and to monitor and evaluate international trade developments.

Mainstreaming trade into national development strategies enables countries to identify the synergies and potential incoherence between their trade policy objectives and implementation and other economic and social policy areas. Mozambique is a positive example of a least-developed country committed to making openness to trade an integral part of its strategy to sustain rapid economic growth and alleviate poverty. In this context, aid for trade has been instrumental in helping Mozambique effectively mainstream trade and other trade-related measures and indicators in its medium-term poverty reduction strategy (known locally as PARPA). Moreover, aid for trade has helped Mozambique to: *i)* raise the awareness of the positive contribution of trade to growth and poverty reduction; *ii)* stimulate public and private dialogues and partnerships; *iii)* address supply-side constraints; and *iv)* more fully integrate into the multilateral trading system. It is important to bear in mind, however, that there are a host of factors that shape and determine the outcome of a country's effort towards integration into the MTS, other than well-targeted donor assistance. In the case of Mozambique, these include full endorsement at high political levels, effective intra-governmental policy co-ordination, as well as effective public-private partnerships (Sitoe, 2005).

In addition, mainstreaming trade policy strategies into PRSs and Country Assistance Plans is a crucial step to signal to the donor community the recipient country's priorities and commitment. These plans are used as tools to coordinate assistance and reveal the potential synergies and overlaps with other areas of the development agenda be they economic or social. It is unclear whether the superficial integration of trade policy into PRSs systematically reflects lack of real domestic priority to the trade agenda. PRSs are a tool to obtain and manage assistance and the incentives for recipient countries will be to emphasise in these plans donors' priorities. The history of the PRSs and the required focus on poverty reduction have not always led to prioritising the reforms needed for trade development, which tend to have complex and often indirect effects on poverty reduction. Thus, lack of mainstreaming into PRSs and CAPs might sometimes reflect lack of political will for further integration into the world economy or a perception that donors do not really prioritise trade as a tool for growth. Indeed, the evaluations' findings also highlight weak integration of trade-related assistance in donor strategies. However, the increasing focus of donors on aid for trade should, by itself, provide stronger incentives to accelerate the mainstreaming process. This will help to ensure that the PRSP process translates into sufficient assistance channelled to aid for trade, as might have been the case in some LDCs were it not for lack of capacity and overwhelming social (health, education) and political (conflict resolution) priorities that have crowded out trade from their development strategies and thus, donor assistance programmes.

Improve practice on the ground: Adapt donors' strategy to recipient characteristics

The failure to apply systematically aid effectiveness principles is not specific to the TRTA/CB efforts. In fact, it is recognised that many donor agencies have few incentives to apply these principles. Their performance is too often assessed according to the levels of disbursements and not on the results obtained. In addition, there are two constraints that affect particularly aid for trade assistance: lack of technical capacity and lack of political will.

It is clear that aid for trade programmes would benefit from greater know-how in both recipient countries and aid agencies. Diagnostic tools are relatively weak and have tended to over-rely on external consultants' analysis with little local input. This has too often led to a superficial analysis of the binding constraints affecting trade capacity and relatively little thinking on the underlying reasons for these constraints and how aid might resolve them. Technical assistance has focused primarily on international trade policy – a key element to improve trade policy making, but it is unclear whether it has helped to improve countries' capacity to identify where aid or government intervention would be most beneficial. Mainstreaming trade into national development strategies and an effective dialogue are essential to identify priority areas for action.

However, at the moment, it is unlikely that this process on its own will be sufficient to ensure successful interventions, particularly when related to supply-side constraints. It is essential that the technical know-how of public intervention of aid for trade practitioners both in recipient countries and donor agencies increases significantly. The interlinkages of a trade development agenda and the domestic one are very complex. Increasing productivity through public intervention and subsidies is a particularly difficult area, prone to capture by vested interests. Lack of capacity is likely to be particularly relevant for export diversification programmes where the capacity of the private sector is also weak (Box 1). When capacity gaps are likely to jeopardise the design and implementation of programmes it might be more effective to curtail support for existing capacity and instead focus on the missing elements through assistance to capacity building and maximising the role of regional institutions and donor's coordination. Intra-developing country cooperation in regional settings has most likely been an under-utilised tool, in part due to the difficulties of establishing regional institutions-donor legal relationships. However, such co-operation has the potential to facilitate reaching the "threshold" level of (1) institutional capacity and resources that are needed to implement WTO agreements and maintain an effective presence at the WTO negotiating table, (2) technical capacity needed to design good government interventions, and crucially (3) of identifying regional binding constraints to increase trade capacity.

Box 1. Transitional Assistance: Bananas in the Caribbean

The reform of the EU Common Organisation of the Market in Bananas (COMB) from a tariff/quota to a tariff only regime will significantly increase the competition faced by traditional Caribbean exporters of banana from both other traditional ACP producers such as Cameroon and the Ivory Cost and Latin American producers. During the 1990s banana exports from the Caribbean islands already declined considerably. In the Windward Islands, for example, they fell by 50%.

To help the 12 traditional ACP banana suppliers (Caribbean and African) with the transition to the new market conditions, the EU adopted a Special Framework of Assistance for Traditional ACP suppliers of bananas (SFA). This scheme was introduced for 10 years with the overall objective of either improving the competitiveness of traditional ACP banana production or supporting diversification wherever competitiveness is no longer attainable. The scheme consists of an annual allocation of around €40 to €45 million divided among the 12 traditional producers according to a 'competitivity' gap formula that provides more generous support to the least competitive countries.

In 1999, only 12% of the scheme was aimed at diversification from banana production. An evaluation report in 2000 of an earlier initiative, highlighting that only the Ivory Coast and Cameroon could hope to compete with the most efficient Latin American producers prompted the European Commission to ask recipients to reconsider their strategies. By 2004, 64% of the funds were aimed at diversification. However, these percentages do not in fact reflect the realities on the ground. According to the evaluation report contracted by the Commission in 2004, only 27% of commitments have been disbursed over the period, and resources dedicated to diversification were not used, revealing weaknesses in the diversification strategies of these countries. Moreover, the report concludes that the disbursed funding did not provide additionality, going mostly to large exporting businesses – the only ones able to anticipate the necessary investments needed for increasing productivity – and did not reach domestic small-holders where productivity levels remain much lower.

Although, the SFA was flexible enough to incorporate the lessons from past evaluations and change its activity focus, the allocation funding system did not adapt to the new diversification focus and the needs of the recipients. Moreover, the bottom-up approach consistent with country ownership principles was hindered by the lack of capacity and of political leadership – particularly regarding diversification efforts – failed to deliver the right selection of projects.

One issue of major importance is that trade reform is extremely sensitive to the political economy conditions of a country. In common with land reform and anti-corruption measures, trade reforms have a great potential to undermine the economic power of political elites and other vested interests. The more restrictive the trade and economic regime is the more powerful entrenched vested interests will be. A successful integration into the world economy often demands considerable reform; there are very few countries where the binding supply constraints are only of a physical nature – solvable by a few hefty investments in infrastructure. Thus, in many cases, genuine country ownership of a pro-growth trade strategy will not be feasible in the short-medium term. This means that mainstreaming and dialogue are unlikely to take place or to be effective tools to develop a good strategy and donors will be unable to align their priorities with that of the recipient country. In such cases, different approaches, based on influencing behaviour through more direct work with the private sector will be necessary.

When state will is weak, projects aimed at building capacity in the private sector and civil society might perform better. Adapting initiatives such as the one village-one product approach developed by Japan to work directly with local authorities or the private sector can increase tangibly the benefits from trade, but also stimulate and strengthen the demand from the private sector and civil society for change and better policies (Box 2).

Box 2. ”One Village, One Product" initiative

The “One Village, One Product (OVOP)” strategy is an adaptation of the *Isson-Ippin* movement which Japan initiated in 1979 to stimulate local economies through a participatory process. Each village or town drives the process by identifying, developing, and promoting a specific product or service in which it possesses a comparative advantage. The role of local authorities is to support those local entrepreneurs and enterprises developing the necessary capacities to innovate, develop brands and link their products to markets.

Similar movements under various names have sprung up in many Asian countries and are even spreading into regions outside Asia, for example, Africa. These movements help micro, small and medium enterprises to manufacture, offer and market distinctive products (*e.g.* handicrafts) or services through the use of locally available materials and local skills and talents. For example, OVOP projects in Nueva Ecija Province in the Philippines, supported by the Japan International Cooperation Agency (JICA) have “generated almost 2,000 new jobs and provided community-based employment for about 195 small communities.”

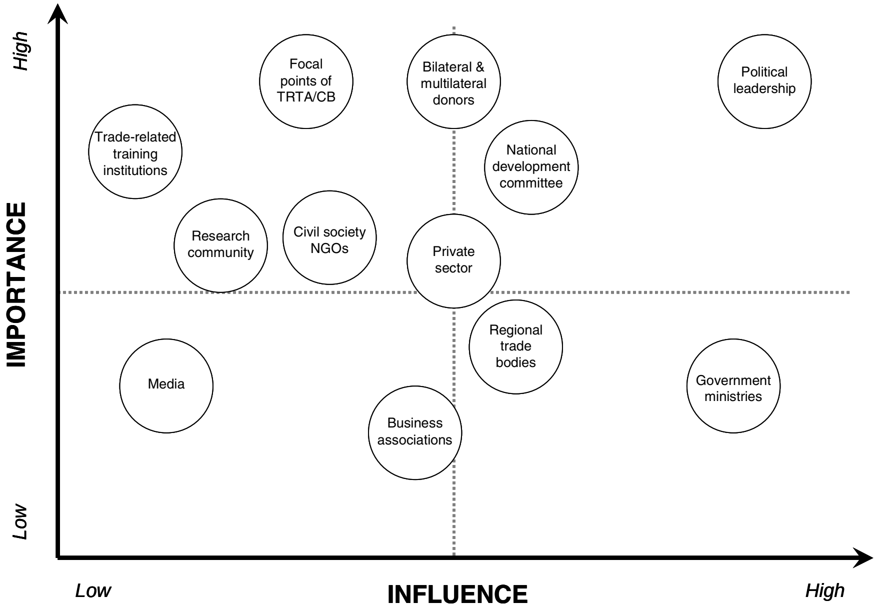
Japan has recently embarked on a five-year (2005-2010) capacity-building project in Malawi, supporting the government in localising the OVOP movement. The core objective of the project is the empowerment of rural communities (by ensuring their participation in the activities) so that they are able to initiate and manage their own community-based development process through, *e.g.*, OVOP. Other donors are also adopting OVOP principles, for example, the main approach of UNDP’s Enterprise Mongolia Project, which assists local entrepreneurs to collectively develop a specialised and branded product. Japan is also supporting the OVOP Initiative in Mongolia through the Japanese Fund at UNDP, which will be implemented under the Enterprise Mongolia Project.

Japan has made the OVOP movement an integral part of its “New Development Initiative for Trade” which was presented at the WTO Ministerial Conference in Hong Kong in 2005 and focused on three areas of trade development support, namely, supply-side support (“PRODUCE”), distribution and export support (“SELL”), and market access for LDCs (“BUY”), with duty-free and quota-free market access for essentially all LDC products. The Initiative, which is a part of Japan’s development package announced at the G8 Gleneagles Summit, aims to provide US$10 billion over the next three years, as well as an exchange of a total of ten thousand trainees and experts during the same period.

Typically, donors have sought to facilitate change through technically sound programmes, supported in country by individual champions of reform or change. Increasingly the importance of understanding the underlying political systems and the mechanics of pro-poor growth has been acknowledged. The Drivers of Change (DoC) approach emerged as a way of applying political economy analysis to the development of donor strategy. The DoC approach seeks to identify the political institutions, structures and agents that can act as key levers to enable pro-poor change and therefore improve the effectiveness of aid. In particular, the role of institutions both formal and informal and underlying structural features is being recognised. For this reason DoC analysis focuses on formal and informal rules, power structures, vested interests and incentives within these institutions. The aim of the DoC approach is not to manipulate the local political economy conditions, but rather to ensure that the country and donors understand the political economy obstacles. This can be facilitated by involving local research institutions and publishing the results of the studies. Some of the key benefits from the DoC studies already undertaken are: making explicit the assumptions behind programmes; clarifying the extent of "political will" for reform and determining the risk this poses to a programme's success; identifying the role that the non-poor groups have in change processes, and suggesting collaboration with non-traditional partners, as well as discontinuing programmes that are unlikely to succeed at present.

Even when a thorough Driver of Change analysis is not possible or warranted, *e.g.* for small, very localised projects, tools such as stakeholder analysis might help to identify the key actors and institutions that need to own the objectives of the programme to ensure a minimum level of effectiveness. Stakeholder analysis typically divides actors into four groups according to how important the objective of the reform/programme/project is to them and how much influence they have over its design and implementation. Figure 11 shows for illustrative purposes a hypothetical classification of key stakeholders in the formulation of a national trade policy.

Figure 11. An illustrative stakeholder analysis matrix



If insufficient ownership remains problematic and is likely to hamper the effectiveness of a programme, more time and resources into persuading sceptics to take ownership will be critical. Useful approaches might include creating pilot projects which deliver early results, formulating jointly the programme and enhancing transparency by publicly documenting performance.

Not only are the aid effectiveness principles of the Paris Declaration particularly relevant to the aid for trade agenda, donors need to tailor their approach to building trade capacity and level of ambition to the country's political economy reality and capacity to design and run effective programmes. Some of the most relevant guidelines for intervention come from the experience of working in fragile states. This does not imply that they should only be applied in fragile states but in countries where the political economy is jeopardising the use of trade as a tool for growth and the capacity for sophisticated economic interventions is limited.

Chapter 7

AN EFFECTIVE AID FOR TRADE PARTNERSHIP: LOCAL ACCOUNTABILITY AND GLOBAL REVIEW

This paper has shown that donors' financial commitments to aid for trade are significant, representing between 20% and 25% of total net ODA and 30% and 35% of sector allocable ODA. Furthermore, the scaling-up of aid and increased priority given to the economic growth agenda are likely to lead to additional resources for aid for trade. At the same time, there is considerable room for improving the effectiveness of aid for trade. And the stakes are high: increasing aid for trade without improving its effectiveness risks contributing to the negative effects of aid flows on export competitiveness instead of mitigating them.

An opportunity to improve effectiveness

The inclusion of aid for trade in the Hong Kong Declaration offers the aid and trade community the opportunity to establish an effective and efficient framework for aid for trade that will ensure that developing countries benefit from WTO agreements and to improve their performance in the global economy. Increasing the effectiveness of aid for trade requires a much more comprehensive and rigorous implementation of the aid effectiveness principles of the Paris Declaration. At the same time, it is clear that despite their apparently widespread acceptance, implementing a genuine management for results approach and setting up review mechanisms for mutual accountability remains a challenge. Moreover, there is a need in aid agencies to strengthen incentives to ensure that the principles of alignment around local strategies and harmonisation of donor procedures are adhered to in practice. In particular, local partnerships that are built on the aid effectiveness principles are needed to provide incentives to recipients and donors alike to:

i) Enhance the credibility of donors' commitment to increase the volume of aid for trade;

ii) Foster the synergies between trade and other economic policy areas;

iii) Strengthen country ownership, align around country strategies and harmonise donor procedures;

iv) Improve co-ordination and coherence of aid for trade with overall aid strategies;

v) Enhance management for results and mutual accountability, and;

vi) Support knowledge management and improve technical capacity in recipient and donor countries.

Some commentators, such as Zedillo (2005), Stiglitz and Charlton (2006), have advocated the creation of a Global Facility for Trade as the best solution to enhance the credibility of donors' commitments. They suggest that such a vertical aid for trade fund should consolidate all existing multilateral categories of aid for trade and be mandated to finance technical assistance, trade related capacity building, enterprise development, and infrastructure projects through a combination of grants and concessional loans. There are a number of arguments against the use of dedicated global funds in general and in aid for trade in particular.

The argument that a vertical fund would enhance the allocation of donor resources to a specific development challenge, which would otherwise remain under-funded is difficult to ascertain. However, global funds are, in most cases, better at raising funds than at disbursing them. Indeed, it is the vast differences between commitments and the release of funds on the ground that drives the gap in credibility. Disbursing aid takes a long time and discrepancies between commitments and released funds persist. In general, global funds are often not better at disbursement than bilateral or multilateral donors. In addition, these global funds require agreement about allocation criteria to disburse funds. In case of aid for trade, this will be difficult to agree upon at a global level. Improved transparency and monitoring at donors' level of more clearly defined aid for trade flows, which this paper argues is not productive, is also unlikely to help bridging this gap. The monitoring of financial flows needs to take place at the recipient level where the full financial cycle can be effectively reviewed and integrated in overall public financial management systems.

Vertical funds can be useful to channel financial resources to specific needs that are relatively neglected in overall donor programmes or which can be easily de-linked from the broad national development strategies.

However, the characteristics of the aid for trade agenda do not satisfy these criteria. First of all, it is neither possible nor desirable to separate the trade-related agenda from the economic growth agenda. A key tool to ensure that recipient countries benefit from integration in the world economy is to build trade capacities, strengthen supply side responses, including through improved infrastructure. Prioritisation of these capacities gaps and needs can only be done effectively and efficiently at the local level when trade is mainstreamed into national development strategies. The prospects of significant scaling-up of aid and related risks of losing export competitiveness through 'Dutch disease' further underlines the need to mainstream aid for trade into the broader development assistance system. Second, a broad interpretation of aid for trade represents a too large proportion of ODA to be managed independently of overall aid strategies. Against that background, aid for trade should be fully integrated into the strategies that are being developed jointly by the IFIs, the UN Agencies and the OECD/DAC, to support the scaling-up process at the country level through partnership meetings focusing on resources and results (OECD, 2006b).

While there are compelling needs to enhance the credibility of aid for trade in the context of the DDA, there are no convincing arguments to create a new global institutional governance structure to mobilise and disburse additional aid for trade. On the contrary, this paper has argued that the lack of financing at the global level is not the problem. The problem is prioritisation of trade in national development strategies and effective aid delivery. To ensure that trade needs at the national level are adequately addressed requires their integration in national development strategies. To ensure that national aid for trade programmes are effective requires the design and management of these programmes with clear and specific objectives to improve trade capacities. This requires, in turn, a system of mutual accountability between recipients and donors at the level where the intervention takes place. Such a local partnership for mutual accountability will allow for the improvement of transparency of financial flows from donor commitments to the disbursement of resources at the national level. This will strengthen local monitoring and evaluation of programmes and provide for genuine local ownership (Easterly, 2006).

To establish the credibility of aid for trade in the context of the DDA, two accountability mechanisms are necessary: the first at national or regional level and the second at a global level. The Local Accountability Pacts (LAP) will strengthen local ownership and management for results. The Global Review Mechanism (GRM) and corrective feedback will ensure that the needs identified by LAP – whether financial or performance related – are addressed. In turn, this will ensure that the WTO Hong Kong aid for trade mandate is implemented in a credible, sustainable and effective manner, respecting the objectives of both the aid and trade community.

Local Accountability

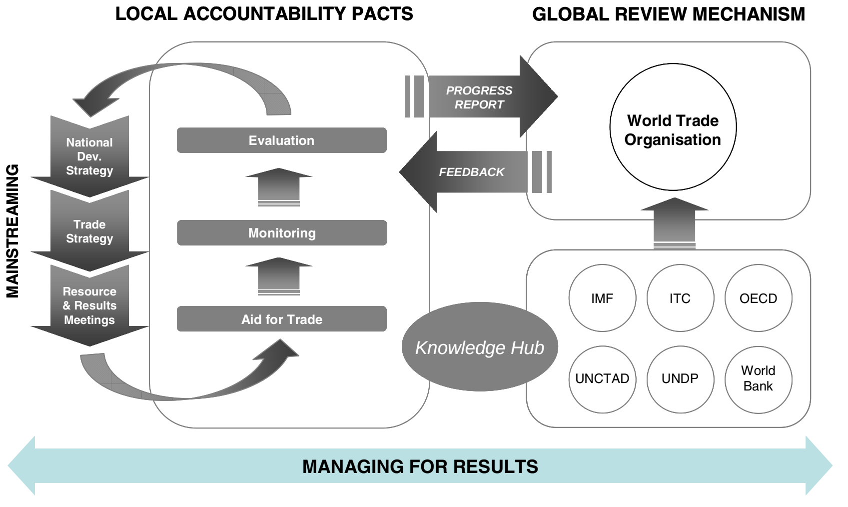
The LAP, which is based upon and aligned with recipient-donor partnership for scaling-up aid, should bring together all the key donors and recipient country actors that are active in the aid for trade area. Their remit would include *i)* integrating trade into national development strategies, *ii)* monitoring the disbursement of aid for trade, and *iii)* evaluating jointly the effectiveness and results of the assistance. Their key mandate would be to provide local feedback through producing a joint performance progress report on the targets set out and results achieved (Figure 12).

The obligation of the LAP to report progress to a Global Review Mechanism would provide a strong incentive to improve the design and implementation of aid for trade programmes and focus minds on managing for results. Reinforcing mutual accountability would also create incentives at local level for strengthening country ownership, aligning donors' priorities to country strategies and stepping up collaboration among donors. It is important neither to duplicate existing mechanisms in recipient countries nor create additional bureaucratic layers or additional conditionality requirements. Many countries already have consultation or policy co-ordination mechanisms that fulfil some of the functions detailed above and could easily expand their remit. Moreover, LAPs are fully compatible with the Resources and Results meetings currently advocated by the international donor agencies to enable recipient countries to manage the scaling-up process of ODA.

Global Review

The role of the Global Review Mechanism is also vital. First, LAPs obligation to report regularly would only succeed in changing practice on the ground, if these reports are seriously reviewed by the trade and development community. The review needs to be transparent and support local processes. The idea is to establish a corrective feedback process enabling the international community to act upon the identified key constraints to improve trade capacity, unmet financial needs, lack of donors' coordination or lack of technical capacity to design, implement and manage aid for trade. It would also spearhead better coordination among the many specific trade-related initiatives such as on standards, trade facilitation, intellectual property which already exist.

Figure 12. An effective aid for trade partnership: Local accountability and global review



The WTO seems at first sight the best forum to review on a regular basis whether aid for trade is being adequately funded and is delivering the expected results. The WTO has a vested interest in ensuring that all its members benefit from trade and WTO agreements. It is a consensus based organisation where developing and developed countries have equal weight. And, it has institutional experience in reviewing complex policy areas through its Trade Policy Review Mechanism. However, it lacks country presence and has little hands-on experience with providing aid (except for technical assistance). This is not necessarily a problem if its role was confined to reviewing annually LAPs performance progress reports and donors' evaluations with the view to formulate recommendations and disseminate the results. However, in order to strengthen the Global Review Mechanism, one option worth exploring would be to ask other international institutions involved in aid-for trade programmes such as UNDP, UNCTAD, the regional banks and bilateral donors, or at least the other two Coherence institutions, *i.e.* the IMF and the World Bank, to support the WTO to implement the Global Review Mechanism.

Moreover, although the traditional evaluations of individual and multilateral donors' strategies are insufficient in themselves to spearhead reform on the ground, they have a key role in ensuring the dissemination of best practice among their own programmes, identifying areas for improvement and increasing transparency on pledges and commitments. The joint OECD-WTO data base already monitors financial commitments in the area of TRTA/CB, while the DAC database provides financial information on donor support for infrastructure and building productive capacity. The database could be complemented with qualitative information and assessments based on the results obtained by different donors. Another possibility is to mandate all the multilateral and bilateral donors active in aid for trade to also report regularly to the Global Review Mechanism.

Finally, using aid to remove the policy and structural impediments to export competitiveness is a challenging task, both for donor and recipient countries. It requires first and foremost enhancing the technical knowledge and capacity of donors and recipient countries. This seem to calls for the introduction of a less formal mechanism dedicated to exchanging ideas, information and lessons of experience and building-up a knowledge hub of best practises and recommendations. However, in order to ensure the sustainability of such a network, it is important that it is low resource intensity and fully demand-driven. The objective should be confined at creating a forum in which aid for trade practitioners from developed and developing countries would discuss their experiences and work jointly to develop trade capacity tools and monitor progress, free from the usual constraints present in forums dominated by donor-recipient relationships. It will also provide a much needed opportunity for developing countries practitioners to learn from other developing countries' experiences.

Annex A. Methodology

At the Doha Ministerial Conference, members recognised the need for more comprehensive data to track and monitor trade related technical assistance and capacity building commitments which are part of the Doha Development Agenda. In response, the WTO and OECD created jointly the trade capacity building database in 2002. The database covers support for trade policy and regulations and trade development provided by 26 bilateral donors and 19 multilateral agencies.

Donor support for both trade-related infrastructure and productive capacity building are reported separate from the WTO/OECD database in the DAC CRS database respectively under the heading “infrastructure” and “production”. The 23 DAC members currently report to the CRS. In addition, the multilateral agencies providing data to the CRS include the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, IFAD, UNAIDS, UNFPA, UNICEF and the World Bank.

While TRTA/CB under the category *trade policy and regulations* can be considered as extended with the sole purpose of promoting trade, *trade development* (and, to an even greater extent, *infrastructure*) activities generally have another major objective (*e.g.* agricultural or industrial development). For example, while coffee export development is clearly “trade-related”, its primary objective is to foster the development of the agricultural sector. Given these variations in the degree of focus on trade capacity, direct comparisons of the amounts between the three categories might result in some double counting. This might in particular be the case for the category *trade development*, were a number of donors isolated the trade component of each activity, whereas others reported the whole activity notifying it as trade-related.

The data is provided on the basis of commitments expressed in 2003 constant prices to allow comparison between the different years. A commitment is a firm obligation, expressed in writing and backed by the necessary funds, undertaken by an official donor to provide assistance for a specified purpose and under specified financial terms and conditions for the benefit of the recipient country or multilateral organisation.

This report includes all grants and concessional loans. Data excludes: aid to countries on Part II of the DAC List of Recipients (countries in transition and more advanced developing countries – Annex C); non-concessional loans (*e.g.* those from EBRD and IBRD); and self-financed activities (*i.e.* activities financed by a developing country for itself and implemented by a multilateral TA agency) Thus, Data presented in this report include Official Development Assistance, which is defined as those flows to countries on Part I of the DAC List of Aid Recipients (developing countries) and to multilateral institutions for flows to Part I aid recipients which are: *i)* provided by official agencies, including state and local governments, or by their executing agencies; and *ii)* each transaction of which is (a) administered with the promotion of the economic development and welfare of developing countries as its main objective; and (b) concessional in character and (c) conveys a grant element of at least 25% (calculated at a discount rate of 10%).

Table A1. Aid for trade: A comprehensive picture of the expanding agenda (1994-2004)

USD million (2003 constant prices and exchange rates)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1. Trade -related technical assistance and capacity building (TRTA/CB) (1)											
Trade Policy & Regulations	..	..	..	..	..	..	..	649	671	850	703
Trade Development	..	..	..	..	..	..	..	1 517	1 419	1 920	1 859
For ref: sub-total								**2 166**	**2 090**	**2 770**	**2 561**
as % of total ODA (2)								**2.8**	**2.7**	**3.1**	**2.7**
Memo: Export promotion (3)	268	95	80	79	202	241	152				
2. Infrastructure											
Transport & Storage	5 574	4 669	6 433	5 407	5 898	6 684	5 382	5 462	4 556	4 428	6 084
Communications	726	587	698	468	557	317	454	457	283	518	793
Energy	3 730	5 155	3 897	4 654	3 668	2 232	2 115	3 097	3 799	3 948	6 033
For ref: sub-total	**10 031**	**10 411**	**11 028**	**10 529**	**10 123**	**9 233**	**7 951**	**9 016**	**8 638**	**8 894**	**12 911**
as % of total ODA (2)	**13.0**	**13.6**	**15.0**	**15.6**	**14.2**	**12.1**	**10.2**	**11.8**	**11.3**	**9.8**	**13.8**
For ref: Narrow aid for trade [1 + 2]	**10031**	**10411**	**11028**	**10529**	**10123**	**9233**	**7951**	**11182**	**10728**	**11664**	**15472**
as % of total ODA (2)	**13.0**	**13.6**	**15.0**	**15.6**	**14.2**	**12.1**	**10.2**	**14.6**	**14.1**	**12.9**	**16.6**
3. Productive capacity building (4)											
Banking & Financial Services	746	539	663	352	1 066	761	541	1 054	726	827	682
Business & Other Services	281	615	992	593	796	1 769	1 929	753	557	738	1 201
Agriculture, Forestry, Fishing	4 731	4 135	4 929	4 196	4 289	3 785	4 002	4 277	3 158	3 828	3 450
Industry & Mining	1 603	863	1 227	1 431	1 193	1 042	1 020	708	1 003	1 327	1 912
Tourism	10	39	84	18	75	84	38	56	39	80	56
For ref: sub-total	**7 371**	**6 191**	**7 896**	**6 590**	**7 419**	**7 441**	**7 529**	**6 848**	**5 483**	**6 801**	**7 301**
as % of total ODA (2)	**9.6**	**8.1**	**10.7**	**9.8**	**10.4**	**9.8**	**9.6**	**8.9**	**7.2**	**7.5**	**7.8**
For ref: Broad Aid for trade [1 + 2 + 3]	**17 670**	**16 697**	**19 004**	**17 199**	**17 744**	**16 915**	**15 632**	**18 030**	**16 211**	**18 465**	**22 773**
as % of total ODA (2)	**22.9**	**21.8**	**25.8**	**25.5**	**24.8**	**22.2**	**20.0**	**23.5**	**21.2**	**20.4**	**24.4**
Memo: as % of total sector allocable ODA (5)	**38.6**	**37.8**	**38.8**	**37.8**	**36.6**	**36.0**	**32.7**	**37.3**	**33.2**	**33.5**	**35.3**
Total ODA (2)	**77 015**	**76 463**	**73 732**	**67 392**	**71 508**	**76 152**	**78 118**	**76 570**	**76 320**	**90 403**	**93 460**

1. TRTA/CB data relate solely to Official Development Assistance. They have been collected only since 2001.
2. Total ODA commitments, excluding debt relief.
3. Data from the CRS for years 1994-2000 are limited to export promotion.
4. From 2001, productive capacity building that is directly trade-related is included in TRTA/CB.
5. Total sector allocable ODA excludes all categories of ODA that are not specifically sector related.

Source: OECD DAC and Creditor Reporting System and WTO/OECD Trade Capacity Building database (commitments)

Annex B. CRS Purpose Codes

Aid for Trade Agenda	CRS/TCBDB Codes
1. Trade-related Technical Assistance and Capacity Building	
1.1 Trade Policy and Regulations	
Trade mainstreaming in PRSPs/development plans	33111
Technical barriers to trade (TBT)	33112
Sanitary and phytosanitary measures (SPS)	33113
Trade facilitation procedures	33121
Customs valuation	33122
Tariff reforms	33123
Regional trade agreements (RTAs)	33130
Accession	33141
Dispute settlement	33142
Trade-related intellectual property rights (TRIPS)	33143
Agriculture	33144
Services	33145
Tariff negotiations - non-agricultural market access	33146
Rules	33147
Training in trade negotiation techniques	33148
Trade and environment	33151
Trade and competition	33152
Trade and investment	33153
Transparency and government procurement	33154
Trade education/training	33181
1.2 Trade Development	
Business support services and institutions	25011
Public-private sector networking	25012
E-commerce	25013
Banking and financial services	24000 to 24081
Agriculture	31100 to 31195
Forestry	31200 to 31291
Fishing	31300 to 31391
Industry	32100 to 32182
Mineral resources and mining	32200 to 32268
Tourism	33200 to 33210
2. Infrastructure	
2.1 Transport and storage	21000 to 21081
2.2 Communications	22000 to 22040
2.3 Energy generation and supply	23000 to 23082
3. Building Production Capacity	
3.1 Banking and financial services	24000 to 24081
3.2 Business and other services	25000 to 25020
3.3 Agriculture	31100 to 31195
3.4 Forestry	31200 to 31291
3.5 Fishing	31300 to 31391
3.6 Industry	32100 to 32182
3.7 Mineral resources and mining	32200 to 32268
3.8 Tourism	33200 to 33210

Source: OECD Reporting Directives for the Credit Reporting System (CRS) [DCD/DAC(2002)21]; 2005 Joint WTO/OECD Report on TRTA/CB, Annex 1. Definitions and Methodology, December 2005

Annex C. DAC List of ODA Recipients

As at 1 January 2003

Part I: Developing Countries and Territories (Official Development Assistance)						**Part II: Countries and Territories in Transition (Official Aid)**	
Least Developed Countries (LDCs)	**Other Low-Income Countries (Other LICs) (per capita GNI < $745 in 2001)**	**Lower Middle-Income Countries (LMICs) (per capita GNI $746-$2975 in 2001)**		**Upper Middle-Income Countries (UMICs) (per capita GNI $2976-$9205 in 2001)**	**High-Income Countries (HICs) (per capita GNI > $9206 in 2001)**	**Central and Eastern European Countries and New Independent States of the former Soviet Union (CEECs/NIS)**	**More Advanced Developing Countries and Territories**
Afghanistan Angola Bangladesh Benin Bhutan Burkina Faso Burundi Cambodia Cape Verde Central African Republic Chad Comoros Congo, Dem.Rep. Djibouti Equatorial Guinea Eritrea Ethiopia Gambia Guinea Guinea-Bissau Haiti Kiribati Laos Lesotho Liberia Madagascar Malawi Maldives Mali Mauritania Mozambique Myanmar Nepal Niger Rwanda Samoa Sao Tome and Principe Senegal Sierra Leone Solomon Islands Somalia Sudan Tanzania Timor-Leste Togo Tuvalu Uganda Vanuatu Yemen Zambia	*Armenia *Azerbaijan Cameroon Congo, Rep. Côte d'Ivoire *Georgia Ghana India Indonesia Kenya Korea, Democratic Republic *Kyrgyz Rep. *Moldova Mongolia Nicaragua Nigeria Pakistan Papua New Guinea *Tajikistan *Uzbekistan Viet Nam Zimbabwe	*Albania Algeria Belize Bolivia Bosnia and Herzegovina China Colombia Cuba Dominican Republic Ecuador Egypt El Salvador Fiji Guatemala Guyana Honduras Iran Iraq Jamaica Jordan *Kazakhstan Macedonia (former Yugoslav Republic) Marshall Islands Micronesia, Federated States Morocco Namibia Niue	Palestinian Administered Areas Paraguay Peru Philippines Serbia & Montenegro South Africa Sri Lanka St Vincent & Grenadines Suriname Swaziland Syria Thailand ▪ Tokelau Tonga Tunisia Turkey *Turkmenistan ▪ Wallis and Futuna	Botswana Brazil Chile Cook Islands Costa Rica Croatia Dominica Gabon Grenada Lebanon Malaysia Mauritius ▪ Mayotte Nauru Panama ▪ St Helena St Lucia Venezuela ---------------- **Threshold for World Bank Loan Eligibility ($5185 in 2001)** ---------------- ▪ Anguilla Antigua and Barbuda Argentina Barbados Mexico ▪ Montserrat Oman Palau Islands Saudi Arabia Seychelles St Kitts and Nevis Trinidad and Tobago ▪ Turks and Caicos Islands Uruguay	Bahrain	*Belarus *Bulgaria *Czech Republic *Estonia *Hungary *Latvia *Lithuania *Poland *Romania *Russia *Slovak Republic *Ukraine	▪ Aruba Bahamas ▪ Bermuda Brunei ▪ Cayman Islands Chinese Taipei Cyprus ▪ Falkland Islands ▪ French Polynesia ▪ Gibraltar ▪ Hong Kong, China Israel Korea Kuwait Libya ▪ Macao Malta ▪ Netherlands Antilles ▪ New Caledonia Qatar Singapore Slovenia United Arab Emirates ▪ Virgin Islands (UK)

* Central and Eastern European countries and New Independent States of the former Soviet Union (CEECs/NIS).
▪ Territory.

NEW DAC LIST OF ODA RECIPIENTS

Effective from 2006 for reporting on 2005, 2006 and 2007

Least Developed Countries	Other Low Income Countries (per capita GNI < $825 in 2004)	Lower Middle Income Countries and Territories (per capita GNI $826-$3 255 in 2004)	Upper Middle Income Countries and Territories (per capita GNI $3 256-$10 065 in 2004)
Afghanistan	Cameroon	Albania	• Anguilla
Angola	Congo, Rep.	Algeria	Antigua and Barbuda
Bangladesh	Côte d'Ivoire	Armenia	Argentina
Benin	Ghana	Azerbaijan	Barbados
Bhutan	India	Belarus	Belize
Burkina Faso	Kenya	Bolivia	Botswana
Burundi	Korea, Dem.Rep.	Bosnia and Herzegovina	Chile
Cambodia	Kyrgyz Rep.	Brazil	Cook Islands
Cape Verde	Moldova	China	Costa Rica
Central African Rep.	Mongolia	Colombia	Croatia
Chad	Nicaragua	Cuba	Dominica
Comoros	Nigeria	Dominican Republic	Gabon
Congo, Dem. Rep.	Pakistan	Ecuador	Grenada
Djibouti	Papua New Guinea	Egypt	Lebanon
Equatorial Guinea	Tajikistan	El Salvador	Libya
Eritrea	Uzbekistan	Fiji	Malaysia
Ethiopia	Viet Nam	Georgia	Mauritius
Gambia	Zimbabwe	Guatemala	• Mayotte
Guinea		Guyana	Mexico
Guinea-Bissau		Honduras	• Montserrat
Haiti		Indonesia	Nauru
Kiribati		Iran	Oman
Laos		Iraq	Palau
Lesotho		Jamaica	Panama
Liberia		Jordan	Saudi Arabia (1)
Madagascar		Kazakhstan	Seychelles
Malawi		Macedonia, Former Yugoslav Republic of	South Africa
Maldives		Marshall Islands	• St. Helena
Mali		Micronesia,Fed. States	St. Kitts-Nevis
Mauritania		Morocco	St. Lucia
Mozambique		Namibia	St. Vincent & Grenadines
Myanmar		Niue	Trinidad & Tobago
Nepal		Palestinian Adm. Areas	Turkey
Niger		Paraguay	• Turks & Caicos Islands
Rwanda		Peru	Uruguay
Samoa		Philippines	Venezuela
Sao Tome & Principe		Serbia & Montenegro	
Senegal		Sri Lanka	
Sierra Leone		Suriname	
Solomon Islands		Swaziland	
Somalia		Syria	
Sudan		Thailand	
Tanzania		• Tokelau	
Timor-Leste		Tonga	
Togo		Tunisia	
Tuvalu		Turkmenistan	
Uganda		Ukraine	
Vanuatu		• Wallis & Futuna	
Yemen			
Zambia			

• Territory.

(1) Saudi Arabia passed the high income country threshold in 2004. In accordance with the DAC rules for revision of this List, it will graduate from the List in 2008 if it remains a high income country in 2005 and 2006. Its net ODA receipts from DAC Members were USD 9.9 million in 2003 and USD 9.0 million (preliminary) in 2004.

Annex D. Key Findings from Selected Donor TRTA/CB Evaluations

This section provides a summary of key findings from selected thematic TRTA/CB evaluations (Table A2), and is an extract from OECD (2006a) *Trade-Related Technical Assistance and Capacity Building: What Do Recent Thematic Evaluations Tell Us?*

Major findings

A number of evaluations note that it has been difficult to determine the effectiveness or longer-term impact of some TRTA/CB programmes, as programme documents do not always define clear and measurable programme goals and (outcome and impact) indicators. Consequently, the direct impact on sustained export performance has sometimes been difficult to substantiate. In cases where such an assessment was possible, the impact varied considerably. A number of (trade development) programmes have, nonetheless, been assessed as "improving the enabling environment for trade" or as contributing to "export diversification."

Half of the reviewed evaluations note that, generally, TRTA/CB programmes have increased partner country understanding of the importance of trade for development and poverty reduction, raised awareness and knowledge of trade policy matters (including WTO-related issues) and strengthened national dialogue on these issues. These capacities are prerequisites for successfully developing more challenging trade capacities, such as enhanced trade agreements' negotiation and implementation capacity, or strengthened supply side capacities. Nonetheless, evaluators highlight that effectiveness is not translated into sustainable impact when programmes are implemented under unfavourable domestic policy or regulatory environments.

Thus, two pre-conditions for success are the existence of a favourable domestic business environment and political will and leadership to use trade as an engine for development. Other factors, such as adequate governance, market access and international competitiveness, also greatly influence effectiveness and impact. Consequently, an understanding of initial internal and external conditions is essential *before* commencing TRTA/CB activities (*e.g.* by performing a thorough diagnosis with partner country stakeholders during the programme planning phase). Donors and partner countries should also consider addressing related issues, such as the "friendliness" of the business environment or governance mechanisms, beforehand or alongside the delivery of TRTA/CB, in order to enhance aid effectiveness.

The following weaknesses have been identified in most evaluations:

- ***Unsystematic or incomplete needs assessments***: Donors did not always assess needs in a systematic and comprehensive manner. When they did conduct such assessments, needs were often listed in broad terms, without prioritisation or consultation with all relevant stakeholders, *e.g.* the private sector and donor field missions. Several IF Action Plan Matrices have, for example, lacked prioritisation. Evaluators also note that, while the identification of EC partners' needs largely rested on extensive consultations, discussions were mainly conducted with Governments, Government agencies and regional organisations, yet to a much lesser extent with private sector stakeholders. Similarly, some DFID's programmes, such as the *Africa Trade and Poverty Programme*, suffered from weak collaboration with country offices during the needs assessment and design phases.

- ***Weak project management and project governance structures***: Some programmes suffered from inadequate management or governance structures; lacked information regarding costs, timing or outputs; were implemented without close consultation with relevant partner country stakeholders or lacked a clear definition of the roles and responsibilities of each entity involved (on the donor and partner side). In DFID's *Africa Trade and Poverty Programme*, for instance, there were at least four different agencies that appeared to be responsible, which complicated decision-making. The IF also suffered from weak programme management (due to limited LDC and donor capacities to manage such a complex multi-donor and multi-beneficiary programme) and from unbalanced representation of beneficiaries on IF oversight bodies (*i.e.* IF Working Group and Steering Committee). Weak management sometimes results in delayed implementation of activities or disbursement of funds, which, in turn undermine ownership, efficiency and effectiveness. This was, for example, the case of the EC *Europe Tunisia Enterprise Programme*, which suffered from an unclear distribution of tasks between the Project Management Unit and the Tunisian Ministries, leading to a two year delay in implementation.

- ***Fragmented TRTA/CB interventions with insufficient synergies to broader development assistance programmes:*** Donors experienced difficulties in designing complementary and rolling interventions in the framework of a longer-term, country-owned TRTA/CB strategy. The DFID evaluation, for example, notes there was little coherence between the various DFID trade projects in Malawi. More generally, it emphasises that DFID trade development programmes were insufficiently linked to its trade policy programmes. In addition, donor interventions were sometimes conducted in isolation from broader (and often complementary) development assistance programmes, such as private sector or rural development programmes. This has lessened their impact. The Netherlands' multilateral TRTA/CB activities (*e.g.* support to the IF), for example, suffered from weak synergies with bilateral, private sector development activities at the country level. Similarly, the World Bank's trade activities were not sufficiently integrated with its finance, private sector and infrastructure work programmes. In addition, national TRTA/CB activities have often been insufficiently linked to regional programmes.

- ***Weak explicit linkages to poverty reduction:*** While most donors' strategies highlight TRTA/CB as a means to promote economic development and reduce poverty, few programmes had actually direct links to poverty reduction, whether at micro-level (*i.e.* households, individuals) or at macro-level (*i.e.* MDGs and national poverty reduction goals), or consistently took account of poverty-distributional outcomes. This was, for example, the case of World Bank trade activities, as well as *JITAP*, which did not explicitly address the trade-poverty linkage.

- ***Insufficient donor co-ordination and complementarity at headquarters and field level***: While donor co-ordination at headquarters and field level has improved, it is still insufficient to ensure synergies between interventions and support mutual efforts toward comprehensive reforms in the partner country. This also holds true for multi-donor schemes, such as *JITAP* and *IF*, which, nevertheless, did contribute to a more co-ordinated and consistent approach amongst donors and international organisations at headquarters and in Geneva (*e.g.* thanks to joint diagnostic studies).

- ***Inadequate internal communications and expertise on trade-related matters***: Field mission staff, in particular, often lack a good understanding of trade's potential role in poverty reduction or of how to support the trade policy process in the partner country. Furthermore, field staff is not systematically consulted during programme planning and design. This undermines field mission staff's buy-in into TRTA/CB, "mainstreaming" of TRTA/CB with other development assistance activities, as well as communication with partner country stakeholders, hence undermining a consistent donor approach towards the partner country. This was, for example, the case of the *JITAP* in Burkina Faso, which suffered from insufficient communication between donor and multilateral agency representatives in Geneva and at headquarters, on the one hand, and donor field missions, on the other. Similarly, there has been insufficient systematic interaction between the World Bank's Trade Department and operational colleagues in the field.

Table A2. Overview of the 10 reviewed evaluations

Donor/ Agency	Author and Title	Period under Review	Method	Main Objectives
EC	ADE, Evaluation of Trade Related Assistance by the EC in Third Countries, Volumes 1 and 2 (2004)	1996-2002	Desk study and field review of several TRTA/CB programmes in, respectively, Kenya; Zambia (ACP); Tunisia (Mediterranean countries- MEDA); Moldova (Commonwealth of Independent States - TACIS) and Viet Nam (Asia and Latin America -ALA)	Help the EC improve its strategies for assisting partner countries in engaging in international trade and maximise the benefits for sustainable growth and poverty reduction.
USA	USAID/Office of Development Evaluation and Information (DEI), An Evaluation of Trade Capacity Building Programmes: Overview (2004)[1]	1999-2003	Desk study, based on the USAID Trade Capacity Building database. Review of 23 programmes conducted through phone/email interviews of USAID project managers in field missions.	Assess the performance of TRTA/CB activities. Identify major challenges in designing and implementing these activities. Determine the desirability of replicating such activities in other countries.
UK	Weston, A, C. Blouin and L. De Silva, The North-South Institute, Evaluation of DFID Support to Trade Related Capacity Building: Synthesis Report (2005)[2]	1998-2004	Desk study and field review of several programmes in Kenya, Bangladesh, Malawi, Ukraine and the Caribbean (CARICOM region)	Assess the effectiveness and the efficiency of DFID assistance. Identify lessons for good practice, which should feed into a new DFID Trade Strategy.
The Netherlands	Policy and Operations Evaluation Department (IOB), An Evaluation of Trade-Related Technical Assistance (2005)[3]	1997-2004	Desk study and field review in Burkina Faso and Tanzania (JITAP), Ethiopia and Yemen (IF) and Geneva (two TA projects of UNCTAD; Advisory Centre on WTO Law-ACWL; Agency for International Trade, Information and Co-operation - AITC and Quakers United Nations Office- QUNO.	Assess the results of selected *multilateral* TRTA programmes and IGOs/NGOs supported by The Netherlands, to enable policy makers to (i) account for funding of TRTA to the Dutch parliament, and (ii) determine whether such commitments should be larger, smaller or different in the future.
World Bank	Agarwal and Cutura, OED, An Independent Evaluation of the World Bank's Approach to Global Programmes: Case Study: Integrated Framework (2004)	2001-2004	Desk study, stakeholder interviews and surveys and field visits.	Assess the performance and impact of the IF and the effect of the scheme on the performance of the Bank and vice versa. Review the strategic role the World Bank has played in the IF, and determine what role it might play in the future.

Donor/ Agency	Author and Title	Period under Review	Method	Main Objectives
World Bank	World Bank Independent Evaluation Group, Assessing World Bank Support for Trade (2006)	1987-2004	Desk study to identify the evolution of trade assistance over time (1987-2001; 2001-04). Review of TRTA/CB interventions in: India, Indonesia, Morocco, Mozambique, Senegal, and Zambia. Interviews and surveys were conducted with key stakeholders.	Assess the development effectiveness of the Bank's trade assistance (lending and non-lending activities, such as research and advocacy). Evaluate whether stated strategies and objectives have been met.
UNCTAD	Denis, Saha, Griffiths, Evaluation of Capacity Building in UNCTAD's Technical Co-operation Activities (2002)	1995-2001	Desk study of 12 programmes with a capacity building component[4] and field review in Romania, Uganda and Viet Nam.	Assess the performance of these programmes in terms of capacity building. Identify explanatory factors for the performance. Provide recommendations for future programming.
ESCAP	ESCAP Secretariat, WTO/ESCAP Joint Training Programme for Developing Countries (2003)	1999-2003	Desk study based a review of programme documents (course plans) and "feedback questionnaires".	Assess the outcomes of ESCAP technical assistance work on WTO-related issues and consider lessons learned for future project planning and implementation.
Integrated Framework for Trade Related Technical Assistance to Least Developed Countries (IF)	Capra International Inc. and Trade Facilitation Office Canada, Evaluation of the Revamped Integrated Framework For Trade Related Technical Assistance to the Least Developed Countries (2003)	2000-2003	Desk study and field review (short visits) to all 5 "old", 3 pilot and 11 new IF countries. Consultations with all relevant stakeholders.	Assess progress in achieving the IF's two main objectives, *i.e.* its effectiveness as a mechanism (i) to "mainstream" trade into the national development plans; and (ii) to assist in the co-ordinated delivery of TRTA/CB in response to LDC needs
Joint Integrated Technical Assistance Programme (JITAP)	Da Silva,L. and Weston A., Report of the Summative Evaluation of JITAP (2002)	2000-2002	Desk study and field review in 8 beneficiary JITAP countries, including consultations with all relevant stakeholders.	Assess the impact of the JITAP and review compliance with the recommendations of the 2000 Mid-Term JITAP Evaluation.

1. The synthesis report relies on three individual evaluation reports:

USAID, Bureau for Policy and Program Coordination (PPC) (2004b), *An Evaluation of Trade Capacity Building Programs, USAID Support for WTO/FTA Accession and Implementation* , PPC Evaluation Working Paper No. 13, USAID, Washington.

USAID, Bureau for Policy and Program Coordination (PPC) (2004c), *An Evaluation of Trade Capacity Building Programs, USAID Behind-the-Border Trade Capacity Building*, PPC Evaluation Working Paper No. 14, USAID, Washington.

USAID, Bureau for Policy and Program Coordination (PPC) (2004d*), An Evaluation of Trade Capacity Building Programs, An Evaluation of Trade Capacity Building Programs Regional Trade Agreements: A Tool for Development?,* PPC Evaluation Working Paper No. 15, USAID, Washington.

2. The synthesis report relies on four individual evaluation reports:

(1) Blouin, C. and I. Njoroge (2004), *Evaluation of DFID Support to Trade Related Capacity Building, Case Study of Kenya*, The North-South Institute, Canada.

(2) The North-South Institute (2004a), *Evaluation of DFID Support to Trade Related Capacity Building, Case Study of Bangladesh*, The North-South Institute, Canada.

(3) The North-South Institute (2004b), *Evaluation of DFID Support to Trade Related Capacity Building, Case Study of the Commonwealth Caribbean*, The North-South Institute, Canada.

(4) The North-South Institute (2004c), *Evaluation of DFID Support to Trade Related Capacity Building, Malawi Case Study*, The North-South Institute, Canada.

(5) The North-South Institute (2004d), *Evaluation of DFID Support to Trade Related Capacity Building, Ukraine Case Study*, The North-South Institute, Canada.

3. The synthesis report relies on five individual evaluation reports:

(1) Lanser, P., P. Wijmenga and P. Mwazyunga (2004), *Evaluation of the Joint Integrated Technical Assistance Programme, Country Reports of Burkina Faso and Tanzania*, IOB Working Document, IOB, The Netherlands.

(2) Liebrechts, R. and P. Wijmenga (2004a), *Evaluation of Trade-Related Technical Assistance, United Nations Conference on Trade and Development (UNCTAD): Programmes on Investment and Competition*, IOB Working Document, IOB, The Netherlands.

(3) Liebrechts, R. and P. Wijmenga (2004b*), Evaluation of the Integrated Framework for Trade Related Technical Assistance to the Least Developed Countries, Country Reports of Ethiopia and Yemen*, IOB Working Document, IOB, The Netherlands.

(4) Plaisier, N. and P. Wijmenga (2004), *Evaluation of Trade-Related Technical Assistance, Three Geneva-Based Organisations: ACWL, AITC and QUNO*, IOB Working Document, IOB, The Netherlands.

(5) Policy and Operations Evaluation Department (IOB), The Netherlands Ministry of Foreign Affairs (2005), *Aid for Trade? An Evaluation of Trade-Related Technical Assistance*, IOB Evaluation, The Netherlands.

4. Capacity building is defined as “the ability of a technical assistance programme to enable beneficiary countries to perform and sustain targeted functions on their own as a direct result of that programme”.

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The Development Dimension

Aid for Trade

MAKING IT EFFECTIVE

One of the most effective ways to realise the potential of trade as a tool for development and poverty reduction is through meaningful market access. That being said, increasing the trade capacity of less advanced developing countries so that they become more dynamic players in the global economy requires a wide range of support. At the 2005 Hong Kong WTO Ministerial Conference, ministers called for the expansion of Aid for Trade to help developing countries benefit from WTO agreements and expand their trade, while recognising that such aid should not substitute for successful market access outcomes in the core areas of the Doha Development Agenda. In effect, the current suspension of talks in Geneva may provide a breathing space to make Aid for Trade fully operational in time for the completion of the negotiations. It is therefore important to keep up the momentum to ensure that Aid for Trade does deliver its promises.

Aid for Trade: Making it Effective sets out how much aid the members of the OECD Development Assistance Committee (DAC) are already providing towards trade-related activities. It reviews the effectiveness of existing programmes, and argues that reinforcing mutual accountability at the local level, together with a global review mechanism, *i.e.* applying the Paris Declaration on Aid Effectiveness, would enhance the impact of Aid for Trade. In particular, strengthening country ownership and management for results are essential to ensure that Aid for Trade delivers larger benefits from the multilateral trading system to the least developed and developing countries, and enables them to develop effectively.

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