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AID FOR TRADE AT A GLANCE: SHOWING RESULTS

Chapter 7. The Role of Complementary Policies in the Success of Aid for Trade

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Members are requested to provide their comments by Friday 24 June COB Paris time.

The chapter will be edited before publication.

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CHAPTER 7.

THE ROLE OF COMPLEMENTARY POLICIES IN THE SUCCESS OF AID FOR TRADE

Executive Summary

Economic literature has shown that the impact of trade on economic growth depends crucially on complementary policies. More specifically, supportive macroeconomic policies and structural policies are crucial to reach the Aid for Trade objective of using trade as an engine for economic growth, poverty reduction, and development.

Furthermore, complementary policies will increase the effectiveness of Aid for Trade notably because they require an adequate sequencing of trade reforms and of aid-for-trade delivery. Thus, these policies should be considered in the design of the trade reform and entail a strong dialogue between partner countries and donors.

This chapter focuses two main questions:

- According to partner countries, how important are the different complementary policies?
- Are the complementary policies discussed in the aid-for-trade dialogue with different stakeholders?

The answers to the questionnaire show that there is a large consensus among partner countries on the importance of complementary policies. In particular, they consider fiscal policy, regulatory environment, and governance as the most important for the success of Aid for Trade. While there are positive signs of regular discussions on complementary policies, more dialogue is needed with South-South and non-DAC donors. Macroeconomic policies and structural policies are an important supplement to the success of Aid for Trade and the impact of trade reforms on development will be larger if discussions take place during the design of aid-for-trade projects and programmes.

1. Introduction

1. Complementary policies, namely supportive macroeconomic policies that make a trade reform sustainable, and structural policies that increase the impact of a trade reform on economic growth, are crucial for the success of Aid for Trade. Many of the complementary policies highlighted as crucial in the economic literature fall within the purview of the Aid for Trade mandate (see Hallaert, 2010 and literature therein). He also stresses that these policies and their proper sequencing need to be considered in the design of aid-for-trade interventions. Thus, in order to maximize the impact of Aid for Trade these aspects need to be part of the dialogue between partner countries and donors.

2. This chapter focuses on partner countries' perceptions of the importance of complementary policies for the success of Aid for Trade and describes their experience with the dialogue on these policies with donors and the private sector.

3. The remainder of the chapter is organised as follows: Section 2 examines partner countries' ranking (by importance) of various complementary policies. Section 3 analyzes the importance of supportive macroeconomic policies. Section 4 provides details about partner countries acknowledgement of the importance of the different structural policies. Section 5 looks at the the frequency of discussion on complementary policies between partner countries and donors. Section 6 concludes by summarizing key findings.

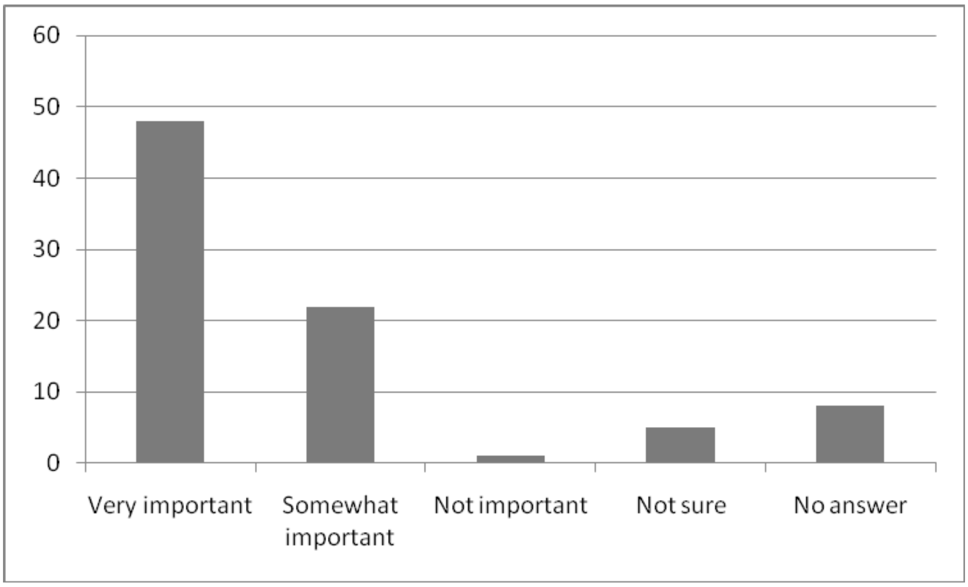
2. How important are the complementary policies?

4. Harnessing the power of trade is often difficult for developing countries and trade reforms alone are likely to be insufficient to power growth. Partner countries are aware of the importance of complementary policies to make trade reforms sustainable and to maximize their impact on economic growth.

5. As illustrated in Figure 7.1, more than 83% of countries responding to the questionnaires (70 out of 84) report that complementary policies are important for the success of Aid for Trade and more than half of them (48) consider these policies even as "very important".[1] Only 5 countries (Dominica, Ethiopia, Mauritius, Solomon Islands, and Trinidad and Tobago) are not sure about their importance and only one country (Serbia) reports that complementary policies are not important. Thus, partner countries recognize that the ecomomic impact of Aid for Trade fundamentally depends on the stance of complementary policies.

[1] The Bahamas, Republic of Congo, India, Kyrgyz Republic, Morocco, Sri Lanka, St. Lucia, and Republic of Yemen have not responded to the question. If only countries that have responded to the question are considered, over 92% consider complementary polices as important.

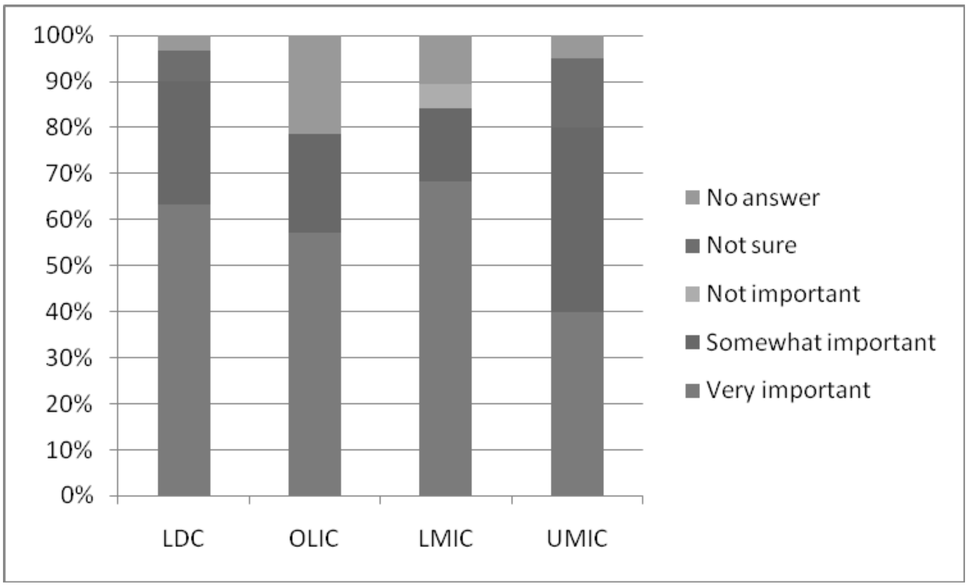
Figure 7.1. Importance of complementary policies in the success of Aid for Trade



6. Results from the questionnaires show a large consensus among every income group and region, on the crucial role that complementary policies play in the succes of Aid for Trade.

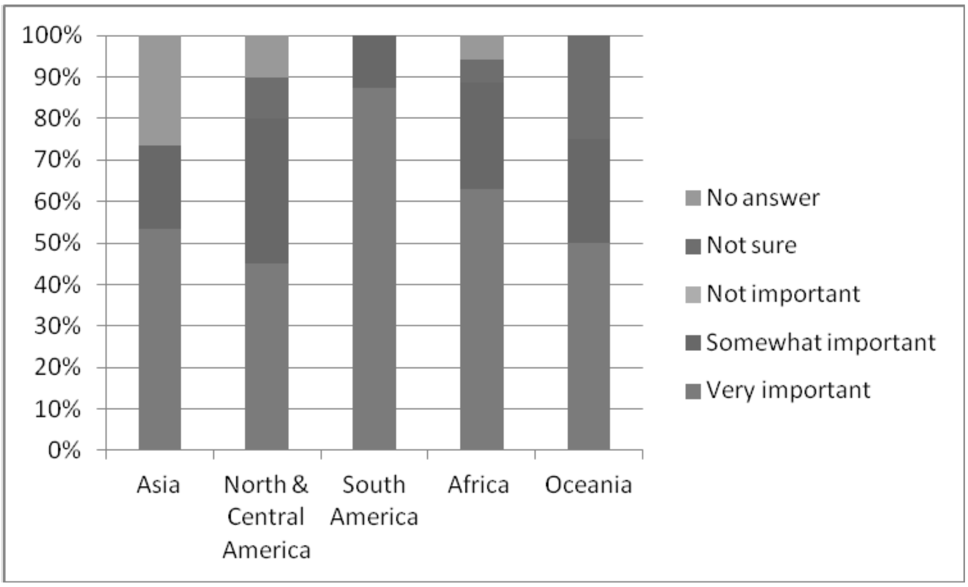
7. In terms of income groupings, results suggest that complementary policies are a particular concern for the poorest developing countries such as the LDCs (63% or 19 out of 30), the OLICs (57% or 8 out of 14), and the LMICs (68% or 13 of out 19). They rate the role of complementary policies as "very important" (Figure 7.2). In the case of UMICs, only 40% (8 out of 20) report that the success of Aid for Trade depends very much on complementary policies. However, this does not mean that the UMICs see complementary policies as unimportant. On the contrary, 80% of them consider these policies as either "very important" or "somewhat important", placing them at the same level as the OLICs. Nonetheless, it is possible that the UMICS consider complementary policies as less important than do the other income groups because their enabling environment (including stable macro economic policies) is already better geared towards generating sustainable economic growth. Among all the income groups, the UMICs have the lowest rate of "very important" score for both supportive macroeconomic and structural policies. This may be intuitive since relatively wealthier developing countries tend to have better market institutions that could help with the adjustment cost associated with trade reform and further promote trade and maximize its impact on growth.

Figure 7.2. Importance of complementary policies in the success of Aid for Trade by income



8. The regional breakdown exhibits a strong correlation with income level (Figure 7.3). North and Central America, where 60% of UMICs (12 out of 20) are located, has the lowest rate of "very important" answers (45%). This contrasts with the great importance given by South America (88%), followed by Africa (63%) where most LDCs are located, and Asia (53%). As a result, the relatively lower importance given to complementary policies by UMICs reflects a regional trend. However, it is noteworthy that none of the regions consider the complementary policies as "not important".

Figure 7.3. Importance of complementary policies in the success of Aid for Trade by region



Note*:* Europe is not shown because of the small sample size (*i.e.* Croatia and Serbia).

9. When all significant answers are combined (*i.e.* considering very important and somewhat important are together), almost 80% of all income groups and more than 73% of all regions agree on the important

role of complementary policies in fostering the success of Aid for Trade. The high level of positive answers reveals that countries are aware of the crucial role that complementary policies play in ensuring that trade contributes to economic growth and poverty reduction.

10. Moreover, the feedback provided by partner countries suggests that in the design of aid-for-trade projects and programmes greater attention needs to be given to complementary policies.

3. Supportive macroeconomic policies

11. Drawing on the experience of past trade reforms, Hallaert (2010) argues that the success of Aid for Trade crucially depends on supportive macroeconomic policies that make reforms sustainable.[2] These policies may be needed to prevent policy reversal. This section focuses on fiscal and balance of payments problems and an inadequate exchange that often make trade reforms unsustainable.

12. First, trade reforms can be unsustainable because of fiscal problems. They may arise for example when the trade reform results in a drop in revenues from taxes on international trade and when such taxes account for a large share of government revenue (Ebrill *et al.* 1999*,* Hallaert, 2004 and 2010).[3]

13. Aid for Trade can help address these problems. In particular, Aid for Trade can help mitigate the fiscal revenue impact of a trade reform by providing technical assistance for the design of the trade reform, by helping rebalance the tax system away from trade taxes to domestic taxes and by providing financial support to mitigate adjustment costs. Redirecting the tax system away from trade taxes to domestic taxes is at the core of the recommendations and technical assistance provided by international organisations such as the OECD and IMF. This strategy has merits on its own because trade taxes are an inefficient and distortive way of raising revenue.[4]

14. Moreover, offsetting the revenue losses from trade reform with domestic revenue helps meet the challenges of globalisation while preserving the resources required to meet the development needs. Furthermore, revenues from domestic taxes are less volatile than trade taxes or other financial flows such as aid or, as evidenced in the current crises, remittances and FDI (Bulír and Hamann, 2007). Thus, they help provide more stability and allow to pay for the recurring and maintenance cost of projects financed by aid, including infrastructure projects (Gupta and Tareq, 2008). In addition, this strategy helps safeguard consistency between the various forms of aid, notably Aid for Trade and budget support. Development needs of developing countries are large and require a scaling up of spending. To finance this spending in a sustainable manner, it is important that donors live up to their commitments but also that countries generate resources internally. Beyond the sustainability issue, this fact points to another coherence issue: coherence between the various forms of aid. Aid for Trade should make sure that revenue losses stemming from trade reform are offset by other forms of revenue otherwise it will undermine the capacity of recipient countries' budgets to finance development needs; a capacity that budget aid and debt relief try to shore up.

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2 Many case studies, including Ebrill *et al.* (1989), Edwards (1993), Foroutan (1993), Rodrik (1989), and Thomas and Nash (1991) analyze specific policy reversals due to macroeconomic imbalances be they fiscal or related to balance of payments problems.

3 Ebrill *et al.* (1999) as well as the World Bank Independent Evaluation Group (2006) documented cases where trade liberalisation was reversed because of a lack of accompanying fiscal revenue reform.

4 Trade taxes have a narrow base and distort both consumption and production decisions. For details, see Whalley and ab Iowerth (2002) and Farhadian-Lorie and Katz (1988).

15. Unfortunately, past experience with tax rebalancing in developing countries calls for caution. In practice, the rebalancing has been only partially successful in low-and middle-income countries. Using a panel of one hundred twenty-five counties during 1975-2000, Baunsgaard and Keen (2005) calculated that countries that rely the most heavily on trade taxes have not been able to recover from other sources the revenues they lost from trade liberalisation. On average, low-income countries have "recovered, at best, no more than about 30 cents of each lost dollar" and for middle-income countries the recovery is in the range of 45 to 65 cents. As a result, the decline in the ratio of trade tax to GDP in low-income countries was accompanied by a decline in the ratio of total tax revenue to GDP. However, this disappointing average performance masks the fact that a few low-income countries were able to fully recover the revenue losses stemming from trade liberalisation.

16. Second, trade reform can be also unsustainable due to balance of payments problems. Experience has shown that an inadequate and uncertain exchange rate policy is often a severe problem. [5] If a currency is overvalued, trade liberalisation triggers a rise in imports while the export response is weak because overvaluation damages competitiveness. Excess demand for foreign exchange will then emerge resulting in balance of payments tensions. In addition, domestic activity usually declines because the contraction in import competing sectors is not offset by an expansion of the export sector. Unemployment rises. Governments then have to either adjust the exchange rate or reverse the trade reform. Shatz and Tarr (2002), among many others, showed that this has been frequently the case including in the recent trade reforms of the 1980s and 1990s.

17. Aid for Trade has also a major role to play to prevent these problems notably in fostering an early export response to the reform. An early export response reduces the balance of payments, unemployment, and fiscal problems that may be associated with a trade reform. These problems arise because trade reform tends to lead to import surges which affect the import competing sector, while the increase in exports and corresponding expansion of the export sector only appear with a lag. For the same reason, a rapid export response helps achieve another objective of Aid for Trade, namely smoothing the adjustment cost of a trade reform. Moreover, when people see the immediate results from the reform, they are more likely to support the reform process.

18. The importance of supportive macroeconomic policies is highlighted in an econometric work quantifying the severity of various constraints to trade expansion faced by partner countries by Hallaert *et al.* (2011). The authors show that both fiscal and exchange rate policies have a large and statistically significant impact on partner countries trade performances. An increase by 1% of GDP in government spending is associated with an exports ratio lower by 1.8% of GDP. Moreover, a 10% appreciation of the real effective exchange rate is associated with a reduction of the openness ratio by almost 7% of GDP. The same study shows that the impact on trade performance of government spending and exchange rate overvaluation differs for different country groupings (*i.e.* landlocked economies, small and vulnerable economies, and commodity exporters). The study also shows that the impact of supportive macroeconomic policies is often larger than the impact of addressing binding export constraints that are targeted by Aid for Trade.

19. Consistent with the empirical evidence, 61% (51 out of 84) of the partner countries rank fiscal policies along with regulatory environment and governance as the three most important complementary policies (Figure 7.4). The questionnaire does allow to identify precisely which aspect of the fiscal policy is considered by partner countries as the most important but comments provide insights and suggest that it

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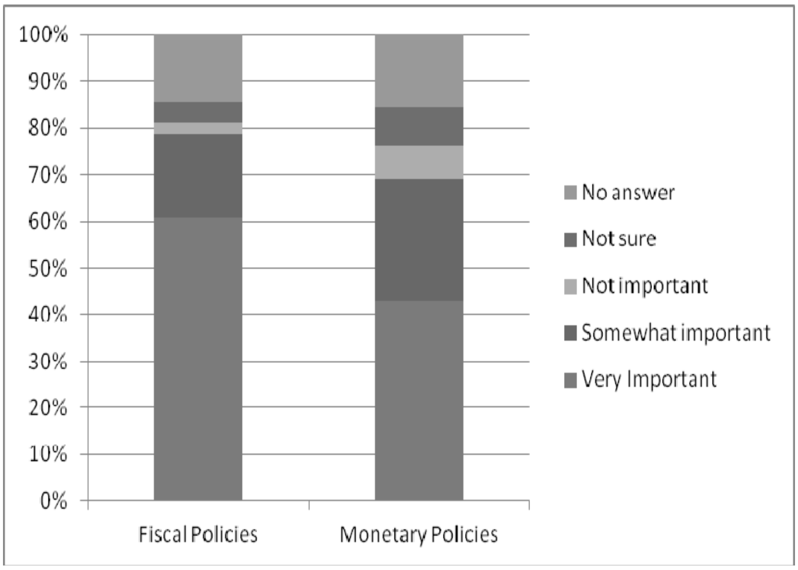
5 For more details on the importance of an adequate and predictable exchange rate and its link with balance of payments problem during trade reform, see Edwards (1993), Hallaert (2010), Krueger (1997; 1998; 2011), Panagariya (2004), Wacziarg and Welch (2003), and World Bank Independent Evaluation Group (2006).

may be related to tax revenues. Gabon and The Gambia, call for tax reforms conducive to the development of small and medium enterprises (SMEs). Guatemala and Saint Vincent and the Grenadines stress the need of increasing domestic taxes (such as VAT and income taxes) and ensuring their collection when progressing along the path of trade liberalisation and reduction of tariff barriers. Indeed, tax policies shape the environment in which international trade and investment prosper (OECD, 2009).

Figure 7.4. Importance of macroeconomic policies



20. Turning to monetary and exchange rate policies, partner countries find them relatively less important for the success of Aid for Trade than fiscal policies. Of the 84 respondents, only 36 say that monetary policies are "very important", while a further 22 acknowledge that they are "somewhat important" (Figure 7.4). Comments related to monetary policies were provided by The Gambia, which stresses the need to decrease the interest rate in order to boost investments. Panama highlights the importance of monetary policies to eliminate or diminish the main obstacles to competitiveness.

4. Structural Policies

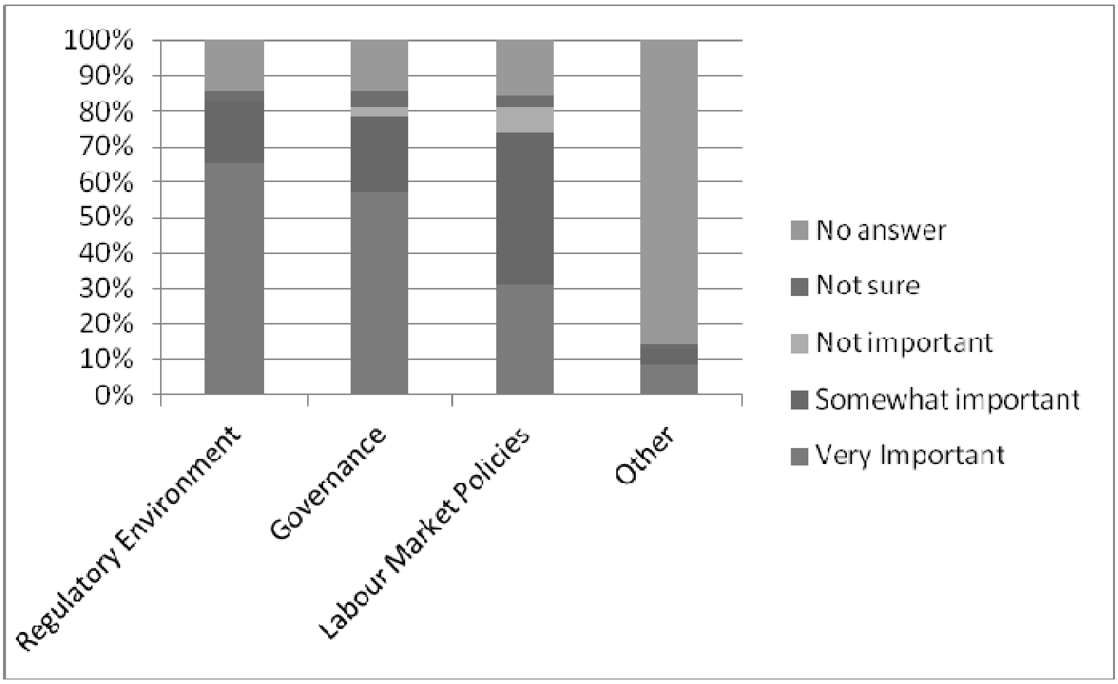
21. The argument that structural policies matter can be summarised with the findings of Dufrénot *et al.* (2010) that there is little evidence of a statistically significant impact of trade openness (measured as the ratio of the sum of exports and imports to GDP) on economic growth during the period 1980-95 but a strong and robust one in the period 1996-2000. The authors argue that this result can be interpreted by the fact that trade liberalisation was complemented by other policies in the second period but not in the first. In the second period *"trade policies were complemented by reforms putting a stronger focus on other macroeconomic and social policies including productivity boosting reforms, spending on social programs, improving the investment climate, and the strengthening of institutions"* (Dufrénot *et al*., 2010, p. 742). Consistent with this strand of literature, Hallaert *et al.* (2011) show that structural policies are very important for trade expansion and economic growth as they affect factors having a large impact on trade performance such as investment, labour productivity, and labour participation.

22. Complementary policies are also crucial to reduce poverty and to facilitate a structural adjustment which are key objectives of Aid for Trade (OECD, 2011). Past experiences and empirical literature show that in order to do so, complementary policies such as labour market policies, education policies, and regulatory frameworks, are crucial. An OECD study (2005, p. 16) provides details on trade-related structural adjustment and examines in detail how to facilitate it. It argues that "*The combined effect of*

complementary policies will be greater than the sum of the parts […]. The key to successful structural adjustment lays less in individual policies than in their interaction". It also points to the need to have a proper sequencing to coordinate the complementary policies because gains from trade and adjustment costs happen at different time.[6] Moreover, although there is empirical evidence that trade helps reducing poverty on average, it also implies adjustment and thus has distributional implications. The impact of trade and trade liberalisation on poverty will thus differ among sections of the community – there will be winners and losers – and drawing benefits from greater market openness will depend on policy settings and complementary policies.[7]

23. Figure 7.5 shows that partner countries perceive regulatory environment as the structural policy that is the most important for the success of Aid for Trade followed by governance and to a much less extent labour market policies.

Figure 7.5. Importance of structural policies



a. Regulatory Environment

24. The trade and growth literature provides ample evidence that regulatory reform increases the impact of trade on growth. For example, Chang *et al.* (2009) found that the positive impact of trade on growth is larger if accompanied by better education, infrastructure, and deeper financial, but also institutional and regulatory reforms. Bolaky and Freund (2008) found that the impact of trade liberalisation is increased if it is accompanied by a regulatory reform. They showed that in heavily-regulated economies the increase in

6 The role of complementary policies is even clearer when one considers, following Banks and Tumlir, (1986) that adjustment costs are not so much the result from the need to adjust but the results of market imperfections that appropriate complementary policies can address.

7 For more details in the role complementary policies in increasing the impact of trade on poverty reductions see OECD 2011, and Winters *et al.*, 2004.

trade fails to positively affect growth. But once the effect of domestic regulation is controlled, the impact of trade on growth is stronger than has been found in other studies.

25. Regulatory environment is ranked by partner countries as the most important complementary policy. Out of 84 respondents, 55 reports that it is “very important” and further 14 “somewhat important”, showing a broad consensus regarding its role in the success of Aid for Trade and to ensure its effectiveness (Figure 7.5). This large consensus may be related to the fact that regulatory environment is a key concern of the private sector and that 64% of partner countries report talking about complementary policies and structural policies with the private sector. This makes the private sector, along with multilateral donors, the most frequent interlocutor on complementary policies (Figure 7.6).

26. When examining the importance of the regulatory environment at the income level, the LDCs gave the lowest rate of “very important” answers (57%) among income groups. This is surprising considering the regulatory constraints on the overall enabling environment in these countries.

27. Most of the comments provided by countries on complementary policies are related to the regulatory environment. More specifically, partner countries perceive that trade policies and regulations aimed at improving the overall business environment related to customs, sectoral policies, and financial regulations are pivotal for the success of Aid for Trade.

28. In terms of policies that affect the business environment, Uganda and Zimbabwe mention that trade facilitation programs such as implementation of one-stop border posts have reduced cargo delays and transport costs. The Lao People’s Democratic Republic and Lebanon, countries seeking to accede to the WTO highlight the need to implement competition law and create enforcement mechanims such as a competition council.

29. Partner countries reported that they sometimes discuss the regulatory environment on a sectoral basis. For example, Chad, the Union of the Comores, and the Republic of Congo (Congo-Brazzaville) emphasize better regulations of agriculture to promote the development of the sector. According to Belize, it is important to implement sanitary and phytosanitary (SPS) measures as well as technical barriers to trade (TBT) regulations to ensure that only safe, certified products are sold on the market. This guarantee allows for aid-for-trade funding to expand production and exports. Lebanon emphasizes the need to implement food safety laws in order to secure and increase food exports. Along with Ecuador, the Republic of Congo, and the Union of the Comoros stress the need of regulations to boost industrial development in fisheries and tourism. Finally comments were also made regarding financial sector regulations. Fiji and The Gambia insist on improving access to credit in order to boost investment in the economy. Zambia argues that floricultural and horticultural export sectors slowed down due to difficult access to credit.

b. Governance

30. Governance is another complementary policy that partner countries perceive as crucial for the success of Aid for Trade. According to Rodrik (2000), political institutions are important for economic development because of the prosensity of democracies to moderate social conflict and search for compromises. The evidence from cross-country analysis is clear: governance is an important determinant of trade performance.[8]

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8 Seek in the context of Aid for Trade, Hallaert *et al.* (2011) and in the literature on trade and economic growth Chang et al. (2009) as well as Bolaky and Freund (2008).

31. Governance also matters for aid effectiveness. The problem of corruption was mentioned in the agenda of the 2005 High Level Forum on Aid Effectiveness in Paris, and commitments were made on transparency and "mutual accountability", showing donors' recognition that the quality of governance does matter for development performance and aid effectiveness.[9] The Commision for Africa (2005, p. 25) also noted that "*the issue of good governance and capacity-building is what lies at the core of all of Africa's problems*."

32. Partner countries rank governance as the most important structural policy along with the regulatory environment (Figure 7.5) with 79% of them reporting governance as either "very important" (48 out of 84) or "somewhat important" (18 out of 84). UMICs have the lowest rate of "very important" answers. This may be because the countries perform better in terms of the quality of their governance and thus pay more attention to other complementary policies such as those fostering the overall enabling environments.

33. Nepal mentions that good governance is a success factor for the effectiveness of Aid for Trade. Burundi and Kenya identify governance as the root cause of unsuccessful aid-for-trade processes. According to Kenya, emerging corruption tendencies triggered a stoppage of Aid for Trade. The Gambia insists on the adoption of be practices to attract more assistance from bilateral and multilateral donors.

34. Governance is an important determinant of trade performance and partner countries agree that enhancing governance conditions is a prerequisite for sustainable economic growth. Given the current financial crisis, partner countries need to implement governance reforms, while the donor community will need to maintain its funding pledges and ensure better management of aid delivery (Kaufmann, 2009).

c. Labour Market

35. Hallaert *et al.* (2011) argue that policies related to labour productivity will contribute significantly to trade expansion and this depends on many factors such as education, training, and labour market policies. This work suggests that a 10% increase in labour productivity increases the export ratio by 3% of GDP.

36. However, labour market policies do not seem to be a priority for partner countries. Among the five complementary policies mentioned in the questionnaire, labour market policies have the lowest score of "very important" answers (31% or 26 out of 84) (Figure 7.5). The importance of labour market policies was rated the highest by OLICs (93% or 13 out of 14), followed by LDCs (83% or 25 out of 30), LMICs (79% or 15 out of 19), and UMICs (45% or 9 out of 20). UMICs have a significantly low rate of positive answers compared to the others. This may reflect the relatively better labour market.

37. Moreover there were few comments provided on this issue. The most illustrative are provided by Fiji, The Gambia, and Cameroon. Fiji emphasises the need for investment in human capital formation, especially training of unskilled labour, and the promotion of labour mobility through the establishment of the National Employment Centre. The Gambia and Cameroon stress the importance of policies to promote employment, particularly in the industrial sector.

d. Other Policies

38. Partner countries stress two additional complementary policies as critical for the success of Aid for Trade, namely investment and education policies. For instance, the Union of the Comoros, Honduras, and Niger emphasise the need to improve the investment climate. Investment is highlighted by the literature as the main transmission channel between both trade and growth and aid and growth by bringing in new

9 For details, see Kaufmann (2009).

technologies and increase productivity, contributing to export performances.[10] Hallaert *et al.* (2011) also estimate that the impact of investment on trade performance of partner countries is very large: a 10% increase in investment is associated by an increase in the openness ratio of more than 4% of GDP.

39. In many partner countries, foreign direct investment is a major source of investment. Thus, promoting policies that do not discriminate against foreigners is crucial for development. In this context, Malaysia provides an interesting example of how a FDI-friendly environment allows achieving some of the most common objectives of Aid for Trade (OECD, 2011) namely export expansion and diversification and generating economic growth (Dogan *et al.*, 2011).

40. The ability to attract FDI is often dependent on the availability of skilled labour force, which Fiji highlights when emphasizing the importance of an education policy. Krueger (2011) notes that "*as with the other prerequisites of an outer oriented trade strategy, appropriate attention to education and training is vital not only for success with an outer oriented trade strategy, but also for domestic economic activity*". As mentioned above, in their cross-country analysis, Chang *et al.* (2009) found that the positive impact of trade on economic growth is larger if it is accompanied by better education.

41. Although Aid for Trade has no direct role in education, "capacity building" activities or training programs supporting the private sector can contribute to the development of human capital in partner countries. More generally, some countries express concern that some aid projects and programs do not always have a strong and clear link with trade although donors report these as Aid for Trade.

42. In fact, despite the broad consensus on the importance of complementary policies, there remains some confusion about what is Aid for Trade and what is not. For example, some countries mention regional trade agreements (RTAs) as a complementary policy. This is clearly part of the aid-for-trade agenda. Equally, education and training in trade policy is part of the agenda, although some partner countries list it as a key complementary policy.

5. Complementary policies are sometimes discussed

43. Complementary policies should be considered in the design and the sequencing of the trade reform which, if supported by foreign aid, require dialogue between partner countries and donors. According to partner countries, the intensity of the dialogue on complementary policies varies across donors, but they report an increase in frequency. Regular dialogues on complementary policies are taking place between partner countries and multilateral donors (56%) and the private sector (52%), followed by Development Assistance Committee (DAC) (45%). Partner countries discuss these policies less with non-DAC donors [11] and providers of South-South Co-operation, respectively 24% and 33% (Figure 7.6).

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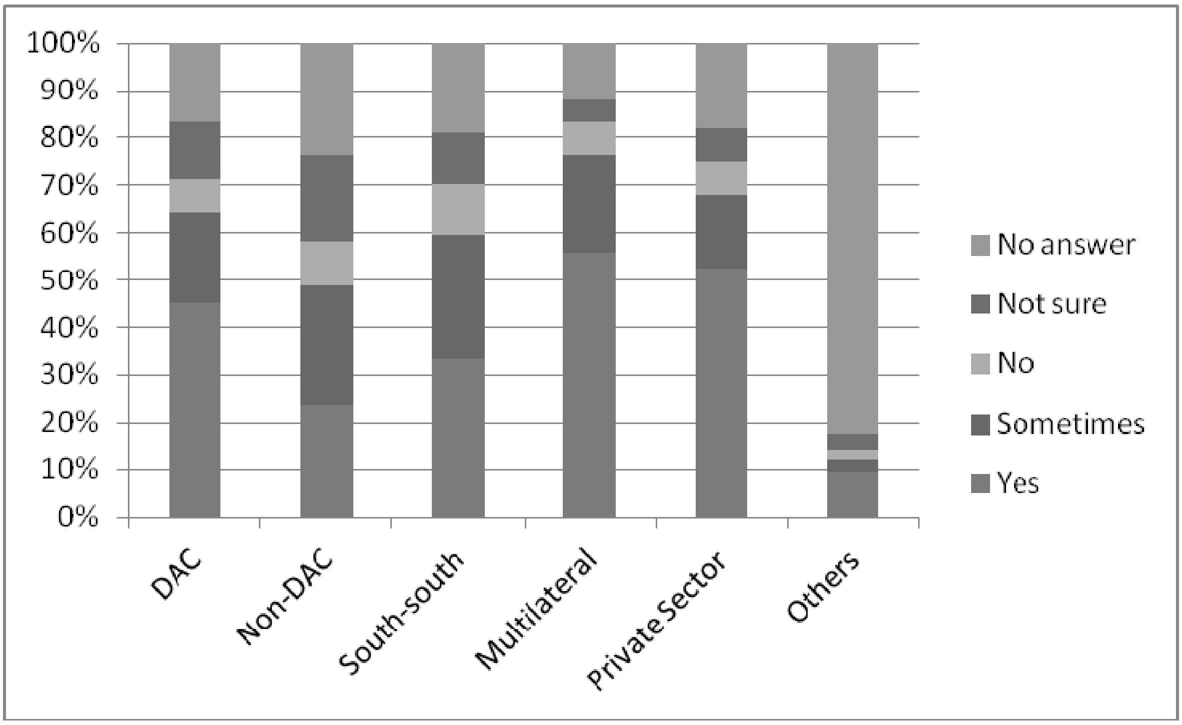
10 For more details, see to Hallaert (2006, 2010) and Gomanee *et al.* (2002).

11 Non-DAC providers of development assistance include non-DAC OECD members, major emerging and transition economies, Middle Eastern donors, non-OECD EU members, and other countries from South East Asia and Latin America. Source: *Working Party on Aid Effectiveness Special Session with Non-DAC Providers of Development Assistance* OECD, Paris 27 November 2007.

Figure 7.6. Discussions on complementary policies



44. The survey shows that the dialogue on complementary policies most frequently takes place with multilateral donors and the private sector. This should not come as a surprise. Complementary policies are likely to be included in the dialogue with multilateral donors because their programmes are large and multifacted. In the case of the private sector, their projects are directly affected by complementary policies such as the regulatory environment. As mentioned above, the frenquency of the dialogue with the private sector may explain why partner countries percieve the regulatory environment as the most important complementary policy. This is also highlighted in the comments provided by partner countries such as The Gambia (see below).

45. The inclusion of complementary policies in the dialogue differs between DAC donors and non-DAC donors. While 45% of partner countries report that complementary policies are part of the dialogue with DAC members, the rate is much lower with non-DAC members (24%). Out of 84 respondents, 16 report (25%) either no dialogue or are not sure that there is any dialogue on complementary policies, and further 16 (25%) report having only sometimes discussions on complementary policies.

46. The reason for the limited discussion of complementary policies with non-DAC donors might be the high transaction costs it involves for these donors. According to Davies (2008) "*building institutional and human capacities for providing development assistance is one of the key challenges for non-DAC donors. (…) In this context, implementing the Paris Declaration can involve significant transaction costs which may be perceived as too large relative to the scale of their development co-operation with a parner country*".

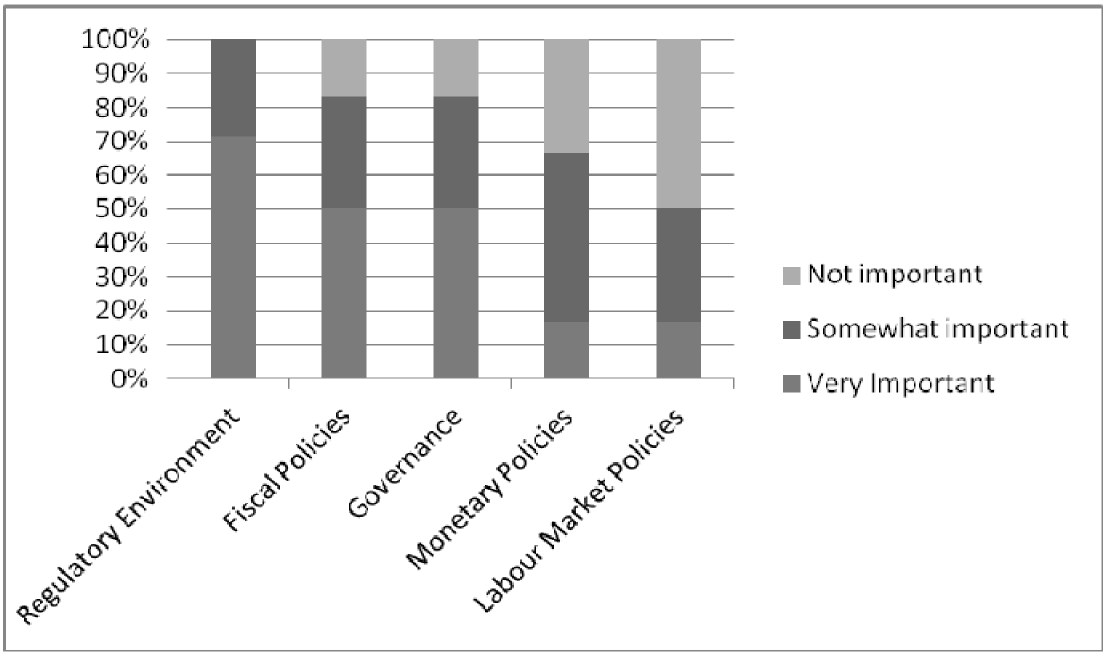
47. Providers of South-South Co-operation do not seem to be best placed to lead dialogue on complementary policies with partner countries. As part of the 2011 survey, 10 providers of South-South co-operation responded to a specially tailored South-South co-operation questionnaire. Although ranked higher than the non-DAC donors, only 28 partner countries out of 84 (33%) report having regular dialogue on complementary policies with South-South donors. Interestingly, Argentina, Chile, China, Colombia,

Ecuador, India, Indonesia and Mexico (8 out of 10) have answered that complementary poilcies are important for the success of Aid for Trade. Brazil and Oman do not see these policies as important and Brazil notes that South-South co-operation should promote partnerships and solidarity among developing countries and not be regarded as traditional ODA.

48. Among these policies, results show that South-South providers share the general view of partner countries that regulatory environment, fiscal policies and governance are the three most important complementary policies.[12] Although there is a consensus among them, the lack of dialogue sometimes leads to the failure of aid-for-trade projects and programmes. For example, India reports that some LDCs have demanded larger product coverage in India's Duty Free Tariff Preferences (DFTP) Scheme, but trade data shows that LDCs are not even exporting the products that are presently covered by the scheme. The DFTP Scheme is kept under review based on feedback received from LDCs and studies to determine if coverage needs to expand, and Rules of Origin need to be modified. This comment clearly underlines the need to further promote dialogue and strengthen coordination for the success and effectiveness of Aid for Trade.

49. The main reason for the lack of dialogue with South-South providers may be due to the fact that these donors differ from traditional donors (chapter 5). Donors from South-South tend to focus on human and institutional capacity development and specific projects. Moreover, often, they prefer not to interfere in the internal affairs of partner countries. However, dialogue on complementary policies does not necessarily mean interference in the internal affairs of another country and promoting dialogue will better ensure the success of Aid for Trade.

Figure 7.7. Importance of complementary policies for South-South providers



50. The dialogue between partner countries and other stakeholders seems less apparent since countries recording no dialogue or having no precise information on this matter are much higher, reaching the 63%

12 Brazil, Oman and Argentina have not responded to the question.

level. While the "other" category is vague and doesn't provide any details, comments to the questionnaire suggest that dialogue on complementary policies is taking place internally. Indeed, several countries commented that these discussions take place in the context of meetings organised at local level with different stakeholders such as sector-groups involved in the povery Reduction Strategy (PRS) framework (Burundi), the different ministries (the Union of the Comores), civil society (the Republic of Congo), specialised institutions dedicated to the promotion of trade (Guinea) and regional organisations such as the Economic Community of West African States (ECOWAS) as mentioned by Nigeria.

51. Other comments clearly underline that while discussions on complementary policies with various donors exist, they are not integrated in the particular aid-for-trade framework but rather take place during annual roundtables or global agreements with donors. The comment of The Gambia clearly goes in that direction: "*The country does not have Aid for Trade Dialogue necessarily, however, dialogue with DAC and Multilateral donors comes in a package where trade-related assistance and complementary policies are discussed simultaneously for example, during donor roundtables"*. This is also the point of Tonga which states that complementary policies are discussed during: "*Annual Dialogue through Donor Missions and MOUs signed*". In line with that statement, Saint Vincent and the Grenadines stresses that complementary policies are not discussed in the particular context of Aid for Trade but rather during each financing agreement: "*Any funding negotiated with international donors is usually dependent on an analysis of the country's economic situation, including its fiscal and monetary policies, governance issues and the regulatory environment.*

52. On the other hand, the comment by Solomon Islands records some efforts from particular donors to dialogue on complementary policies within the context of Aid For Trade even if these initiatives are rare: " *There is little specific aid-for-trade dialogue with donors. There may be some isolated discussions with donors with regard to certain trade-related projects. The private sector occasionally raises concerns with regard to fiscal policies and the regulatory environment during consultation on Aid for Trade initiatives. In aid dialogue more generally, most donors discuss complementary policies to some extent. The DAC donors tend to discuss complementary policies more than other donors".*

53. The evidence form the survey indicates a gap between the importance of complementary policies in Aid for Trade and the extent to which they are subject to discussions with donors is not so large. The problem seems more related to the fact that discussions take place during annual events such as donor consultations and not during the design stage of the aid-for-trade projects. This might pose the risk that the dialogue does not specifically address the crucial role of complementary policies for trade reform and trade related capacity builidng.

54. In sum, answers to the questionnaires suggest that more dialogue on complementary policies may be needed. It should focus specifically on partner countries' trade capacities and should take place before the design stage of comprehensive trade capacity building programmes.

6. Conclusion

55. Promoting complementary policies will help Aid for Trade to reach its objective of using trade as an effective development tool. Indeed, a large body of literature shows that complementary policies are crucial in making trade reforms sustainable and in increasing the impact of trade on economic growth. The chapter shows that the fact that complementary policies have a large impact on trade performance is well understood by partner countries.

56. Results show a large consensus among partner countries, from every income group and region, on the crucial role complementary policies play in the success of Aid for Trade. Although partner countries acknowledge the role of supportive macroeconomic policies that ensure the trade reform is not reversed,

they find monetary policies relatively less important than fiscal policies. Structural policies are also very important to maximize the impact of trade on economic growth. Partner countries identify regulatory environment, and governance as the most important structural policies for the success of Aid for Trade, much more than labour market policies.

57. Supporting both macroeconomic and structural policies will increase the success of Aid for Trade and this requires ensuring and strengthening dialogue on these policies between partner countries and donors. Once countries have determined the most relevant complementary policies that will ensure that the trade impact leads to economic growth, adequate sequencing and policy coherence should be taken account in the design of aid-for-trade projects and programmes. This cannot be achieved without considerable discussion between partner countries and donors.

58. Results show that the dialogue on complementary policies most frequently takes place with multilateral donors and the private sector. While there are positive signs of discussions on complementary policies, more dialogue is needed with non-DAC donors and providers of South-South providers. The large transaction costs and the reluctance to interfere in internal affairs could explain the lack of dialogue on complementary policies with these two categories of donors. However, discussing these aspects may help ensure the success of their Aid for Trade interventions. Moreover, partner countries underline the problem that discussions take place during annual events such as donor consultations and not during the design stage of the aid-for-trade projects. The impact of trade reforms on development will be even larger if discussions take place before the design of aid-for-trade projects and programmes.

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