

DEVELOPMENT CO-OPERATION DIRECTORATE
TRADE DIRECTORATE

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AID FOR TRADE: A SCOPING PAPER

Meeting of the DAC on 17 January 2006 and the Trade Committee Working Party on 26-27 January 2006

Purpose: The attached scoping paper develops a proposal to analyse the different dimensions of Aid for Trade, including the political, economic and financial aspects and design options.

Action required: The paper is submitted for DISCUSSION and COMMENT, in order to provide guidance to the Secretariat in undertaking this work.

Timing: A preliminary draft could be made available for discussion in March - April 2006 with a view to presenting a final report to the June Trade and DAC Committees.

Link to Programme Work and Resource Implications: The project can be fully funded with existing Part I resources. For the Trade Committee work, it falls under output area 3.1.3 Facilitation of WTO negotiations. For the Development Assistance Committee work falls under output area 5.1.3 Policy Coherence for Development, Economic Growth and Poverty Reduction.

Cooperation and context: The work will be done jointly by the Development Cooperation and Trade Directorates in close co-operation with the IMF, World Bank and WTO.

Contact: Ms. Martina GARCIA, tel: +33 (0)1 45 24 13 82 - e-mail: martina.garcia@oecd.org
Mr. Frans LAMMERSSEN, tel: +33 (0)1 45 24 89 88 - e-mail: frans.lammersen@oecd.org

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1. Introduction

1. The Doha WTO Ministerial Declaration emphasises that commitments to help developing countries overcome their trade-related institutional and human resource capacity gaps are core elements of the development dimension of the multilateral trading system. The Hong Kong Ministerial Declaration states 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.*

2. Furthermore, the WTO Director-General has been invited to

- i) create a Task-Force with the aim of providing recommendations by July 2006 on how to operationalise Aid for Trade and ensure that it contributes effectively to the development dimension of the DDA, and
- ii) consult with WTO Members as well as with the IMF and World Bank, relevant international organisations, and the regional development banks, with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate through grants and concessional terms.

3. In his speech to the WTO Ministerial Council, Secretary-General Johnston stated that the scope, definition and instruments necessary for a wider aid for trade agenda will require more work and that the Organisation, and in particular its aid and trade communities, are ready to contribute to this debate. Such a contribution is in line with the conclusions of the April 2005 joint meeting of the bureaux of the Development Assistance Committee and Trade Committee and the October 2005 special DAC meeting on Aid for Trade.

4. The output of the proposed work will provide

- i) a comprehensive overview and analysis of the aid for trade agenda from the aid and trade perspectives,
- ii) an assessment of what is required to make aid for trade an effective tool for helping developing countries fully realising the benefits of trade liberalisation and WTO Agreements, and .
- iii) an input into consultations on the resource implications of Aid for Trade to be launched by WTO Director-General.

5. Evidently, Aid for Trade should not be used to compensate for a DDA outcome that falls short of its ambitions. Rather, the DDA offers the aid and trade communities a unique opportunity to convey their commitment to provide increased support to those countries that are actively engaged in making trade an engine of economic growth, poverty reduction and development. The projected scaling-up of ODA from USD 80 billion in 2004 to USD 130 billion in 2010 offers a new opportunity for increasing this support,

while the Paris Declaration on Aid Effectiveness provides guidance on how to provide greater value for aid money.

6. The remainder of this note sets out the background (section 2), objectives (section 3), scope and structure (section 4) of a joint DCD/ECH paper and the timing and resource implications (section 5).

2. Background

7. Since the launch of the Doha talks in 2001, the total volume of aid for trade-related technical assistance and capacity building has increased steadily to reach USD 3 billion in 2004. Contributions to the multilateral trust funds (*e.g.* Joint Integrated Technical Assistance Programme, Integrated Framework Trust Fund, the International Trade Centre and the WTO) increased from USD 26 million in 2001 to USD 45 million in 2004. Support for economic infrastructure – particularly transport, energy and telecommunications – reached USD 9.3 billion in 2003.

8. Although the volume of aid for trade has increased significantly, the need for further increases has been reiterated in the WTO July 2004 Framework agreement, with specific references to existing and new commitments. After the completion of the Uruguay Round, support was focussed on providing assistance to (i) make trade policy at the national level, (ii) participate in WTO negotiations, and (iii) implement WTO agreements. With the start of the Doha Development Agenda, the agenda has expanded and now also encompasses aid to (iv) manage adjustment cost from liberalisation, and (v) address supply side constraints.

9. At the September 2005 meeting of the Joint World Bank-IMF Development Committee, Ministers endorsed a proposal for an enhanced Integrated Framework (IF), including expanding its resources and scope and making it more effective. In addition, they agreed that the enhanced Integrated Framework will organise the diagnostics on developing countries' needs for trade capacity building and infrastructure, as well as the impact of preference erosion following multilateral trade liberalisation. Finally, the World Bank and the International Monetary Fund were asked to examine the adequacy of existing mechanisms to address regional trade needs and explore new mechanisms as appropriate.

10. Ministers in Hong Kong-China welcomed the Development Committee conclusions and proposals for enhanced Integrated Framework, and called for the enhanced IF to enter into force no later than 21 December 2006. During the Hong Kong-China negotiations, Aid for Trade became a key element in the development package under discussion with several donors pledging significant new commitments on Aid for Trade¹.

3. Objectives

11. The objectives of the paper are to:

- Clarify the scope of the Aid for Trade agenda, in particular, the economic, political and implementation aspects;
- Identify the key criteria for a successful Aid for Trade package, and;
- Provide input into the WTO General Council consideration on how Aid for Trade might contribute most effectively to a successful conclusion to the DDA.

1. The US offered to double its Aid for Trade budget to USD 2.7 billion. Japan pledged to spend USD 10 billion over three years on LDCs trade-related infrastructure and customs systems. The EU committed to step up annual spending to EUR 2 Billion by 2010.

4. Scope and structure

12. The paper will address five questions:

- i) What is the scope of the agenda?
- ii) What is the rationale for support?
- iii) How much aid for trade do DAC donors already provide, *e.g.* ODA for trade related technical assistance, capacity building and addressing supply side constraints (incl. infrastructure) and how could expansion of these programmes be financed?
- iv) What has been the experience of these and other support programmes?
- v) What will make aid for trade an effective tool for helping developing countries, particularly LDCs, to fully realise the benefits of trade liberalisation and WTO Agreements?

4.1 *The evolving agenda*

13. The concept of trade-related technical assistance has dramatically evolved since the Uruguay Round. From the traditional technical assistance and capacity building aimed mostly at improving developing countries' negotiating capacity, it now encompasses support for addressing supply side constraints. Thus trade related technical assistance now includes capacity building, institutional reform, facilitating the implementation of WTO agreements and other trade-related institutions such as customs and quality assurance, infrastructure investment, assistance with adjustment costs, such as preference erosion, and areas traditionally considered to be part of the general development assistance agenda. Moreover, several special mechanisms, such as the Integrated Framework and the OECD-WTO database, were created to deliver aid and monitor its implementation, while attempts to better integrate trade policy in national development and poverty reduction strategies continued in earnest.

14. This section will present a brief assessment of the evolving agenda on Aid for Trade linking it to developments in trade and aid policies as well as to empirical results on the impact of trade liberalisation in poor countries.

4.2 *The rationale for aid for trade*

15. The basic argument to increase and deliver Aid for Trade more effectively is that a successful outcome of the Doha Development Round would constitute an important Global Public Good, that is a good from which everyone benefits, but to which not everyone has sufficient incentives to contribute. International trade, when coupled with domestic reform, can be a powerful engine in promoting sustained economic growth, employment opportunities and poverty reduction. But this potential contribution is still seriously under-realised in many developing countries. Governments, institutions and enterprises often lack the capacity, *e.g.* information, policies, procedures, institutions and/or infrastructure, to compete effectively in global markets and take full advantage of the opportunities provided through international trade. Many developing countries are also concerned about their ability to manage adjustment pressures arising from trade integration. With well designed support, all countries, including LDCs, have the potential to benefit from an ambitious Doha reform package. This section will address the political economy and the development rationale for providing Aid for Trade.

16. The paper will provide an assessment of what is required to ensure that the Aid for Trade package supports an ambitious outcome of the DDA. For example, we can examine the following questions: Should potential rent losers benefit from an aid for trade package, should support be directed to

other economic sectors, or should efforts target the broader economic, political and institutional needs to increase the contribution of trade to economic growth and poverty reduction? Since DDA-induced adjustment costs depend on the depth of commitments, how does this relate to the level of ambition in the negotiations and what does this entail for the volume of aid for trade? Will additional aid be distributed according to need, special links with donors or official WTO country classifications? In addition, since aid for trade, at least implicitly, acknowledges that the losers from trade liberalisation can be helped to move into more productive and competitive industries, what might be the consequences for national policies in assisting domestic groups that are negatively affected by trade liberalisation?

17. There are three main rationales to scale up aid for trade. First, aid for trade can be considered as a pure compensatory package designed to ensure a Pareto-Optimum outcome of the DDA, *e.g.* no individual can be made better off without another being made worse off. This would take the form of a pure financial transfer. Second, it might be used as an income redistribution mechanism, similar to domestic programs, aimed at mitigating individual adjustment costs, typically in the form of subsidies to the economic sectors or individuals more directly challenged by the adjustment. Finally, a number of proponents justify the need for additional aid for trade on the grounds that developing countries are under-investing in trade-related human and physical capacity. The paper will explore the implications of these three types of rationale with particular emphasis on the last one. It will seek to assess the extent and causes of under-investment, and in particular, whether the public goods' characteristics of trade-related investments are a sufficient explanation, or whether other important factors are also at play, *e.g.* incentives structures, the political economy of change, etc. It will explore which other types of market and/or government failure might be causing such shortfalls and whether additional funds could correct them.

18. The paper will also explore the challenges of identifying which supply-side constraints in developing countries should be prioritised in order to maximise value for money, as well as discuss the impact of increasing Aid for Trade in the context of general scaling-up of aid and renewed concerns about absorption capacity and inflationary pressures if aid fails to lift productivity (Dutch disease). An important challenge will therefore be to identify and target critical supply side constraints that can be addressed through aid and which result in increased productivity, competitiveness and economic growth.

4.3 *Financing Aid for Trade*

19. This section will analyse past and expected trends in the volume of aid for trade using primarily the WTO-OECD Trade Capacity Building Database, complemented with data from the Food and Agriculture Organisation (FAO), the Integrated Framework, the International Monetary Fund, the International Trade Center, the United Nations programmes, *e.g.* UNDP, UNECA, UNESCAP, UNIDO, UNCTAD, the World Bank Group and announced commitments. In addition, it would also examine alternative sources of finances and its implications for overall ODA budgets.

4.4 *Programme experiences*

20. This section will discuss main findings from bilateral and multilateral past and present programmes providing assistance to (i) trade policy making at the national level, (ii) participation in WTO negotiations, and (iii) implementation of WTO agreements. Over time, the agenda has expanded and now also encompasses aid to (iv) manage adjustment costs from liberalisation and, (v) address supply side constraints, such as institutional reform and infrastructure. Where possible, the differences between programmes financed by grants or concessional loans will be examined.

21. The analysis here will also seek to draw lessons from the OECD's Trade and Structural Adjustment Project (TASAP)², and in particular the role of wider economic policy in allowing capital and labour to move from declining to expanding areas of activity as well as from more national trade adjustment programs for workers and firms, and regional structural adjustment programs. Experience with the IMF Trade Integration Mechanism, Extended Fund Facility will also be taken into account

4.5 What will work

22. The final section will draw the main policy recommendations emerging from the analysis in previous sections and existing guidelines on aid effectiveness. In particular, Aid for Trade needs to pay close attention to the basic principles of aid effectiveness, *e.g.* (i) local ownership, (ii) alignment around national systems and strategies, (iii) harmonized donor efforts, and (iv) management for results. At the same time, the effectiveness of any aid for trade package will depend on how closely instruments are linked with objectives. *e.g.* while the effectiveness of a compensatory package could be maximised if additional funds were fully integrated in recipients' national budgets, aid aimed at increasing supply capacity might be most effective if tightly targeted at identifiable market failures and/or activities to enhance productivity and competitiveness .

23. It is clear that design and delivery mechanism will need to be adapted to objectives and geographical scope. Strategies that are better at integrating trade policy with national poverty reduction are likely to be essential, but, so is effective regional cooperation, particularly regarding issues such as transport infrastructure, customs reform and telecommunications.

5. Timing and Resource Implications

24. It is important that the work will be progressed and shared in the early months 2006 to provide input into the consultations to be launched by WTO Director-General Pascal Lamy. If approved, a first preliminary version of the report will be presented to the Trade Committee Working Party and DAC in March 2006. The final report should be ready for discussion by the aid and trade communities at the end of April 2006 in order to provide input to WTO task force on aid for trade and in time for consultations with members ahead of the July General Council meeting on the subject, linkages with other relevant international organisations will be actively fostered.

25. The study will be carried out within existing resources. For the Trade Committee, work falls under output area 3.1.3 Facilitation of WTO negotiations, and for the DAC, work falls under output area 5.1.3, Policy Coherence for Development, Economic Growth and Poverty Reduction.

2. See OECD (2005) **Trade and Structural Adjustment: Embracing Globalisation**, Paris.