The attached draft Chapter 4 of the Development Co-operation Report 2010 is circulated for REVIEW and COMMENT. Comments should be received by the Secretariat contact person indicated below no later than 4 December. This text is a preliminary version, so Delegations are invited to limit their comments to matters of substance. The final document will be edited once all comments have been received.

Contact:
Frans Lammersen - Tel: +33(0)1 45 24 89 88 - Email: frans.lammersen@oecd.org
DEVELOPMENT CO-OPERATION REPORT 2010
CHAPTER 4 – AID FOR TRADE: A ROUTE OUT OF POVERTY?

Summary

Most low-income countries consider trade to be a key component of their growth and poverty reduction strategies. However, trade flows have declined by around 10% as a consequence of the economic crisis, undermining confidence in trade’s role as an engine for growth and poverty reduction. Despite this, turning away from trade is not the answer. On the contrary, we need to ensure that market opening is accompanied by policies that lift people out of poverty and distribute the benefits of trade more equitably across and within developing countries. This is exactly the rationale of the Aid-for-Trade Initiative described in this chapter.

The initiative has already made remarkable progress: developing countries are prioritising trade in their development strategies and partner countries are scaling up resources. Maintaining momentum, despite the economic crisis, will require broad-based country and regional dialogue to show that aid for trade is worthwhile, contributes to wider development goals and can set and achieve specific targets.

Figure 4.1. Geographical and sectoral aid for trade, 2002-2007

1. Introduction

1. Trade, and especially international trade, is an essential component of economic growth and can reduce poverty when the right conditions are in place. Many developing countries have begun to integrate themselves into the global economy and are overcoming trade barriers. However, lack of capacity – information, policies, procedures or infrastructure – has meant that many countries have been unable to benefit from greater access to international markets or compete with wealthier countries. In response, in 2005 the World Trade Organization (WTO) members agreed to support poorer members in using trade as an engine of growth (Box 4.1).
Box 4.1. The Aid-for-Trade Initiative

The Aid-for-Trade Initiative was launched at the 2005 Hong Kong WTO Ministerial Conference. It aims to help low income countries overcome the structural limitations and weak capacities that undermine their ability to produce, compete and maximise the benefits from trade and investment opportunities. The initiative will “enable developing countries, particularly least-developed countries (LDCs), to use trade more effectively to promote growth, development and poverty reduction and to achieve their development objectives, including the Millennium Development Goals (MDGs).” (WTO Task Force on Aid for Trade).

Because trade is a diverse and complex activity, aid for trade is broad and not easily defined. It includes:

- Technical assistance: helping countries to develop trade strategies, negotiate more effectively, and implement changes.
- Infrastructure: building the roads, ports, and telecommunications that link domestic and global markets.
- Productive capacity: investing in industries and sectors so countries can diversify exports and build on their comparative advantages.
- Adjustment assistance: helping with the costs associated with tariff reductions.

The initiative is reviewed every two to three years. The Second Global Review (July 2009) evaluated progress since the first review held in November 2007 and scrutinised how the initiative is being implemented on the ground. The next Global Review is tentatively scheduled for 2012.

2. The rationale for aid for trade has been strengthened by the crisis. The quantity and quality of aid, including aid for trade, are now more important than ever for economic growth and human welfare. Aid for trade provides an essential stimulus in the short term, creating employment and reigniting growth, while also addressing long-term competitiveness challenges. Aid for trade also covers trade-related infrastructure, storage and distribution systems which are essential for food access and security (Box 4.2).

Box 4.2. Food security

The sharp rise in food prices in 2007 and 2008, and their subsequently even steeper fall, have underlined the fragility of global food security. The price rises led to riots and substantial instability in a large number of developing countries. Donors responded quickly to provide short-term emergency assistance. However, there is increasing concern about falling domestic and aid spending on agriculture. ODA to agriculture and food security fell from its 1980 high of 17% to under 4% of total bilateral ODA in 2007. The joint 2009 OECD/FAO Agricultural Outlook forecasts that global food markets will remain volatile for some time, given their strong links to crude oil prices.

Achieving global food security in the longer term requires actions for agriculture, as well as actions outside the agricultural sector. Farmers, especially small-scale farmers, need to increase productivity, diversify their income base and improve their ability to respond to market needs. They also need effective social protection and insurance mechanisms, much greater access to innovation and technology and more effective public institutions. All stakeholders (developing countries, donors, private sector and civil society) will need to work together to increase the capacity of countries to invest in agriculture and to make the sector a prosperous one that raises income and feeds the poor. More broadly, efforts are needed to diversify the structure of economies and reduce poverty to make food more affordable. This will have to include aid for trade arrangements that bolster the critical infrastructure and systems on which food
production, marketing and access depend.

Global food security is now at the top of the international agenda. It was a central theme at recent G8 and G20 meetings, with a UN General Assembly and a World Food Summit coming hot on their heels. Many donors are now scaling up aid to agriculture, rural development and food security and making them much higher priorities. A key challenge ahead will be to turn political promises (from developing countries and donors) into sustainable and effective investments in food security.

3. *Aid for Trade at a Glance 2009* – an overview of the latest monitoring of the Aid-for-Trade Initiative published by the OECD in co-operation with the WTO (OECD, 2009a) – shows that there have been many achievements. These are outlined in the following section. To build on these achievements, however, the next step is to show that the initiative ultimately contributes to trade creation and poverty reduction. This is particularly important in the face of the worst economic crisis in generations. Stakeholders in developed and developing countries alike are eager to know whether the Aid-for-Trade Initiative is leading to the desired results. In particular, they are asking: do country-owned trade strategies and donor-funded trade programmes build the capacity to trade, improve trade performance and reduce poverty? How do we know we are on the right track? How can we tell success from failure? We explore the answers to some of these questions here.

2. **Under what conditions can trade reduce poverty?**

4. “Aid for trade should support the broader development goals we all share, focusing not only on building trade capacities but contributing to a healthier environment and to fighting poverty.” OECD Secretary General Gurría, at the 2nd Global Review of the Aid-for-Trade Initiative, 6-7 July 2009.

5. The relationships among trade, growth and poverty are complex. Though opinions differ as to the nature of these relationships, most agree that developing countries can gain real benefits from opening up their economies. Indeed, the weight of evidence is that greater openness is important for growth and has been a central feature of successful development. No country has developed successfully by closing itself off from the rest of the world, very few countries have grown over long periods of time without experiencing a large expansion of their trade, and most developing countries with rapid poverty reduction also enjoy high economic growth (*i.e.* the growth accounts for a large share of observed changes in poverty reduction).

6. Of the numerous empirical studies on the topic, however, most have failed to establish a systematic relationship between greater integration and growth, and there is little agreement on causality (OECD, 2009b). Economic growth, in general, is a rather messy process and will not be equitable if left to its own devices. For this reason, governments need policies that bring the benefits of growth to those sub-groups of people that would otherwise not be reached. To make growth more beneficial to the poor, policies need to tackle the multiple dimensions of poverty, including the economic, political, social dimensions, as well as the cross-cutting dimensions of gender and environment. Policies must also help to empower the poor to contribute to and participate in the growth process (OECD, 2006).

7. In looking at both trade-to-growth and growth-to-poverty links, Cicowiez and Conconi (2008), for example, conclude that the critical elements in translating economic growth into poverty reduction seem to be complementary and multidimensional public policies. Work by the University of Adelaide exploring the links between trade, growth and poverty reduction lists five pre-requisites for a positive relationship between trade and poverty reduction: i) trade openness; ii) domestic reform; iii) a robust and responsible private sector; iv) institutional reforms; and v) political will and co-operation (Redden, 2008).
8. In short, while trade, and therefore aid for trade, is positively linked to growth, trade policies are by no means the only policies that are important for reducing poverty.

3. The Aid-for-Trade Initiative: a progress report

9. As mentioned earlier, monitoring has shown that the Aid-for-Trade Initiative has made good progress. Partner countries are mainstreaming trade in their development strategies and clarifying their needs and priorities. Donors are improving aid-for-trade delivery and scaling up resources. In 2007, as was the case in 2006, aid for trade grew by more than 10% in real terms; total new commitments from bilateral and multilateral donors in 2007 reached USD 25.4 billion, with an additional USD 27.3 billion in non-concessional trade-related financing. Preliminary data for 2008 show a continued increase in aid for trade.

Impacts on trade

10. An OECD/WTO partner country and donor aid-for-trade questionnaire sought to shed light on the impact of this funding on trade. Over 80 partner countries and 50 donors responded, giving a clear sign of across-the-board engagement in the initiative. In these self-assessments, partner countries generally agreed that the following four aid-for-trade programmes have been most effective:

- **Trade policy analysis, negotiation and implementation:** The Philippines suggest that training and workshops have been particularly useful in helping officials to better understand the function, structure and rules of the multilateral trading system. Sri Lanka reports that WTO technical assistance has helped to train trade negotiators, but it also expresses concern that WTO programmes risk turning officials into “rule takers” rather than “rule makers” by focusing too narrowly on rules, rather than development policy. A related study indicates that a 10% increase in aid to trade policy and regulations is associated with a 1.5% reduction in trading costs (Cali and te Velde, 2008).

- **Trade facilitation:** This is the second most frequently identified area where aid for trade is seen as effective. Simplification of customs procedures and improvements to port authorities are considered particularly important and useful (e.g. Ghana, Kenya and Malawi). An OECD (2009b) study found that customs reform – often supported by technical assistance programmes, financial assistance or public-private partnerships – may bring important increases in customs revenue over a relatively short period of time: for example 150% in Angola half-way through the five-year reform programme, and 58% in Mozambique during the first two years of the programme.

- **Competitiveness:** Belize reports that the EU-funded Banana Special Framework of Assistance, which provided technical assistance, supplies, infrastructure, schools and teacher training, played a significant role in improving the competitiveness of its banana industry.

- **Export diversification:** Zambia reports that European Development Fund projects helped it to increase the export capacity of its horticulture and floriculture sectors. In Grenada’s case, an

---

1 Other than this survey, there have been very few aid-for-trade-specific evaluations, in part because the initiative has only recently emerged as a distinct objective of development co-operation. Consequently, the WTO Task Force has recommended that increased evaluation of aid for trade should be promoted and funded. This will also mean developing appropriate methods for evaluating aid for trade at the programming and policy levels. In particular, the evaluation and aid-for trade policy communities should work out specific measures for evaluating aid-for-trade activities, as compared to other development programmes.
initiative that brought together the public and private sectors, as well as NGOs, enabled the design of a broad strategy for increasing and diversifying exports.

**Mainstreaming of trade by partner countries**

11. Increasingly, partner countries are becoming actively involved in the Aid-for-Trade Initiative. In general, they find that there is positive impact on trade performance resulting from aid-for-trade programmes and projects. Although independent surveys raise questions about this assessment, it is, nevertheless, a clear indication of the growing awareness among partner countries that trade can play a positive role in promoting economic growth and reducing poverty. Nearly all partner countries report having national development strategies and more than half have fully mainstreamed trade through well-developed operational priorities and action plans (Figure 4.2).

![Figure 4.2. Mainstreaming of trade by partner countries](image)


12. While partner countries increasingly discuss their priorities with donors through a variety of dialogues, donors note that the success of these dialogues depends critically on the extent to which trade-related priorities have been mainstreamed and operationalised by those countries. Mainstreaming is essential, because without an operational trade-development strategy, it is hard to attract donor support to address specific supply-side constraints. With competing claims on limited resources, especially in times of economic crisis, it will be difficult for donors to sustain increased aid-for-trade flows without clear demands from partner countries.

**An increasing commitment by donors**

13. Bilateral donors provided USD 15.8 billion in aid for trade during 2007, well over 60% of total flows, and many channelled their funds through multilateral agencies. Consequently, multilateral donors tended to allocate a significantly higher share of their sector allocable aid to aid for trade than bilateral donors. Four donors, which are also the largest providers of total ODA (*i.e.* the World Bank, the United States, Japan and the European Commission), continued to dominate aid-for-trade flows in 2007.

14. At the 2005 Hong Kong WTO Ministerial Conference (Box 4.1) a number of donors pledged to increase their aid for trade by 2010. Donors are on track to meet, or have already met, these pledges (Figure 5.3). The USD 4.3 billion increase in aid for trade in 2007 was additional, *i.e.* not at the expense of
other programmes, such as health or education. Donors are planning to continue increasing funds for aid for trade over the medium term. Furthermore, calculations suggest high disbursements of commitments.

Figure 4.3. Donor progress towards Hong Kong pledges


15. Aid-for-trade flows to low income countries are growing faster than to any other income group. Most are spent on infrastructure, in particular transport and power, whereas flows to middle income developing countries reflect their priority to build productive capacities, including trade development. The largest share of aid for trade goes to Asia, although Africa, especially sub-Saharan Africa, is catching up and received most of the additional funds in 2007. With the exception of Europe, all other regions (i.e. Latin America and the Caribbean, and Oceania) also saw their volumes of aid for trade increase during 2006 and 2007.

16. Donors are also strengthening their capacity to respond to rising aid-for-trade demand by bolstering in-house expertise and raising awareness among policy makers and practitioners at headquarters and in the field. Furthermore, donors are aligning around partner countries’ procedures and systems, and undertaking more and more joint initiatives, including triangular co-operation. Partner countries acknowledge these positive trends.

4. Regional aid for trade: an area for growth

17. International experience has demonstrated that regional trade integration can be a powerful catalyst to economic growth. However, developing countries sometimes face particular capacity constraints that limit their ability to capitalise on the full potential from such processes. For example, poor cross-border infrastructure may prove to be a particular challenge for low-income developing countries. This
highlights the need for more and better aid to address the constraints to regional trade integration, a point increasingly affirmed by partner countries and donors alike.

18. Partner countries have identified common priorities for regional integration, including transport infrastructure, trade facilitation, competitiveness and export diversification, as well as capacity for regional trade negotiations. Donors have also recognised the importance of regional integration and report a rising demand for regional aid for trade. Financial support for trade-related global, regional and multi-country programmes – areas which were identified among the challenges highlighted during the first Global Aid-for-Trade Review – has doubled since 2005 (OECD, 2009a). Most partner countries affirm that they benefit from regional aid for trade and that their main constraints to regional trade are being addressed.

19. *Aid for Trade at a Glance 2009* (OECD, 2009a) includes three case studies of regional aid-for-trade efforts: i) a recently launched pilot programme to improve the trade and transport corridor in the Southern region of Africa for the freer flow of goods and people; ii) a regional integration project to boost inter-connectedness among the countries in Mesoamerica through improvements in transport infrastructure and the regulatory environment; and iii) an economic corridor development project in the Greater Mekong sub-region of Asia to enhance physical links and promote closer economic ties among countries in the sub-region. All three case studies illustrate how aid for trade is being used to tackle both common and region-specific challenges. However, one challenge to regional integration efforts is a lack of co-ordination between donors and partners. To strengthen regional capacity and improve effective participation in the regional and multilateral trading systems, further co-ordination on aid for trade is needed.

5. The next steps

20. As noted in this chapter, the relationship between trade, growth and poverty reduction is complex. But it is clear that openness and integration can contribute to economic development and poverty reduction. The Aid-for-Trade Initiative has succeeded in raising awareness about these important links, but also about the binding trade-related constraints that keep developing countries from benefiting fully from trade expansion. The initiative has also succeeded in mobilising resources to build trade capacities related to policies, institutions and infrastructure.

21. In order to maintain momentum, particularly in light of the current economic crisis, several practical steps are needed:

- We need to show that aid for trade is worth doing. This means demonstrating the large potential gains from broad-based multilateral trade liberalisation and the integration of developing countries into the global economy.

- We need to promote and fund more evaluations of the impact of aid for trade, and develop better methods for conducting effective evaluations.

- We need to show that aid for trade can hit the target. In order to achieve this, the targets need to be identifiable. This means case-by-case, country-by-country identification of the nature and extent of the impediments that are presently preventing the benefits of trade from being fully realised.\(^2\) We need to identify exactly how aid for trade will address these impediments, how it

\(^2\) The monitoring report contains around 80 Aid for Trade at a Glance fact sheets which provide a tool for each country to strengthen the links between demand, response, outcomes of priority programmes and their impact on trade performance. These fact sheets help to create incentives, through a sustained dialogue among governments, civil society, private sector and donors, to improve the coherence of aid for trade with overall development strategies around which donors should align their support.
will work with, and add value to, initiatives by private firms, and how it will fit into the evolving framework of regional and multilateral co-operation.

- We need to ensure that we incorporate the Paris Declaration principles of ownership, mutual accountability and management for results into aid-for-trade programmes. Aid for trade is part of a larger picture encompassing international co-operation, improved policy coherence and a whole-of-government approach to economic development and poverty reduction. It needs to be shown that aid for trade contributes to the wider goals of partner countries. Trade development strategies will only be successful and sustained where the partner country takes the lead in determining the goals and the priorities of the strategy and sets the agenda for how they are to be achieved. To date, local ownership remains relatively weak in many developing countries.

- We need to broaden the aid-for-trade dialogue to engage parliaments, citizens, civil society and the private sector more effectively. The Aid-for-Trade Initiative is only fully understandable to those stakeholders working with it directly. Broader engagement and greater outreach will avoid it becoming a subject of interest only among bureaucrats, divorced from the political landscape in which it must be carried forward. This is especially important given the political sensitivity of many trade reforms.

22. The OECD, in collaboration with international partners, is working to achieve these objectives.

References and key resources


