CHAPTER 1
THE **IMPACT** OF THE ECONOMIC CRISIS ON AID FOR TRADE

SUMMARY

The global economic crisis is an exogenous shock for developing countries that affects them in different ways and through different transmission channels. World trade is experiencing its largest decline in generations. Foreign direct investment (FDI) and other private flows are also declining and remittances are expected to drop significantly. Developing countries are, therefore, not in a strong position to address the consequences of the current economic crisis.

Donor support against the effects of the crisis is vital to minimise the potential impairment of the long-term prospects for developing countries. This implies sustaining and expanding concessional financing, including aid for trade, to revive economic growth prospects. The speed and scale of the response will be critical factors in determining the impacts of the crisis on human welfare and on economic performance. This is why the volume and the quality of aid are now more important than ever for investment, growth and human welfare.

An important contribution to reviving economic growth around the world would be the conclusion of the Doha Development Agenda (DDA), one of the most appropriate collective stimulus packages. An ambitious and balanced conclusion to the Doha Round is also the best way to safeguard individual trade interests and the multilateral trading system against the threat of an outbreak of protectionism.

Aid for trade is needed now more than ever, to provide much needed additional stimulus, averting the worst consequences of the economic downturn, while addressing underlying vulnerabilities to get the enabling environment for growth right - assisting producers in partner countries to effectively participate and compete in local, regional and international markets. Aid for trade will help partner countries address broad growth and poverty reduction challenges, overcome long-term constraints and make their economies more resilient with diversified sources of growth.

INTRODUCTION

Shortly after the first Global Aid-for-Trade Review in November 2007, the world economy entered the deepest and most synchronised recession in generations, caused by a global financial crisis and deepened by a collapse of world trade. The OECD forecasts that world real GDP growth will fall by 2.75% this year, the first such fall in 60 years.[1] Moreover, the WTO projects that the volume of world trade will contract in 2009 by as much as 9%, driven lower by the collapse in global demand and by shortages of trade finance.[2]

No one can predict precisely how deep this recession may be, nor how long it might last, but there is no doubt about the negative long-term implications for developing countries. The weakening of their performance will be sharp and substantial, with serious repercussions for their ability to attain their economic and social objectives, including poverty reduction. The World Bank estimates that only one-quarter of the most vulnerable developing countries have sufficient resources to prevent a rise in poverty. Against that rather bleak background, ODA should play a counter-cyclical role to rebalance the sharp reversal in overall financial flows to developing countries. Alongside scaling up the volume of aid, ensuring its effectiveness is equally critical and the Accra Agenda for Action provides directions for doing so.

This chapter on the impact of the economic crisis on aid for trade is based on the March 2009 report to the WTO Trade Policy Review Body[3] and the May 2009 report to the OECD High Level Development Assistance Committee (DAC).[4] The next section will discuss some of the impacts of the economic crisis on developing countries followed by a section on the characteristics of the fiscal and financial support programmes at the national and global level. Trade-related policy developments and trade finance are then discussed. The prospects for ODA and the need to deliver scaled-up resources effectively are then considered while the penultimate section outlines why aid for trade matters more in the current circumstances. The final section concludes.

IMPACT ON DEVELOPING COUNTRIES

Since the end of 2008, developing countries have begun to feel the full effects of the financial and economic crises. Initially, banks and other financial institutions in most developing countries seemed to have been shielded from the financial crisis due to their limited exposure to the financial instruments that lay at its core. Since then, however, it has become clear that their domestic capital markets and their access to international capital markets are being affected directly and significantly. Investors in developed countries have pulled resources back from emerging markets and other developing countries, in part because of the de-leveraging process of their financial institutions.

The effects of the crisis are evident in the decline of net private capital flows, including FDI to developing countries in the second half of 2008.[5] Furthermore, trade has contracted significantly.

- Global *FDI* inflows are estimated to have declined by more than 20% in 2008, marking the end of a four-year growth cycle. Furthermore, recent International Monetary Fund (IMF) projections show that FDI in 2009 will continue to fall by almost 20% from its 2008 level (IMF, 2009a). In developing countries and transition economies, preliminary estimates by the United Nations Conference on Trade and Development (UNCTAD) suggest that FDI inflows grew by 4% in 2008, a rate that is substantially lower than in 2007. Moreover, these estimates point to a sharp decline in the 4th quarter of 2008 and prospects for 2009 are likely to be far more negative.[6]

- *Trade* (average of exports and imports) fell sharply in value (current dollar) terms for most countries towards the end of 2008 and into 2009, although the extent of the declines may have been magnified by falling commodity prices and the appreciation of the US dollar against a number of currencies as the financial crisis intensified. The WTO expects the volume of world merchandise exports to fall by 9% in 2009 – the largest such decline in over 60 years. The WTO also anticipates that the contraction in developed countries will be particularly severe with exports falling by 10%. In developing countries, which are far more dependent on trade for growth, exports will shrink by 2% to 3%.

The situation will be particularly difficult for those developing countries that rely heavily on inflows of worker remittances and tourism, both of which are projected to fall.

- After years of rapid growth, *remittance* inflows to developing countries are estimated to have reached USD 422 billion in 2008, but with deceleration apparent in the second half of the year. World Bank projections suggest that remittances to developing countries will fall by between 1% and 6% in 2009.[7] The negative impact is particularly problematic for those countries for which remittances are large relative to GDP, including many smaller economies such as Moldova (38%), Tonga (35%), Lesotho (29%), Honduras (25%), Guyana (23.5%) and Jamaica (19.4%).

- A sharp drop in the growth of international *tourism* worldwide in 2008 is reported by the World Tourism Organization (UNWTO).[8] After a 5% increase in the first half of the year, growth in international tourist arrivals turned negative (-1%) in the second half, and annual growth was an estimated 2%, down from 7% in 2007. It is expected that international tourism will stagnate or even decline slightly throughout 2009.

Finally, many developing countries that generate a large share of export earnings, government revenue and GDP from commodity production are confronted with failing export recipes.

- *Commodity prices* were very volatile in 2008, surging in most cases in the first half of the year but then reversing sharply as the financial and economic crises set in. In the second half of 2008, non-energy commodity prices declined by 38%, with substantial declines in food, agricultural raw materials and metals and minerals. Petroleum prices fell by 69% between July and December 2008. The IMF reports that commodity prices are unlikely to recover in the short run.[9]

In addition, there has been an outflow of domestic savings as investors from developing countries transfer their money to lower risk, newly government-guaranteed, financial markets in developed countries. In such an environment, developing countries will find it more difficult to raise capital and compete for resources with the governments of OECD countries seeking to finance their financial and fiscal stimulus programmes.

Aid levels have been the only positive development in 2008, when total net ODA from members of the OECD's DAC rose by 10.2% in real terms to USD 119.8 billion. This is the highest dollar figure ever recorded. Some further increases in aid can be expected. A DAC survey of donors' forward spending plans suggests an 11% increase in programmed aid between 2008 and 2010, including larger disbursements by some multilateral agencies.

Despite increased aid levels, the World Bank estimates that developing countries are facing a financing shortfall of between USD 270 billion and USD 700 billion in 2009; at the same time, external financing needs for developing countries are likely to increase because of falling export earnings.[10] Coupled with the need of many developing countries to finance existing private external debt, this is projected to lead to a sharp deterioration in the external payments situation in the second half of 2009. Low-income developing countries are particularly vulnerable because of their already weak balance of payments positions, mainly the result of the 2007 and early 2008 spike in global fuel and food prices.[11]

CRISIS RESPONSES

A variety of initiatives are underway – from national fiscal stimulus and financial support programmes, to co-ordinated global actions – aimed at reversing the fall in global aggregate demand and the contraction of international trade in goods and services. As part of these efforts, policy-makers have recognised the importance of actions to restore credit markets, including for traders in developing countries facing particular challenges in accessing trade finance at affordable rates. Trade openness is an important complement to these efforts. Trade restrictions act as a tax on incomes and production and thus contradict the main objective of programmes to boost real aggregate demand.

National fiscal stimulus

Most G20 countries and some other governments have announced substantial fiscal stimulus programmes aimed at boosting domestic demand. The IMF has recommended a global fiscal stimulus target of 2% of aggregate GDP each year for 2009-2010. According to the IMF, that target has not yet been met by the G20 countries for 2009 and there risks being a substantial reduction in discretionary fiscal stimulus in 2010. Nevertheless, several countries have implemented supplementary programmes of financial support for individual sectors or industries.

Some of the stimulus programmes include specific conditions that aim to reduce the leakage into imports and concentrate the stimulus effects on domestic firms and job creation. These conditions act in the same way as traditional import restrictions and produce the same effects: higher prices and less choice of goods and services purchased through the stimulus programme (*i.e.* lower value-for-money), along with less efficient allocation of resources and ultimately reduced competitiveness of the domestic economy. In short, restricting imports by attaching conditions to stimulus programmes taxes producers and income, and reduces the net impact of each programme on domestic and global aggregate demand.

National financial support

Governments at the centre of the financial crisis have provided unprecedented injections of public funds to their banking and financial services sectors. Their priority has been to guard against the systemic risk posed to the economy by the failure of large financial institutions and to revive the role that banks must play in transforming savings into investments and in allocating capital and credit to where they will be most productively used. There has also been an increase in state aid, including direct funding, special loans and guarantees, in some countries to support manufacturing industries, notably steel and automobiles.

In globally-integrated industries, such as automobiles, it has become more difficult and costly to try to target national problems of over-capacity or inefficiency by using trade restrictions or subsidies. Some governments are choosing instead to give assistance by channelling tax incentives or subsidies to consumers rather than to producers. An example is several European Union (EU) member states' programmes to provide cash grants or interest-free loans to consumers who "scrap" their old vehicles in 2009. As long as this kind of support is provided without restricting consumers' choice to buy domestic or foreign cars, these measures can result in both domestic production and imports of automobiles rising. This illustrates the general point that there is often more than one kind of economic policy that can be used to achieve a given objective. By considering the alternatives, governments can take account of, and often reduce, any adverse impact on trade while still achieving their primary objective.

Global actions

The G20 London Summit has greatly enhanced the role of the international financial institutions (IFIs) in the global efforts to combat the worldwide economic recession. The communiqué states that up to an additional USD 750 billion will be available to the IMF, in addition to a one-time Special Drawing Rights (SDR) allocation of USD 250 billion. Moreover, G20 leaders agreed to ensure the availability of at least USD 250 billion of trade finance over the next two years through their export credit and investment agencies and through the IFIs. At the London Summit, G20 leaders also reaffirmed their commitment to refrain from raising new barriers to investment or trade in goods and services, imposing new trade restrictions or implementing WTO inconsistent measures to stimulate exports.

In response to the crisis, the World Bank has established the Vulnerability Financing Facility to facilitate faster spending for the most vulnerable. The facility is composed of the following initiatives, mainly financed through existing internal resources: i) the Global Food Crisis Response Program with USD 1.2 billion; ii) the Financial Crisis Response – International Development Association (IDA) Fast Track Facility, which will fast track up to USD 2 billion; iii) the Rapid Social Response Fund to protect the poor and vulnerable in middle and low-income countries; and (iv) the Infrastructure Crisis Facility to stabilise existing infrastructure assets, ensure delivery of priority projects, support public-private partnerships and support new infrastructure development. The platform proposes direct International Bank for Reconstruction and Development (IBRD) and/or IDA funding of infrastructure projects of up to USD 15 billion per year.

The IMF proposes enhanced support for Poverty Reduction and Growth Facility countries[12] through the doubling of its concessional resources and a modified Exogenous Shocks Facility to provide assistance both to PRGF countries and countries without IMF programmes. The facility is a concessional lending facility with a *rapid access* window, which allows a country to access 25% of its quota for each exogenous shock, and a *high access* window for up to 75% of quota, subject to periodic reviews.

After the G20 summit, the EC adopted a EUR 314 million package of projects to support agriculture and improve the food security situation in 23 developing countries across the globe as part of the EUR 1 billion "Food Facility" adopted at the end of last year in response to the growing food security problems faced by developing countries. The EC also advanced EUR 3 billion, or 72% of the expected budget for African-Caribbean-Pacific (ACP) countries, to safeguard social expenses. In addition, the FLEX mechanism for ACP countries affected by terms-of-trade shocks will be operational before the end of 2009 with an overall financing envelope of least EUR 500 million (additional to the funds for the "Food Facility").

Parts of these initiatives – and in particular those focussed on adjustment support and maintaining investment in infrastructure projects – are related to the wider aid-for-trade agenda. More directly linked to the objectives of the Aid-for-Trade Initiative are, however, international efforts to address the crisis related shortage of trade finance in developing countries.

TRADE FINANCE

The drying up of global liquidity combined with a general re-assessment of risks by commercial banks led in the second-half of 2008 to a rise in the cost of trade finance instruments, such as letters of credit and, in some cases, to serious gaps between demand and supply.[13] According to trade-finance experts who met at the WTO in March 2009, there is an unmet demand for trade financing of between USD 100 billion and USD 300 billion on an annual and roll-over basis. In some countries foreign exchange has also become scarce. The situation has continued to deteriorate, mainly for North-South and South-South trade.

In co-operation with other multilateral and regional organisations, the WTO has mobilised various actors to shoulder some of the risk from the private sector and to encourage co-financing among the providers of trade finance. A two-track approach is being followed to: (i) find collective short-term solutions, notably by mobilising government-backed export credit agencies and international financial institutions, through their private-sector branches, operating mostly on commercial terms; and (ii) develop technical measures allowing for better interaction between private and public-sector players in the short and medium term, all of which aim at removing the obstacles to risk co-sharing and co-financing by various institutions.

The response of public-backed institutions has been positive and efforts have focussed on three areas:

- All regional development banks and the International Financial Corporation (IFC) have roughly doubled the capacity limits under their trade finance facilitation programmes, from around USD 4 billion to USD 8 billion, thereby financing potentially some USD 30 billion of trade involving small countries and small transactions (of USD 250,000 on average). The African Development Bank (AfDB) has launched a similar trade finance facilitation programme for Africa (see Chapter 5).

- Export credit agencies have also stepped in with programmes for increased guarantees, short-term lending of working capital and credit guarantees aimed at small and medium-scale enterprises. A few agencies have also opened liquidity windows. For certain countries, the commitment is very large for local firms. In other cases, co-operation is developing to support regional trade, in particular chain-supply operations.
- Central banks in countries with large foreign exchange reserves – where for one reason or another the private sector faces a shortage of liquidity in dollars – have been supplying dollars to local banks and importers. However, such facilities are unavailable to developing countries with lower foreign exchange reserves, unless they can arrange to swap foreign exchange against local currency with their main trading partners

The trade finance market is expected to continue to experience difficult times in 2009. This is why the World Bank Group has launched a global initiative to support trade in developing markets and address the shortage of trade finance. The *Global Trade Liquidity Pool* began operations in May, with targeted initial commitments of USD 5 billion from public sector sources. The programme should be able to support up to USD 50 billion of trade liquidity over the next three years. The programme has received commitments of USD 1 billion from IFC. The United Kingdom intends to make a contribution of up to £ 300 million; Canada announced commitments of USD 200 million and the Netherlands USD 50 million. The Japanese government recently announced a USD 1.5 billion trade finance initiative to be implemented by the Japan Bank for International Cooperation (JBIC).

At the institutional level, members to the OECD Arrangement on Officially Supported Export Credits adjusted the disciplines of the Arrangement to sustain trade and investment flows in two ways: i) by allowing more emerging-market countries to benefit from longer credit terms, and ii) by allowing greater government participation in private-sector syndications to facilitate the financing of infrastructure projects which might otherwise be postponed or cancelled.

TRADE-RELATED POLICY DEVELOPMENTS

There has been a marked increase in protectionist pressures since September 2008. The economic crisis has also drawn attention to standing legislation in the area of trade in agriculture that automatically or semi-automatically increases support to farmers whenever agricultural prices fall. This results in effects that are pre-programmed to reinforce the current contraction of trade. Examples of such measures are countercyclical payments and loan deficiency payments in the United States, and the recent reintroduction of export subsidies and the resumption of intervention purchases for dairy products by the EC.

Trade liberalisation and facilitation

At the same time, some governments have taken trade liberalisation and facilitation measures in the past six months, involving the reduction or elimination of import tariffs and export taxes and the expansion of trade-finance facilities. The purpose of these measures varies, but each one presents an example of trade policies contributing positively to help reverse the contraction of global trade and to stimulate aggregate demand by reducing consumer prices and producer costs. More trade policy initiatives of this kind, particularly if they were to be undertaken collectively by the major trading countries, would make an impact on a global scale.

A successful conclusion of the DDA would restore confidence in a moment of crisis and reinforce the stability and predictability of the global trading system. The Doha Round is arguably the most easily achieved – or the "lowest hanging" – global stimulus package available to the international community, and would complement the national stimulus packages that many countries have put in place. While national expenditure programmes mainly stoke domestic demand, the completion of the Doha Round would fuel foreign demand for a country's goods and services, through the concerted reduction in trade barriers, boosting the confidence of business and consumers in developed and developing countries alike.[14]

Trade distortion

The WTO secretariat has collected information on new import and export restrictions, trade-related subsidies and trade remedy actions that have been taken since September 2008. Many of these measures have been imposed only recently or are still in the process of being implemented, so their trade effects are not yet clear. As a general rule, measures that are transparent and non-discriminatory and that provide for procedural fairness are likely to be less costly for trade. WTO rules act as a check on the degree to which these measures can restrict trade flows. The current crisis, however, highlights the extent to which WTO rules and the individual market access schedules provide substantial room for trade restriction and distortion. This will continue at least until the Doha Round is completed.

Some governments have reacted to the crisis by imposing new trade-restricting and distorting measures. So far, there has not been a general trend in that direction, but a pattern is beginning to emerge of increases in import licensing, import tariffs and surcharges and trade remedies to support industries that have faced difficulties early on in this crisis. Reports of various kinds of non-tariff measures affecting trade, such as standards and technical regulations (including sanitary and phytosanitary [SPS] measures), are also rising. It would appear for the time being that this is due less to an increase in the number of new measures than to changes in the way in which existing measures are being applied and administered.

OFFICIAL DEVELOPMENT ASSISTANCE

In 2008, total net ODA from members of the OECD's DAC rose by 10.2% in real terms to USD 119.8 billion. This is the highest dollar figure ever recorded. Bilateral development projects and programmes have been on a rising trend in recent years; however, they rose significantly by 12.5% in real terms in 2008 compared to 2007, indicating that donors are substantially scaling up their core aid programmes.[15]

In 2005, donors committed to increase their aid at the Gleneagles G8 and UN Millennium +5 Summits. The pledges, combined with other commitments, implied lifting aid from USD 80 billion in 2004 to USD 130 billion in 2010, at constant 2004 prices. While a few countries have slightly reduced their targets since 2005, the bulk of these commitments remain in force. The same honouring of commitments is noticeable in aid for trade (see Chapter 3). However, reduced growth in 2008 and the prospect of continued economic contraction in 2009 will reduce the dollar value of commitments expressed as a percentage of national income.

Overall, the current commitments imply an ODA level of USD 121 billion in 2010, expressed in 2004 dollars, or an increase of USD 20 billion from the 2008 level. Some further increases in aid can be expected. A new survey of donors' forward spending plans suggests an 11% increase in programmed aid between 2008 and 2010, including larger disbursements by some multilateral agencies. However, the current outlook suggests that at least USD 10-15 billion must still be added to current forward spending plans if donors are to meet their current 2010 commitments.

The 2008 ODA data as well as forward spending plans suggest that with further effort, most donors could still reach their 2010 targets. The countries that have already met the UN ODA target of 0.7% of gross national income (GNI) are expected to continue to do so. However, a few countries are likely to fall short. For example, ODA in 2008 from Austria, Italy and Greece, excluding debt relief, is well under half their ODA/GNI target for 2010.

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 stood at USD 25.4 billion, while non-concessional lending provides an extra USD 27.3 billion in trade-related financing. Based on donors' indicative forward spending plans, continued growth of aid for trade is expected over the medium term. A special crisis-related effort can ensure that these plans are realised, which is even more important now that the economic crisis is reducing developing countries' growth prospects and their ability to make progress towards the MDGs.

Countercyclical aid

While the full effects and duration of the economic crisis are still to be seen, it is important for aid to play a countercyclical role and help balance the sharp reversal in overall flows to developing countries. ODA has played such a positive counter-cyclical role during some previous financial crises. After the 1982 Mexican debt crisis, commercial lending was significantly reduced for about a decade, yet ODA rose slightly during this period, playing a strong role in maintaining capital flows to Latin America. However, the global economic recession in the early 1990s produced large fiscal deficits in donor countries that led to deep cuts in ODA, which fell from 0.33% of GNI in 1992 to 0.22% in 1997.

Aid cuts at this point in time would place a dangerous additional burden on developing countries, which are already facing restricted sources of income and increased poverty, and perhaps undo some of the progress developing countries have made towards meeting the MDGs. At the end of 2008, DAC members pledged to honour their commitments on the invitation of the OECD Secretary-General, and the Chair of the DAC. More recently, the World Bank and IMF have launched new calls for increased aid funding. However, ensuring that aid acts as a counter-cyclical force will require strong political will and co-ordination at the global and country level.

Raising the quality of aid is just as important as raising its quantity. The Accra Agenda for Action, endorsed in September 2008, contains commitments to make aid more effective and offers a unique framework to ensure a global co-ordinated response to the crisis. The Accra Agenda sets out three broad challenges: (i) strengthening country ownership; (ii) building more effective and inclusive partnerships; and (iii) delivering, and accounting for, development results. Clearly, these challenges also apply to the delivery of aid for trade. While there is a need to press ahead with those undertakings, three sets of actions need to be prioritised: (i) removing barriers that hinder rapid disbursement; (ii) increasing the predictability of aid; and (iii) addressing excessive fragmentation of aid.

Removing barriers that hinder rapid disbursement

Ensuring swift disbursements of existing aid commitment at country level is vital to closing the public expenditure gap in developing countries. In seeking rapid disbursement the Accra Agenda underscores the value of increasing the proportion of aid that is provided through so-called programme-based approaches. The Accra Agenda commits donors to making more use of programme-based approaches, which have also the merit of reducing fragmentation by using country systems for planning, budgeting and implementation. The World Bank notes that almost three quarters of developing countries are deemed to have the institutional capacity to effectively absorb at least some scaling up of budget support.

Increasing the predictability of aid flows

The crisis makes the predictability of aid in the short and medium term both more important and more difficult: more important, because partner developing countries have to be able to plan and implement critical measures to safeguard the vulnerable and to re-launch growth: more difficult, because donors are in dire fiscal straits. Managing this tension will require vision, commitment and transparent information. DAC members, in addition to providing information on their immediate commitments, should review their medium-term spending plans and share these on a regular and timely basis with partners.

Addressing excessive fragmentation of aid

Reducing the costly fragmentation of aid becomes even more important when ODA flows are expected, at least in the short term, to increase in response to severe needs, and where there is pressure within individual agencies to disburse rapidly. DAC members should reassert, by action and statement, their willingness to follow partner countries' leads in reducing fragmentation and to follow best practices in the division of labour.

WHY AID FOR TRADE MATTERS MORE

The progress in aid for trade – as noted in this report – pertains to a very different global economic environment, where the benefits of trade, and its importance in the context of a comprehensive and coherent development strategy seemed assured. This environment has changed dramatically. As set out in this chapter, world merchandise trade is likely to shrink some 9% in volume terms in 2009, with developed economy exports falling by some 10%, on average, and developing country exports dropping by 2-3%. The credit crunch has limited the availability of finance for trade and infrastructure investment. Moreover, lower commodity prices have diminished the returns from trade in some developing countries and reduced the incentives for private sector involvement. The crisis has increased poverty; the number of chronically hungry people is now in excess of one billion. With more needs generated by the global economic recession and a declining pool of resources, how can the aid-for-trade rationale be strengthened?

The original rationale for aid for trade - to assist developing countries to better connect to the global marketplace - is still important. Addressing behind the border issues and infrastructure constraints are long-term goals, which are essential for poverty reduction programmes. In addition, aid for trade can have an immediate stimulus effect, averting the worst consequences of the downturn, while laying the groundwork for a more stimulating business environment; assisting producers in partner countries to effectively participate in local, regional and international markets. In Asia, where the most important examples of recent export-led growth are found, emphasis has shifted towards developing domestic demand, through social safety nets, infrastructure and regionalism.[16] These kinds of reorientations create opportunities for the Aid-for-Trade Initiative and will strengthen the potential contribution of trade to the growth and poverty reduction objectives of low income countries.

Aid for trade has a long-term perspective

While the crisis creates short-term problems for partner countries, aid for trade has a long-term time horizon. The crisis has highlighted underlying vulnerabilities in developing countries, which aid for trade aims to address. By reducing supply-side constraints, increasing competitiveness, diversifying their productive capacity and reducing trade costs, aid for trade can help low-income countries overcome barriers that constrain their ability to grow. This agenda is particularly important in the current economic climate – it is essential to get the enabling environment for growth right. These structural economic adjustments take time, but progress needs to be maintained. Otherwise the poorest countries are likely to remain poor long after this crisis has past.

Aid for trade is part of the wider development agenda

Aid for trade is essential to achieve other important policy goals. For example, measures taken to boost agricultural productivity and food production will not succeed as long as producers are not connected to local and regional markets. This lack of connectivity harms producers by diminishing their competitiveness. In addition, inadequate storage and distribution infrastructure decimates already low yields in partner countries with 30-40% of produce lost due to a lack of storage. These and other aid-for-trade needs have to be addressed with some degree of urgency. In fact, the aid-for-trade agenda greases the wheels of the partner country economies and the initiative is a critical component in addressing growth and poverty reduction challenges beyond the trade realm.

The objective remains, but priorities may change

Until now, the focus of the initiative has been primarily on increasing the benefits of international trade. Aid for trade, however, is well suited to foster a more bottom up approach where binding constraints are addressed, diversification supported and the business and regulatory reforms tailored to increase competitiveness. By connecting producers and business to local markets, building strength and synergies over time, producers could become more specialised, develop comparative advantages and enhance their price competitiveness, better enabling them to penetrate international markets.

Behind the border Issues

The main barriers to trade in developing countries and LDCs remain regulatory and infrastructural in nature. The likelihood that countries will take advantage of trade largely depends on institutions and the business and regulatory environments (Chapter 6). Furthermore, in low-income countries trade facilitation can be at least as important as further reduction in trade tariffs in boosting trade. Maintaining and improving developing countries' access to markets is therefore a key element of the development agenda. Improvement of trade-related infrastructure, finance, regulations and logistics such as customs services and standards compliance are necessary in order to reduce trade costs associated with behind the border issues.[17]

South-South trade and regional trade

South-South trade is likely to continue to expand. As emerging markets have grown, their demand for food, energy and commodities from other partner countries has increased. Emerging markets have declined less in the last six months than those in developed countries. This would seem to be a good time to renew efforts to further develop and diversify south-south trade, which in the long term would benefit most developing countries, ending over-reliance on the markets of rich countries and creating multiple sources of growth.

Aid for trade as stimulus

In the context of the economic crisis, prioritising infrastructure, behind the border issues and regional and local trade seems to be the most effective way to reignite economic growth and reduce poverty. Infrastructure projects can stimulate the economies of partner countries, providing an immediate boost for their economies, creating opportunities for local employment, strengthening local suppliers and producers and creating positive impacts around the economy through the multiplier effect. The World Bank estimates that the highest multipliers in terms of developing country responses would come from increased infrastructure investment and support for SMEs and microfinance, all of which require aid-for-trade support.

CONCLUSIONS

Since the recession began to take hold in the fourth quarter of 2008 there has been little cause for optimism in the outlook for trade in 2009. Despite the large size of the expected drop in world trade, there remain substantial additional downside risks. Further adverse developments in financial markets could prolong the current crisis, as could a surge in protectionism. Recovery, particularly for developing countries, could be slower than expected if household consumption does not return to a more normal growth trend soon.

Although ODA levels and aid-for-trade flows have, so far, remained unaffected, special crisis-related efforts are called for, including assuring medium-term aid predictability, avoiding aid fragmentation and addressing barriers that hinder rapid disbursement. In order to realise their full potential, these actions will need to be complemented by efforts to strengthen country ownership and mutual accountability mechanisms. This is even more important now that the economic crisis is reducing developing countries' growth prospects and their ability to make progress towards the MDGs.

Trade has been a powerful engine for growth and, depending on the pace and pattern, has significantly helped reduce poverty. Maintaining and improving developing countries' access to international markets remains of paramount importance. Supporting low-income countries to benefit from these opportunities through aid for trade is equally important.

Aid for trade is needed now more than ever. In the short run it will provide much needed stimulus, through increased infrastructure investment, support for SMEs and microfinancing. These measures have a high multiplier effect and will avert the worst consequences of the global economic downturn. In the longer run aid for trade addresses major impediments to growth by removing supply-side constraints and improving the regulatory and business environment. In addressing underlying vulnerabilities aid for trade will assist partner countries in dealing with broad growth and poverty reduction challenges, overcome long-term constraints and help their economies become more resilient with diversified sources of growth.■

NOTES

1. OECD Economic Outlook: An Interim Report, March 2009

2. WTO: PRESS/554, 23 March 2009.

3. WTO Job(2009)30

4. DCD/DAC(2009)12/REV1

5. The Institute for International Finance estimates that net capital flows to emerging economies have declined to USD 467 billion in 2008, half of their 2007 level. It is projected that they could decline in 2009 down to USD 165 billion, less than one-fifth of their 2007 level. (Institute for International Finance, Capital Flows to Emerging Market Economies, 27 January 2009).

6. UNCTAD Investment Brief, Number 1, 2009.

7. World Bank, "Migration and Development Brief 8", 11 November 2008. The Inter-American Development Bank (IADB) reported that remittances to Latin America and the Caribbean countries are expected to decrease in 2009; data for January 2009 shows that remittance flows fell by between 11 per cent and 13 per cent (SELA Servicio Informativo, 16 March 2009 and BBC Mundo.com of 17 March 2009).

8. UNWTO World Tourism Barometer, Vol.. 7, No.1, January 2009. Figures reflect international tourist arrivals only (excluding domestic tourism), for which comprehensive data is available.

9. IMF, "The Implications of the Global Financial Crisis for Low-Income Countries", March 2009.

10. World Bank "Swimming against the Tide: How Developing Countries are Coping with the Global Crisis" report prepared for the G20 Finance Ministers and Central Bank Governors, 13-14 March 2009, and World Bank News Release No. 2009/245/EXC.

11. IMF, "The Implications of the Global Financial Crisis for Low-Income Countries", March 2009.

12. The Poverty Reduction and Growth Facility (PRGF) is the IMF's low-interest lending facility for low-income countries. As of August 2008, 78 low-income countries are eligible for PRGF assistance. Loans have an interest rate of 0.5%.

13.IMF survey data suggest spreads above the London Interbank Offered Rate (LIBOR) have increased by some 25 to 300 basis points per annum, and in some cases as much as 600 basis points. (http://www.imf.org/external/pp/longres.aspx?id=4318)

14. WTO DG Lamy, "Reconciling America with an open trading system", Washington, D.C., 24 April 2009

15. http://www.oecd.org/document/35/0,3343,en_2649_34447_42458595_1_1_1_1,00.html

16. This bottom up approach aims to create "a stronger and more resilient regional economy, with multiple sources of growth, [which] will also contribute to a stronger, more vibrant and more resilient global economy" (President Kuroda At the Opening of the 42nd Annual Meeting of the Board of the Governors of the Asian Development Bank, May 4th 2009)

17. Global Monitoring Report 2009: A Development Emergency (2009), World Bank, Washington, D.C. .