

# BRIEFING PAPER

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## TrAid: What Future For Developing Countries?

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**Francesco Rampa\***

### Trade negotiations and Aid for Trade

Developing countries (DCs) are involved in a number of trade-related international negotiations with potentially significant implications for future development. Drawing a parallel with the liberalisation talks at bilateral and regional levels, the most important is the World Trade Organisation (WTO) Doha Round and, for African, Caribbean and Pacific countries (ACP), the Economic Partnership Agreements (EPAs) with the European Union (EU).

Many fear that with these new waves of liberalisation the abstract long term gains for DCs will come at high short term costs, with possible loss of fiscal revenues and other restructuring costs, loss of policy space for national development strategies, loss of preference margins, and expensive requirements to implement regulatory harmonisation in areas of standardisation and trade facilitation. In particular, there is growing concern that without removing supply-side constraints and improving the competitiveness of DCs, internal trade-related reforms and improved market access abroad will not translate into economic development and poverty reduction. While trade rules and trade negotiations are key elements for the trade and development linkages, DCs are unlikely to benefit from trade if no real improvements occur in terms of modern and efficient customs, roads and ports, infrastructure and institutions which are needed to meet standards in export markets, information about markets, and so forth. They would be left with the risks from trade liberalisation.

These concerns have spurred a debate, increasingly at the core of broader international discussions on aid and North-South relationships, on what is required to make trade liberalisation an acceptable instrument for development. Adopting a broad definition of 'aid for trade' (AfT) as the required trade-related donors' assistance and institutional support across a range of areas, this paper focuses on Europe and its economic relations with the ACP and the lessons that can be drawn from this case for the multilateral debate on aid for trade.

### EPAs: Searching for the Development Dimension

The ACP-EU relations, governed by successive Lome Conventions and currently the Cotonou Agreement (CA), have always been a comprehensive partnership, and one of the first between developed and developing countries to establish tight linkages between trade and development issues. And this is being explored further: the EPAs currently negotiated between the EU and the ACP regions should first and foremost

be development-oriented free trade arrangements (FTAs). Placed in the context of the overall development strategies of ACP countries and the objectives defined in the CA, EPAs should build on and strengthen regional integration initiatives, facilitating the integration of the ACP countries into the world economy and stimulating their economic development and growth, with a view to contributing to sustainable development and poverty alleviation. These objectives are not only stated in the CA, but have been restated numerous times, by the EU, the ACP countries and various actors from civil society.

Three years after the start of the negotiations (in September 2002), one would have expected an emerging consensus between the parties on the practical way forward to integrate the development dimension into EPAs. Yet, sharp differences still prevail on the approach to development in these negotiations, creating tensions and frustrations among the parties.

For the European Commission (EC), EPAs will foster development mainly through trade liberalisation, creation of the right policy framework for trade liberalisation and to attract investment. By creating free trade areas (FTA) with the EU, the ACP countries will benefit from the standard gains from trade such as increased market access to the EU, reduced prices of EU imports for ACP consumers and associated competitive effects should foster economic growth and hence development. In addition, by building on the ACP regional integration processes, EPAs should contribute to the establishment of effective regional markets in the ACP, thus attracting and stimulating (both domestic and foreign) investment, a necessary condition for sustainable development.

According to the EC, these positive effects will be reinforced by several elements. EPAs will not only address tariff barriers, but also non-tariff and technical barriers to trade, as well as a number of trade-related "behind the border" measures (such as trade facilitation, competition, investment, etc.), thus increasing the benefits from trade. EPAs will not only cover trade in goods and agricultural products, but also in services (for some ACP countries services constitute an increasingly significant sector). With its comprehensive coverage, the new partnership should therefore also contribute to lock in policy reforms in the ACP, increasing the relevance and credibility of their regional integration process and facilitating their integration into the world economy. Last, but not least, EPA negotiations should be accompanied by discussions on the development assistance available for the ACP, as well as possible complementary support by other donors.

\* Programme Officer, European Centre for Development Policy Management (ECDPM). The views expressed in this paper are those of the author and do not necessarily represent the views of ECDPM.

## Directions of Doha Development Agenda

The Doha Development Agenda (DDA) is the first round of multilateral trade negotiations explicitly devoted to the promotion of development and the alleviation of poverty. Every element of the Agenda refers to the need to take the problems and interests of developing countries into account, and the linkages between aid and trade are often emphasised. It is now clear that for most developing countries to accept trade liberalisation as an instrument for development, trade agreements should be accompanied by support for them. The key areas of support would be to negotiate, implement the required policy reforms and to adapt their economies to benefit from new export opportunities. Recent research has also showed that for many poor countries, DDA will not deliver large immediate benefits, but gains could be generated in the long run through complementary measures, particularly improved infrastructure and increased productivity of the poor.

Source: Hertel and Winters in World Bank Global Monitoring Report 2005: Chapter 4

While most of the ACP countries would agree with the EU on the development opportunities entailed in an EPA, they tend to consider trade liberalisation and regional integration as necessary, yet far from sufficient conditions to foster development and alleviate poverty. In other words, creating large open regional markets and increasing export opportunities for the ACP are only factors of potential development, which require additional conditions to be beneficial. In particular, ACP economies need to have the capacity both to benefit from increased market access and to face greater competition domestically. Trade liberalisation should be accompanied by development support to address supply-side constraints, as well as related institutional and structural weaknesses. This support should be determined by and synchronised with the EPA negotiation and implementation processes. Proper sequencing of liberalisation commitments and implementation with development support is also of prime importance.

The trade-related assistance should indeed be timely and efficiently delivered to coincide with the needs and challenges faced by the ACP (for certain regions and it might need to come before the implementation of trade liberalisation). In addressing these issues, all ACP countries have noted an increasing dichotomy between the political rhetoric at the EU level, where the pro-development component of EPAs is repeatedly emphasised and the pragmatic approach adopted by EC trade negotiators, who focus on a narrower definition of development based mainly on trade-related gains, thus avoiding, according to some ACP negotiators, substantive discussion on the broader development dimension of EPAs. The ACP have continuously stressed that high adjustment costs may even negate the benefits from market liberalisation through an EPA: fiscal reform to face the loss of import revenues, adjustment measures for loss of competitiveness and restructuring of domestic industries, institutional development (to address issues such as compliance with food and safety standards, harmonisation of custom procedures, etc.), etc.

These concerns and the perceived lack of concrete steps on the EU side to address them are causing a mounting frustration on the ACP side, that was recently expressed strongly at the highest political level: "the negotiations have not proceeded in a satisfactory manner having failed to start addressing most issues of interest and concern to the ACP regions, in particular the development dimension and regional integration priorities"<sup>1</sup>. Though obvious differences exist, similar discussions and tensions over the development dimension of trade take place at WTO, involving all developing countries.

## WTO: Is Additional Aid the Development Dimension?

In the last two years, AfT debate has gained importance in the overall development discourse, especially in the context of

multilateral trade negotiations. An increasing number of initiatives focused on extending special financial facilities to low-income countries to help them finance adjustment costs and strengthen supply/trade capacity while undertaking trade liberalisation. IMF announced in 2004 the Trade Integration Mechanism to help countries expecting short-term balance of payments difficulties in coping with the effects of multilateral liberalisation (IMF, April 2004). In 2005, the UNDP proposed a temporary AfT Fund and the British government proposed the establishment of a Trade Adjustment Facility.

Most contributions to AfT have come from multilateral institutions<sup>2</sup>, and the views currently prevailing in the debate<sup>3</sup>, supported especially by the WB and IMF, focus on three elements:

- AfT resources should be in *addition* to existing aid levels and come from reforms (for instance the EU's CAP) or from gains from trade in rich countries *in the context of ongoing trade negotiations*;
- new resources should be *channelled through existing frameworks* (in particular the Integrated Framework), without creating new mechanisms;
- more *involvement of the private sector* in design and delivery of AfT is crucial

Many see the need for more and better input from DCs in defining the AfT agenda, particularly in terms of EPA and WTO trade reforms. More proposals from DCs should be put forward on what are the options for delivering aid for trade and whether mechanisms already in place constitute the right AfT framework.

The additional adjustment costs entailed in further trade liberalisation do point to the need for more resources. Such adjustments should not come at the expense of other legitimate development concerns already addressed through aid (infrastructure development, education, health, etc.), which may play a more vital role in ensuring sustainable development and poverty alleviation than a new trade regime. However, additional resources (channelled through existing mechanisms with an increased private sector involvement) are unlikely to constitute the solution to the problems captured in the AfT discussions (in WTO and EPA alike). A number of points regarding all three elements outlined above should be taken into account in this debate.

*Firstly*, there are good reasons to believe that AfT is fundamental by itself to make trade work effectively for development and additional resources *should not be linked to the outcome of ongoing trade negotiations*. The programme of TRCB addresses supply-side constraints and implement existing trade-related aid projects. TRCB is still needed by many DCs to fully benefit from Uruguay Round liberalisation, in addition to facing the challenges and opportunities from the DDA. Some stakeholders fear that additional aid will be used as

leverage for convincing DCs to sign off DDA. To avoid a sort of ‘broad conditionality’ outcome, the ambition and results of the DDA could be separated from the debate and results on ‘AFT’. On the other hand, issues of accountability and effectiveness in recipient countries are still valid, so governance will have to be strengthened as part of AfT initiatives; in this way additional funds will have the lowest level of ‘project-specific conditionality’ as possible. On the same note not only should AfT not be a substitute for special and differential treatment for DCs in trade rules<sup>4</sup>, but also it should not be conceived as compensation for negotiation outcomes allowing certain developed countries to maintain significant barriers to exports of goods and services from DCs.

*Secondly*, channelling any additional resources *through existing frameworks* (in particular the IF) may not be the most effective solution for AfT delivery. Creating new mechanisms should be considered. There are certainly many aspects of the IF that could be improved: better integration into donor programming; concrete instruments for participation by dynamic private sector agents; and strengthened ownership and implementation capacity by recipient governments. In addition, using current Poverty Reduction Strategy Papers frameworks with the related macroeconomic assumptions as in the IF case for all AfT initiatives may be problematic as often the policy prescriptions from such approach are based on targeted export growth figures. Export growth does not occur simply through market access and would exactly require first the removal of S-S constraints (through AfT). Possibly the most serious concern with the proposal of using the IF as the instrument for multilateral AfT is that IF is accessible only to LDCs. All developing countries, and particularly the small and vulnerable, need both a diagnostic phase for trade-related needs and the implementation of projects to address S-S constraints. The objectives of the IF are valid for all, not only LDCs<sup>5</sup>.

*Thirdly*, in terms of *stakeholders’ involvement* in AfT, it is not clear why only the private sector should participate more. A lot remains to be done to improve the effective contribution of national governments in the design and delivery of AfT. Moreover, the type and number of actors and institutions involved in AfT could be expanded. Not only existing IF’s members but other organisations and agencies like United Nations Industrial Development Organisation (UNIDO) or the Regional Economic Communities could be involved in AfT decision-making. Participation of civil society during the implementation phases may also be justified. In general, more “competition of ideas” among stakeholders would make AfT initiatives more effective and tailored to the local context.

#### Need for Trade-related Capacity Building

In recent years, multilateral and bilateral aid donors have increasingly made available ‘Trade-related Capacity Building’ (TRCB) funds for overcoming problems in exploiting trading opportunities. An example of this type of aid is the Integrated Framework (IF) for Trade-Related Assistance. This programme brings together the key multilateral agencies – the International Monetary Fund, the International Trade Centre, United Nations Conference on Trade and Development, United Nations Development Programme, WTO and the World Bank – to generate a broad-based policy agenda for trade and growth consistent with a country’s development strategy, and to prioritise capacity building needs to which bilateral and multilateral donors respond. Moreover, in response to the DDA, most donors increased their activities in the areas of TRCB through contributions to multilateral programmes and trust funds like the DDA Global Trust Fund.

It would be relevant to include the above issues in the discussions taking place on AfT during the upcoming 6<sup>th</sup> WTO Ministerial Conference in Hong Kong. It could be the first occasion for DCs to strongly emphasise that multilateral AfT is not only about pledging additional aid but should also entail concrete improvements in related mechanisms and institutions as well as in participation of DCs. This will be crucial to ensure that additional assistance is successful, which requires AfT to be long-term oriented, demand driven, and targeted at the most appropriate level within recipients countries (regional-national-local).

#### TrAid: What lessons from the ACP-EU relations?

In the context of North-South relations, the Cotonou Agreement between the ACP and EU is a unique partnership, for at least three reasons. It is comprehensive, encompassing three dimensions of the partnership: political issues, trade and economic cooperation, development assistance. Moreover, the EU (Member States and EC) with its Overseas Development Assistance constitutes the largest donor in the world. Finally, as seen above, the significant linkages between trade and development have always been acknowledged and promoted through the CA and are becoming even more central now with EPA negotiations.

It is worth comparing the experience of trade and development linkages under the Cotonou framework with the current debate on multilateral mechanisms for ‘aid for trade’. ACP-EU relations may provide some lessons, and synergies between EPA and WTO negotiations in terms of AfT could be identified. The broad scope of EPAs beyond market access to cover trade-related issues and behind the border measures corresponds to the increasing ambition of WTO talks. DCs are likely to face similar problems in both arenas for implementing such comprehensive agreements. Related AfT needs in terms of adjustment costs and accompanying measures may coincide and EPAs could represent a benchmark to be used in multilateral discussions on AfT, given that the Cotonou framework as a trade and aid strategy has been in existence for several years and EPAs are likely to be implemented before the DDA results start to be enforced.

With respect to possible lessons, the ACP-EU relations highlight:

- the complexity of managing different aid instruments at different levels (national and regional) and the value addition that such a range can offer if synergies and complementarity can be achieved;
- the importance of coordination mechanisms between all involved institutions (EC and EU Member States sometimes have overlapping donors programmes);
- the weak capacity of developing countries to fully participate in design and implementation of aid projects (particularly to quantify trade liberalisation costs and identify national priorities for accompanying measures), and to take on the complex requirements imposed by many donors;
- (legal) security of funds, multi-annuality of financial envelopes [like the European Development Fund (EDF)], partnership principles, joint management by donors and recipients (forming the basis of Cotonou Development Co-operation) are potential key to success;

## Europe Aid

Europe is the biggest donor in the world [EU's ODA for 2005 stands at €46 bn] and is increasing both overall assistance (up to €90 bn in 2015 in an effort to reach the UN target of 0.7 percent ODA/GNI) and aid for trade funding [last June the EC pledged to increase AfT to €1 bn per year as part of a refocusing exercise of development funds]. If multilateral AfT debates will result in further mainstreaming trade in ODA, then decisions by EU as a donor to ACP countries (nearly half of the developing WTO members), will have a major impact on trade and development at the global level.

- the importance of careful sequencing of implementation of trade reforms and development support, since assistance affects not just negotiations such as for EPAs, but also the capacity to implement any agreement;
- when joint management of aid results in comprehensive consultative processes involving private sector and civil society ('non-state actors' in the CA) ownership of aid decisions is maximised;
- the importance of effective and timely delivery of development support, as donors and recipients should concentrate on quality, and not on quantity of aid only;
- in terms of experience with EDF, the major bottlenecks in aid disbursement procedures are found in: complex institutional settings; risk aversion and focus on accountability, and not on achieving policy objectives; heavy reporting/auditing requirements; the financial regulations prepared/approved without sufficient contributions from technical officials involved in implementation; the procedural uncertainty and different interpretations from different stakeholders leading to slow programming and delivery of funds, lack of harmonisation of procedures across different aid instruments.

It would make sense to take into account these issues and the concrete outcomes from EPAs in terms of development and trade while designing multilateral frameworks for AfT. First of all it is important to bear in mind that development does not simply mean additional resources. The development dimension of trade agreements should be included in the trade and trade-related provisions, in the accompanying measures and policies to facilitate the preparation, negotiation and implementation of agreements, as well as in timely and effective processes for support delivery. To this end, EPA shows the urgency of both greater coherence and complementarity of trade and development policies by donors and of specific proposals on AfT by DCs (following systemic needs assessment and based on well defined national development objectives). This may require first a strengthening of the capacity of DCs to design effective development measures accompanying trade liberalisation and to participate in development policy management as well as thorough discussions among donors on how to improve their aid delivery performance. New multilateral AfT mechanisms should solve and not replicate existing bottlenecks to aid effectiveness. At the Hong Kong Ministerial and in subsequent discussions within the WTO, specific amendments to existing funding instruments should be identified and innovative thinking is required to make AfT a real contribution to development and not a mere pledging exercise. This calls for comprehensive participatory processes within DCs, including different ministries of national governments, regional integration organizations and civil society at large, both to identify the best AfT frameworks and to propose priorities for spending.

In terms of both trade & development policies and practice, the EU-ACP experience (with both achievements and problems) could be a useful learning tool, starting from principles (like partnership and multi-annuality, joint management, security of funds) down to procedural matters (in terms of timing, sequencing, capacity, complementarity, and administration of development cooperation).

## References

- 1 'Declaration of the 81st Session of the ACP Council of Ministers' on the progress in EPA negotiations (Brussels, 21-22 June 2005), available at [http://www.acpsec.org/en/com/cou81\\_decisions\\_e.pdf](http://www.acpsec.org/en/com/cou81_decisions_e.pdf)
- 2 See for instance "Aid for Trade: Competitiveness and Adjustment," Joint Note by the Staffs of the IMF and the World Bank, 12 April, 2005; Hoekman, Bernard, "Strengthening the Global Trade Architecture for Development," World Bank Policy Research Working Paper, 2002; UNCTAD Least Developed Countries Report 2004: Chapter 7; Integrated Framework for Trade-Related Technical Assistance.
- 3 For a comprehensive discussion see Prowse, Susan. May 2005 (Draft Version). "Aid for Trade: Increasing Support for Trade Adjustment and Integration – a Proposal." Available at: <http://www.ictsd.org/dlogue/2005-07-01/Docs/Susan%20Prowse%20CONCEPT%20PAPER%20DRAFT.pdf>
- 4 On the contrary, trade rules may need to be amended in order for AfT to be effective. For instance (S&DT) time and product coverage for DCs' liberalisation may have to be reviewed (if AfT finances fiscal reform to face adjustment costs, then a government will have to wait this is completed before trade liberalisation is implemented).
- 5 Though there is also a need for more articulated differentiation among developing countries (for instance Malaysia doesn't need the same aid as Kenya, and Burundi probably needs more than Kenya); and AfT initiatives (any enhanced IF for example) will have to take this into account.

