

## Aid for Trade *A Perspective from South Asian LDCs*

— Selim Raihan\*

### Introduction

Over the years, lack of trade-related infrastructure facilities and deficiency of knowledge on market access potentials in the developing countries, especially in the least developed countries (LDCs), have deprived them from gaining through greater openness. The costs of trade liberalisation in terms of, for example, preference erosion, impact of increased food prices for net food importing developing countries (NFIDC), adjustment costs during economic policy changes with resource reallocation and impact on shaping national development policies, signifies the need for assistance for the developing and the LDCs.

International aid circulating from the developed to the developing and the LDCs is not new. Along with its other bilateral and multilateral characteristics, there is a common ideology that international assistance comes with some development strategies, designed by the developed country experts in most of the cases. However, in the multilateral trade negotiation under the WTO talks, a concept of Aid for Trade (AFT) has been incorporated in the Hong Kong Ministerial Declaration for the first time, as a special and committed assistance aimed at fostering trade. AFT has an initial objective of helping specially the LDCs and also the developing countries to maximise the benefits from enhanced market access as well as to minimise the costs of trade liberalisation. This new part of negotiation is subject to a relatively short time for preparation in terms of definition, distinction between provisions for developing and thereafter, reaching an agreement under the ongoing Doha Round of negotiation by the WTO Members.

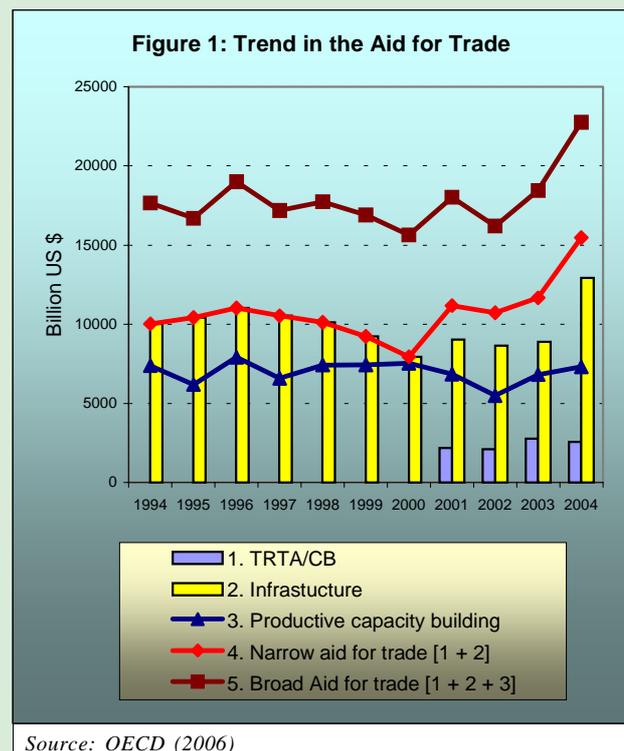
AFT is, therefore, considered as a comprehensive package, which is believed to promote growth and development in the developing and LDCs. The rationale of AFT is to ensure the balanced market access in agriculture, industrial goods and services through significant investment on infrastructure and institutional developments in the developing and LDCs.

Studies have indicated that the South Asian LDCs, especially Bangladesh and Nepal, are likely to face significant preference erosion and adjustment costs as a result of the implementation of different multilateral trade negotiations on agricultural and non-agricultural commodities. Also, these countries lack appropriate

infrastructure and institutions, which are vital for reaping maximum benefits from trade. Therefore, AFT is, no doubt, a very crucial issue for the South Asian LDCs.

### Background of AFT

After the formation of the WTO, there was an initiative in 1997 for strengthening LDCs' trade capacities and this is known as the *Integrated Framework for Trade-Related Technical Assistance to the Least Developed Countries (IF)* supported by six donors, the IMF, ITC, UNCTAD, UNDP, the World Bank and the WTO, with OECD/DAC as observer. Although the amount of aid for trade-related technical assistance and capacity building has increased significantly from the beginning of the Doha Round in 2001 (see Figure 1), at the end stage, to make it really pro-developmental, the Hong Kong Ministerial Declaration included AFT as a formal clause in Article 57.



Source: OECD (2006)

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In response to the requests from G-7 and G-8 finance and development ministers, the World Bank and IMF jointly proposed the AFT package to assist developing countries, especially LDCs, in achieving the objectives of the Doha Round. The aim of the package was 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.

The rationale for aid targeted to trade expansion can be two fold:

- aid flows in terms of international economic cooperation most of the times are unpredictable, attached to specific conditionalities, incorporate lack of coordination among the donors, and there is uncertainty relating to ownership of the recipient country; and
- international assistance in general has a small allocation for trade related development.

Therefore, the objectives of the proposed aid for trade package are to address supply-side constraints in developing countries in taking advantage of the enhanced market access facilities arising from trade liberalisation, and to assist them in coping with the adjustment cost of trade liberalisation, including costs of preference erosion, of higher food prices, of implementation of WTO agreements, and of tariff revenue losses.

### **Operationalising AFT under the WTO**

The Director General of the WTO formed the Task Force for Operationalising AFT in February 2006 with 13 member countries/regions to provide recommendations to the WTO General Council by July 2006. The objectives of the Task Force were to examine the scope of existing AFT, outstanding needs or gaps, the kind of delivery mechanisms needed to address those gaps, and how AFT could contribute to the development dimension of the Doha Round. The Task Force was set for encouraging concrete and result-oriented proposals and communications from different international agencies and country groups. After considering the scope and mechanisms for AFT and receiving submissions from both international organisations and WTO Member countries, the WTO AFT Task Force submitted its recommendations to the WTO General Council of 27-28 July 2006. The General Council took note of them and formally considered them in October 2006.

The Task Force recommended that Aid for Trade cover six broad categories:

- Trade Policy and Regulations*, which includes training trade officials, helping governments implement trade agreements, and complying with rules and standards.
- Trade Development*, which includes providing support services for business, promoting finance and investment, conducting market analysis and e-commerce.
- Trade-related Infrastructure*, which includes building roads and ports.
- Building Productive Capacity* for improving the capacity of a country to produce goods and services.

(e) *Trade-related Adjustment*, which includes financial assistance to meet adjustment costs from trade policy reform, including balance of payment problems resulting from lost tariff revenues or from the erosion of preferential market access.

(f) *Other Trade-related Needs*

It is to be noted that categories (a) and (b) cover the traditional forms of aid, namely, trade-related technical assistance and capacity building and categories (c) and (f) expand the Aid for Trade agenda.

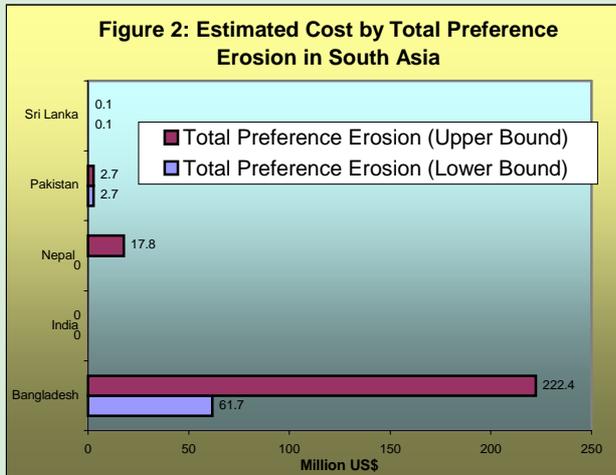
The report submitted by the Task Force also placed recommendations for shaping and operationalising the AFT programme processed through strengthening 'demand' and 'response' from the recipients and donors. The report explicitly mentioned that sectors to be considered under the AFT programme should be included in the national development agenda of the country, such as Poverty Reduction Strategy Paper (PRSP). Therefore, the recommendations include that recipient countries should mainstream trade-related aspects separately in their development strategies. The countries are suggested to form National Aid for Trade committee to work for identifying national priority programmes and projects and evaluate the total AFT programme, and to incorporate the private sector, besides the public sector, in the development works and initiatives relating to greater trade openness.

In addition to the country level suggestions, the report placed some regional (including sub-regional and cross-border) and global strategies for balancing the demands and responses of AFT. According to the report, AFT should target for enhanced regional integration; there should be initiatives for regional needs assessment and the possibility of establishing Regional AFT Committee should also be explored. Construction of a global database and the provision for multilateral channels for AFT are highlighted in the report too. All these require assigning responsibility to specific authorities.

### **A Perspective from the South Asian LDCs**

#### ***AFT is complementary to development dimensions***

AFT has generated immense concerns in both developing and LDCs. Since AFT is still in its inception period, country-specific concerns have not yet been properly raised. However, there are some common concerns among the LDCs, which are very much relevant for the South Asian LDCs like Bangladesh and Nepal. LDCs are interested to treat AFT as complementary rather than substitutes to the development dimensions of trade. This suggests, rather than financed through cutting the existing development projects, new money should be financed through AFT. LDCs also believe that instead of targeting any specific sector, AFT should be incorporated into the country's growth and development agenda. Moreover, to be pro-poor, the AFT should generate employment opportunities in the LDCs. Also, to ensure the maximum benefit, aid could be directly channeled to the sectors, such as infrastructure and human capital development.



Source: Low et al. (2005), Low et al. (2006), Raihan et al (2007), Alexandraki et al. (2004) and IMF (2003)

Note: Upper and lower bounds indicate the possible maximum and minimum preference erosion respectively, as a result of different multilateral trade negotiations, indicated by any studies. There has been no study estimating the preference erosion for India. However, many studies have indicated the possibility of preference gains for India. Therefore, the upper and lower bounds for the preference erosion cost for India are assumed to be zero.

The rationale for avoiding the reallocation to trade of resources from other sectors, such as education, health, poverty reduction or governance, is that it would endanger an economy's competitiveness in the medium-term. In fact, competitiveness in a globalised economy is achieved through the interaction of numerous non-trade factors, such as the quality of the education system, a healthy working force, an efficient transport system, an impartial judicial system and other more subjective factors such as political stability, the investment climate, and the thrust between government and the business community. In LDCs, where often the social objectives as defined by the Millennium Development Goals (MDGs) for 2015 are not yet reached, it would be a tragic mistake to reduce basic social expenditures to reallocate aid towards trade. Indeed, aid for trade and social expenditures are separate tracks that should receive adequate level of financing from the development community for fostering a sustainable, vigorous and quality growth.

#### **AFT is not a 'one-size-fits-all' development model**

LDCs are apprehensive about some negative impact that the AFT programme may generate. One should note that the AFT package is not a 'free lunch'. The donors will confer AFT so that the developing and LDCs can liberalise their markets in agriculture, non-agriculture and services at no real costs. When a country receives AFT, it is under the binding commitments of the WTO Agreements to liberalise its economy. Donors, however, have no such commitments on their part and hence will not be subjected to any penalty in case of any violation of the AFT package. Also, the package treats the long-run development of a country as a linear function of its trade liberalisation measures. This indicates that AFT does not properly incorporate the fact that developing and LDCs may have different development priorities, which cannot

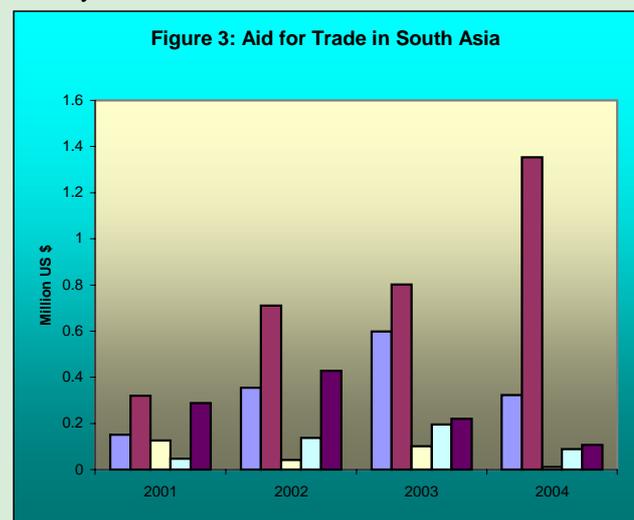
always relate to trade reform measures. AFT therefore, cannot be considered as the 'one-size-fits-all' development model.

#### **The allocation on AFT is to be prioritised**

There also exists the question of allocation. It is quite likely that there would not be enough funds to meet the demands of every developing and least developed country. One should argue that countries that have lower abilities to absorb the adverse impact of trade liberalisation should be prioritised, while others might propose that countries with severe supply-side constraints should be given more emphasis. However, it has been observed that the allocation of AFT does not follow simple rules. Figures 2 and 3 depicts the picture for the South Asian region.

In some recent studies, it has been found that Bangladesh will face the highest preference erosion cost within the region (see Figure 2) if non-agricultural market access (NAMA) negotiations are implemented. Nepal will come second, whereas the South Asian developing countries like India, Pakistan and Sri Lanka will likely incur either zero or very low preference erosion cost.

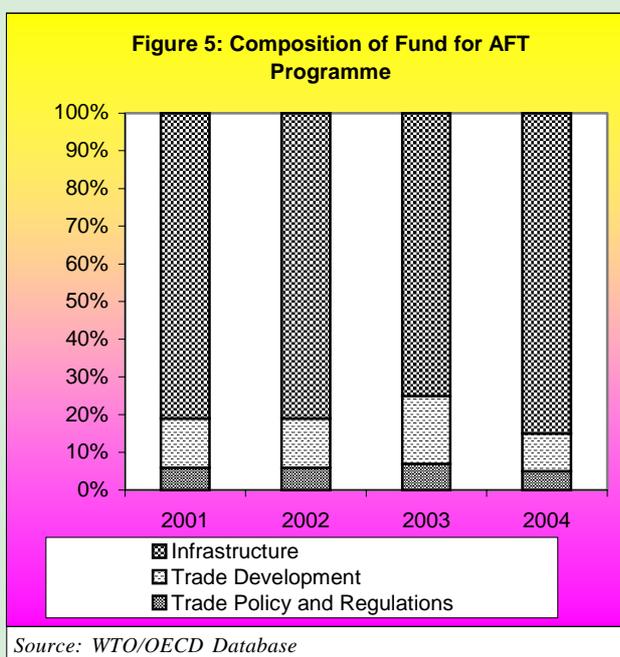
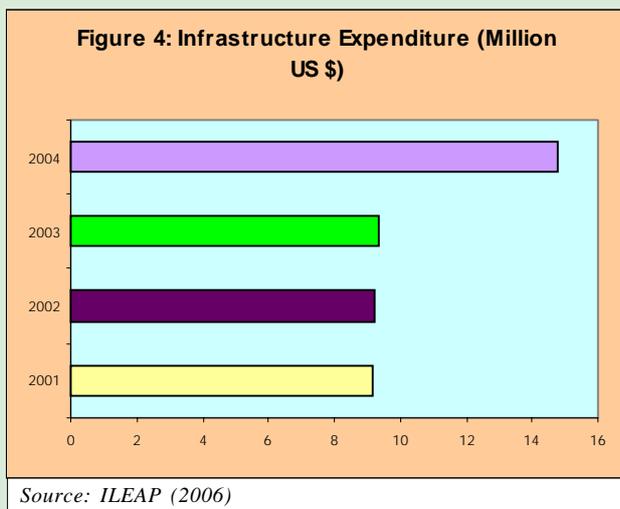
The estimates in Figure 2 suggest that Bangladesh should receive the highest priority followed by Nepal with respect to the allocation of AFT, if the cost incurred by preference erosion is taken into account. The reality, however, has been quite different. Figure 3 presents the total amount of aid given to the South Asian countries since 2001. It can be seen from this figure that over the years India has been the highest recipient of AFT. Though Bangladesh comes second, the difference between Bangladesh and India in terms of receipt of AFT has been widening in recent years. Nepal has been the lowest recipient of AFT in the region. Very interestingly, while the amounts of AFT allocated to Bangladesh and Nepal have gone down in recent years, the same has increased for India.



Source: ILEAP (2006)

#### **Existing Fund for the AFT is to be looked at**

Various studies have been conducted on the source and pattern of AFT funding. Different studies have suggested different criteria. Pandey (2006) has proposed



that AFT should have an annual fund of US\$15bn (at constant prices of 2005) – a US\$3 per poor person in the LDCs. Stiglitz and Charlton (2006) have argued that both loans and grants could be used as the instrument of AFT.

In practice, there is a growing concern among the developing and least developed countries about the lack of fund for the programme. However, the fund for AFT project has shown an increasing trend since the year 2001. In 2001, total amount available for the project was US\$11.2bn. In the year 2004, the amount increased to US\$17.4bn. The bulk of this increase was due to the sharp rise in the infrastructural activities (see Figure 4). It can also be seen from Figure 5 that infrastructure expenditure comprises a significant portion of AFT in each year. Nevertheless, bulk of these expenditures rose from the US infrastructure expenditure on Iraq and Afghanistan (ILEAP, 2006).

#### **Designing of the AFT architecture is crucial**

LDC proposal (2006) suggests that in designing the AFT architecture, the structural changes brought to the aid business by the Paris Declaration should be embedded

in the AFT procedures and operational modalities. Increasingly, development aid is deployed in a budgetary support environment, based on harmonisation of donors' practices (for example, one single needs assessment and assistance strategy, joint reporting) and alignment on national procedures and systems. The implication for the AFT architecture is that the system should be country demand-driven and based on strong national structures and procedures for planning, programming, delivering and monitoring AFT resources. In view of the above, the LDC's position is in favor of a multi-faceted AFT architecture comprising:

- A Multilateral Trade Facility, for financing projects responding to gaps identified in the existing aid for trade. Such a Multilateral Trade Facility could have up to three specialised windows:
  - ◆ investments in regional and cross-border projects;
  - ◆ financing adjustment costs; and
  - ◆ investments in trade-related infrastructure and supply-side strengthening as identified in the Diagnostic Trade Integration Studies (DTIS).
- A mechanism for monitoring AFT pledges, distinguishing between AFT trends and new and additional aid resources and effective disbursement and utilisation of the AFT funds by recipient countries.
- An overarching mechanism for streamlining, coordinating and leveraging existing funds, facilities and trade initiatives is to be in place. It would work in close cooperation with the AFT structures established in the developing countries.

#### **Conclusion**

AFT has promises for the LDCs as well as for the developing countries. AFT, however, should be incorporated in the national growth and development agenda of a country to act effectively on its goal, rather than being implemented separately. For this, mainstreaming of trade in national development agenda/strategy is very important.

For the LDCs in South Asia, in broader sense, there are three determinants of export performance:

- domestic productive capacity
- trade-related infrastructure including transport and storage facilities
- effective market access

AFT can work for enhancing the first two, and therefore, providing assistance for capacity building in market access negotiations. Balance of payments problems can be tackled by gradual improvement of productive efficiency, which would help reducing import dependence.

Different donor agencies have different rules and regulations regarding funding. There is the need for coordination based on some common rules to bring them together to contribute to a stable and predictable source of AFT.

AFT, as a development agenda, should be aimed to reduce poverty, which, however, cannot be achieved

without significant employment generation. Therefore, AFT programme should explicitly include employment dimension to act as pro-poor.

Studies, in assessing the effectiveness of AFT disbursed under the IF programme so far, have indicated that that loans are more efficiently invested for productive purposes rather than grants except in sectors like health and education, being public goods in nature. Further, countries with good policies and a higher absorption capacity benefit most from larger loans and countries with higher poverty and poor absorption capacity are better off with grants even of a lower amount.

The effectiveness of aid is subject to a better partnership arrangement between the recipient country government and the donor agencies in terms of ownership of funds, alignment with the agendas of the partners and harmonisation in terms of information and simplification

along with mutual accountability. Additionally, the evaluations by the donors indicate the positive impact of aid so far that is notified most is the improved understanding about the potential benefits of trade liberalisation.

Recent evaluations of the aid for trade sector have pointed out some weaknesses: (i) some aid programmes could be streamlined and built upon; (ii) increased coordination between multilateral programmes and between bilateral and multilateral programs could produce superior outcomes at a lower cost; (iii) international support should better respond to the priorities identified by the LDCs rather than projecting donors' views; and (iv) aid predictability and long-term commitment should be solidified. A more equitable distribution of aid between developing countries and LDCs is required. No conditionality should be attached to AFT assistance.

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