

AID-FOR-TRADE: CASE STORY

COMMONWEALTH SECRETARIAT

Assessing the effectiveness of Aid for Trade

A case story submitted by
Commonwealth Secretariat

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* This case story has been prepared by Edwin Laurent and Mohammad Razzaque based on several analytical studies sponsored by the Secretariat. The views expressed here are those of the authors as presented in the list of the studies attached, and do not necessarily reflect the official views of the Commonwealth Secretariat. For further information, please contact Edwin Laurent, International Trade & Regional Corporation Section, Economic Affairs Division, Commonwealth Secretariat Marlborough House, Pall Mall, London, SW1Y 5HX, email: e.laurent@commonwealth.int

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Executive Summary

Aid for Trade has become an important developmental initiative that aims to support developing countries' participation in global trade. Since its launch in the WTO Hong Kong Ministerial Conference, the initiative has attracted intense interest amongst developing countries including the sub-Saharan Africa, and small and vulnerable economies. The donor community has also responded positively by allocating more resources in favour of AfT.

The Commonwealth Secretariat has now conducted several studies to assess the effectiveness of the AfT initiative. The main purpose of these studies has been to provide some quantitative and empirical evidence on how AfT works in different developed country groups. Based on a theoretically consistent analytical framework that links trade-related performance indicators to AfT flows and their various components, the empirical exercises in the studies have made use of time series data across developing countries to examine the aid effectiveness. Although the term 'aid for trade' is relatively new in international trade policy discourse, aid flows to different activities that have been included under different AfT categories have long been reported by major donors, making the quantitative assessment feasible.

The empirical assessments undertaken show that there are certain areas where AfT flows have had significant favourable effects for recipient countries. Particularly, the effects of aid to trade facilitation in reducing trading costs have been very robust. A doubling of aid to trade facilitation is found to be associated with a decrease in the cost of importing by 5 per cent. There is also quantitative evidence of increased aid to economic infrastructures having positive impact on export performance. In general, for the whole set of developing economies, doubling of such aid leads to a 3.5 per cent increase in the merchandise exports by recipient countries. However, aid to productive capacity does not seem to have any noticeable impact. These results generally hold true for both SSA and SVEs.

In the light of these results while one may suggest a re-consideration of the AfT allocation across activities and sectors, it is however very important to further examine the lack of effectiveness of aid to productive capacity. Recipient country and region specific factors should also be taken into consideration in allocating AfT resources and to make the AfT initiative more demand-driven and accountable.

Assessing the effectiveness of Aid for Trade

I. Background

The value of external financial assistance for enhancing the ability of developing countries to trade has been recognized for quite some time and Aid for Trade (AfT) has been a priority area of the Commonwealth Secretariat's work programme on international trade ever since the issue was first formally discussed by the members of the World Trade Organisation (WTO) at their Hong Kong Ministerial Conference in 2005. Given its importance, the Commonwealth commissioned a major study, undertaken by Professor Joseph Stiglitz, triggering further meaningful discussions on its various aspects that would ensure addressing the needs of developing countries. The study proposed a set of general principles for an AfT mechanism, identified the areas where such assistance would be required, and put forward recommendations for its better and more effective utilization. The study greatly influenced the related policy discourse and many of the recommendations of the WTO Task Force on Aid for Trade were in line with what was proposed in the study.

Since the establishment of the WTO's role in monitoring AfT flows, the Commonwealth Secretariat's work in the area, until now, has mainly focused on understanding their effectiveness. Particularly, empirical exercises have been undertaken to find some evidence on how AfT actually works in developing countries. This case story, based on a number of Commonwealth Secretariat-sponsored studies, provides a summary of the key findings in this respect. It is organised as follows: after this background, Section II highlights the objectives of the analytical work sponsored by the Secretariat; Section III briefly introduces the methodological framework applied in these studies; Section IV summarises the main results, first by the developing countries as a whole and then by two country groups namely, small and vulnerable economies (SVEs) and Sub-Saharan Africa; Finally, Section V provides some lessons learnt and recommendations for better and more effective utilisation of AfT support.

II. Objectives of the studies undertaken by the Commonwealth Secretariat

As pointed out above, the main objective of the Commonwealth-sponsored studies is to seek quantitative and empirical evidence of the effectiveness of AfT. While doing so, it has also been intended to examine the effectiveness by type of AfT provided. Attempts have also been made to understand the comparative effectiveness by studying different groups of countries such as the small and vulnerable economies (SVEs) and Sub-Saharan Africa. The aim has been to make use of the real data that have been collected by the Organisation for Economic Cooperation and Development (OECD) for several years (since much before the launch of the 'Aid for Trade' initiative in the WTO) in providing a comprehensive and informative assessment. In this process, one key objective was to understand to what extent AfT helped promote recipient countries' supply side capacity, which is most often considered as a binding constraint to trading capacity of these countries.

III. Methodology

At the outset, it is important to note that while the specific term 'Aid for Trade' (AfT) is relatively new in multilateral trade policy discourse, the Organisation for Economic Cooperation and Development (OECD) has long been reporting data on such flows to developing countries that are comparable to the six categories of trade related assistance identified by the WTO (viz. trade policy and regulations, trade development, trade-related infrastructure, building productive capacity (including private sector development), trade-related adjustment (including support for adjustment

associated with changes in international trade regimes), and other trade-related needs). This allowed Commonwealth studies examining the overall impact of AfT and also of its various types using fairly long time-series information over a large cross section of countries.

For the empirical exercises, first a theoretically consistent analytical framework was developed to understand the routes through which AfT would contribute to export performance. This framework was then utilised in building an empirical specification, linking trade-related indicators to AfT and its various components and controlling for other concomitant factors that can also affect countries' performance. To be more precise, the empirical analysis examines three types of impacts: a) the impact of aid for trade facilitation on the cost of trading (as measured by the time and costs of importing and exporting); b) the impact of aid to economic infrastructure and aid to productive capacity on total exports; c) the impact of aid to economic infrastructure and aid to productive capacity on sectoral exports. The outcome variables used in the analyses are very much standard measures of trade performance in the literature.

The empirical set up controls for any country specific time invariant factor (such as geography, colonial history, etc.), for any time varying factor common to all countries (such as international price movements) and a number of other possible determinants of the outcome variables (for instance, in the case of total exports, population, market potential, government effectiveness and inflation are controlled for). Furthermore, while examining the impact on exports, the studies also control for the possibility that AfT allocation may be driven by trade performance (which would thus bias the results) and by exploiting the fact that AfT is also allocated across countries on the basis of other factors not related to trade performance (such as political affinity and respect for civil rights). While the AfT data by recipient countries, as mentioned above, come from the OECD Creditor Reporting System (CRS) database on aid disbursements, the information on the cost and time of trading has been collected from the World Bank's "Doing Business Report" for various years. Finally, most other data on exports and other variables are from the World Bank World Development Indicators. The empirical exercises are undertaken using the panel regression techniques, the results from which were subjected to standard statistical tests to confirm their robustness.

IV. Results - AfT effectiveness in the overall sample of developing countries

The findings of the first analytical work carried out by using time series data across the set of all developing countries for which the required information is available. As per the empirical specifications, the association between AfT flows and various export performance and trade facilitation-related indicators is tested. The basic premise for this exercise is that both the direct and indirect effects of trade related assistance are potentially important to stimulate competitiveness and exports, and focusing the analysis on AfT it is possible to depart from the generally controversial discussion on the aid-growth relationships by isolating the impacts of specific types of aid on specific outcomes.

The results provide some clear-cut evidence that that aid for trade facilitation (A_{TF}) has a statistically significant negative impact on the cost of trading. A 100% increase in A_{TF} is associated with a decrease in the costs of importing by 5%. To be more precise, using the estimates and data, it is found that an increase in A_{TF} by US\$ 390,000 is associated with a US\$ 82 reduction in the costs of unloading a 20-foot container of goods from a vessel, clearing them through customs, loading them onto a truck and transporting them to the factory or wholesale. Taking into account that in the year 2000 the number of 20-foot containers loaded and unloaded in African ports reached almost 7.3 million, the potential benefits out of aid for trade facilitation are likely to be quite significant, substantially enhancing the competitiveness of the countries involved. This cost reducing effect is

robust to controlling for other relevant factors as well as to using different indicators of cost of trading (e.g., costs of exporting and time to importing).

AfT is also found to have an overall positive and significant impact on exports on the group of developing countries as a whole. In particular an additional 100% of AfT is associated on average with a 3.5% increase in merchandise exports by the recipient country. This effect is entirely driven by aid to economic infrastructure, while the other main category of aid for trade, aid to productive capacity, appears to have no discernible effect on the aggregate exports. The estimates suggest that a US\$ 86 million increase in aid to economic infrastructure (i.e., a 100% increase at the mean) is associated with a US\$ 650 increase in real exports after 1 year and by US\$ 750 million after 2 years. When the effects on sectoral exports are considered, some positive effects of aid to productive capacity are captured, which is likely to be due to an allocation skewed toward already well performing sectors.

The results also suggest that aid to economic infrastructure is particularly beneficial for mining and manufacturing exports, while it has almost no effect for tourism and a marginally positive impact on food exports. These findings may be consistent with the importance of transport and energy infrastructure in mining and manufacturing production relative to the other sectors. Although not statistically significant, the impact of aid to productive capacity is generally positive across sectors. On the other hand, aid to mining exports appears to have a negative effect, which would require further scrutiny.

Results for the small and vulnerable economies (SVEs)

The discussions around Aid for Trade (AfT) have tended to treat beneficiaries as a fairly homogeneous group of developing countries. However, groups of recipient countries differ according to a variety of factors and needs, which are important to acknowledge in devising any AfT strategy. One group of countries that have not, in our view, received adequate attention in this respect despite their special and unique development challenges is SVEs. Given the development challenges faced by SVEs and their massive dependence on international trade for economic growth, the need for well designed and effective trade-related assistance cannot be overemphasised. In this backdrop, The Commonwealth Secretariat has undertaken a comprehensive study to highlight the case for AfT to SVEs, to examine the past flows of such aid to these countries, and evaluate the effectiveness of various types of AfT.

Building on the analytical framework mentioned above, results from the statistical analysis, amongst other suggest that aid for trade facilitation is likely to have a more significant cost-reducing effect on the costs of handling imports and exports in SVEs than in the rest of developing countries. This finding is consistent with these countries' having on average higher unit transaction costs on exports than other developing countries (as these are spread over smaller volumes of exports). The results further suggest that aid to economic infrastructure increases overall exports more in SVEs than in other developing countries, although the effects for SVEs fail to appear as statistically significant. On the other hand aid to productive capacity is found to have no significant effect on SVE exports.

In the case of SVEs, research findings suggest that sectoral aid seems to have a positive impact on tourism and mineral exports, which is larger in SVEs than in non-SVEs. This is an important result considering the relevance of tourism in the export basket of SVEs. On the other hand, food and manufacturing exports by SVEs do not appear to benefit similarly from higher AfT.

Results for Sub-Saharan Africa

A further study sponsored by the Commonwealth Secretariat focuses on the impact of AfT on another group of developing countries, for which the trade performance is particularly important, i.e. countries in the sub-Saharan Africa (SSA) region. Their disappointing trade performance in the last four decades has been recognised by many as one of the main factors for the relatively poor economic performance. Sub-Saharan Africa, on average, has far higher transport costs than elsewhere and such costs have been a major constraint to trade and growth in the region. Given these types of constraints, the kind of assistance provided by AfT could be especially relevant to address those supply-side constraints which prevent African countries from effectively participating into the world trading system.

The findings in the Commonwealth study suggest that aid to trade facilitation (A_{TF}) has a cost reducing impact on the costs of trading in SSA, which is of similar magnitude to the other developing countries. Among the main SSA regional economic communities, A_{TF} is found to have had the strongest effects in the Southern African Development Community (SADC). On the other hand, aid for trade policy and regulation (a broader category of Aid for Trade, which encompasses assistance for trade policy formulation and regulation, and training support for officials, etc. thereby influencing the processing of trade) has a significantly more negative impact on the cost of trading in SSA than in the other developing countries. That is, favourable effects of AfT for trade policy and regulation are more pronounced in SSA.

In terms of the broad impact of AfT on exports, the returns to aid to economic infrastructure on exports are much larger in SSA than in other developing countries, while the opposite is true for aid to productive capacity. It looks as if SSA benefits significantly from infrastructure investments, but not from direct support to its productive sectors. It is mainly SADC (rather than other regions) that seems to drive this differential pattern of aid to economic infrastructure and aid to productive capacity in SSA. The analysis further suggests that part of the beneficial effect of aid to economic infrastructure in SSA occurs through the facilitation of intra-SSA trade. Finally, the estimates duly point to the importance of soft infrastructure investments (in finance and business services) in developing countries and in SSA in particular relative to other developing countries. However, the overall results also suggest that other forms of infrastructure support including transport and energy are important as well, especially in SSA.

V. Lessons learned and recommendations for more effective use of AfT

It then follows that the studies provide some interesting and useful evidence of the effectiveness of AfT. The favourable effect of aid for trade facilitation in reducing the costs and time of trading in developing countries is robust and consistent. This effect is particularly significant for SVEs. AfT aimed to facilitate the cross border trading operations is likely to yield a high return on the investment and enhance overall competitiveness of the economies. Given the evidence, aid to trade facilitation should continue to be an important component of AfT.

The findings also highlight a clearly differential impact of the two main components of AfT on developing countries' exports: while aid in support of economic infrastructure exerts a strongly positive influence on exports; aid to enhance productive capacity fails to register a similar effect. This differential pattern is accentuated in the case of SSA, in line with the importance of the constraints that the dearth of infrastructure poses on SSA countries' ability to trade. While this finding may suggest a re-consideration of the AfT allocation across activities and sectors to the extent that it has a heterogeneous impact on trade-related performance especially as far as AfT

types are concerned, it is very important to further examine the lack of effectiveness of aid to productive capacity. Certain productive sectors such as commodities and other traditional activities in SVEs and SSA suffer from lack of dynamism and thus the development of productive capacity may only be valuable if it is focussed on the dynamic sectors with stronger linkages effects for the rest of the economy.

The empirical results provide a confirmation of the importance of supporting infrastructure development for developing countries' ability to trade. This is true not only for hard infrastructure (such as energy and transport infrastructure), but also – and our research suggests this may be even more important – for soft ones such as financial and business infrastructure.

As far as SVEs are concerned, donors could consider introducing AfT programmes (or projects) addressing specific trade-related constraints faced by SVEs. AfT could help inter alia by funding infrastructure for greater connectivity and improving the efficiency of existing infrastructure.

The review of the trends of AfT flows undertaken in the Commonwealth studies show that one component of aid for trade assistance, known as the support for trade related adjustment costs, has not been adequately utilised. An important aim of AfT is to help developing countries adjust to multilateral trade liberalisation processes. There can be various adjustment requirements, ranging from tackling export shortfalls to capacity development for dealing with new trade measures and provisions, where support would be required. Among these, adjustment support for loss of trade preferences has become one of the most critical issues for many small and vulnerable economies and to some extent for the Sub-Saharan African countries. The assessment presented in one of the Commonwealth studies shows that potential absolute loss of exports due to preference erosion could be in range US\$162 million - US\$ 654 million, which is about 15 to 29 per cent of total such losses for developing countries as a whole. For certain SVEs such as Belize, Dominica, Jamaica, Mauritius, Sao Tome and Principe, St Lucia, and St Vincent and Grenadines adjustment challenges due to preference erosion are likely to be excessive. Under this circumstance, AfT support for trade adjustment would be extremely important for small states.

The dissemination of the findings from the Commonwealth Secretariat sponsored studies in different forums, involving policymakers, trade negotiators, parliamentarians and civil society groups, have also contributed to further understanding of the factors influencing the AfT effectiveness. Amongst others, many consider institutional weakness as one of the major factors constraining the mainstreaming of aid for trade in national development strategies and its operationalization. Institutional building has also been recognised as essential to enhance the ownership of aid for trade. Most stakeholders are also of the view that significant information gaps exist as currently there is no comprehensive database on AfT at the country or regional level. As a result, it is believed that the evaluation of AfT flows and their obligation is not adequately known. It is therefore important for countries to develop and strengthen databases of different types of aid for trade and projects where these funds are being utilised to enable the evaluation and monitoring of AfT. Because of a lack of recipient country specific database, the monitoring of AfT is thought to remain primarily a donor-driven initiative. There is also a need for country-specific case studies on AfT to help recipient countries learn lessons and share experiences from each other on the best practices in AfT projects.

VI. Conclusion

Aid for Trade has become an important developmental initiative that aims to support developing countries' beneficial participation in global trade. Since its launch in the WTO Hong Kong Ministerial Conference, the initiative has attracted intense interest amongst developing countries including the

sub-Saharan Africa, and small and vulnerable economies. The donor community has also responded positively by allocating more resources in favour of AfT.

The Commonwealth Secretariat has now conducted a range of studies to assess the effectiveness of the AfT initiative. The objective and empirical assessment undertaken in this regard shows that there are certain areas where AfT flows have significant favourable effects for recipient countries. Particularly, the effects of aid to trade facilitation in reducing trading costs have been very robust. There is also quantitative evidence of increased aid to economic infrastructure having a positive impact on export performance. However, the aid to productive capacity that has been provided does not seem to have had noticeable impact. These results generally hold true both for SSA and SVEs.

In the light of these results while one may suggest a re-consideration of the AfT allocation across activities and sectors, it is however very important to further examine the lack of effectiveness of aid to productive capacity. Recipient country and region specific factors should also be taken into consideration in allocating AfT resources and to make the AfT initiative more demand-driven and accountable.

Selected recent publications of the Commonwealth Secretariat on Aid for Trade

- ***An Agenda for the Development Round of Trade Negotiations in the Aftermath of Cancun***, Commonwealth Secretariat, London, by Stiglitz, J. (2004).
- ***Aid for Trade***, Commonwealth Discussion Paper, and also published as Chapter 2 in Mbirimi, I. (ed) (2007), *After Hong Kong: Some Key Issues for Developing Countries*, Commonwealth Secretariat, London, by Stiglitz, J. and Charlton, A. (2006).
- ***Quantifying Aid for Trade: A Case Study of Tanzania***, Economic Paper No. 82, Commonwealth Secretariat, London, by Turner, L. (2008).
- ***Towards A Quantitative Assessment of Aid for Trade***, Economic Paper No. 83, Commonwealth Secretariat, London, Cali, M. and te Velde, D. W. (2008a).
- ***“The effectiveness of aid for trade: Some empirical evidence”***, *Commonwealth Trade Hot Topics*, Issue 50, Commonwealth Secretariat, London, by Cali, M. and Te Velde, D. W. (2008b).
- ***“Aid for Trade in Small and Vulnerable Economies”***, *Commonwealth Trade Hot Topics*, Issue 59, Commonwealth Secretariat, London, by Cali, M. and te Velde, D. W. (2010).
- ***“Aid for Trade: Policy Issue for ACP States”***, *Commonwealth Trade Hot Topics*, Issue 75, Commonwealth Secretariat, London, by Bonapas Onguglo.
- ***Effectiveness of Aid for Trade and in Small and Vulnerable Economies: An Empirical Assessment***, Economic Paper 91, Commonwealth Secretariat, London, by Cali M., Razzaque, M. A., te Velde, D. W. (2011).
- ***Effectiveness of Aid for Trade in Sub-Saharan Africa: An Empirical Assessment***, forthcoming, Commonwealth Secretariat, London, by Cali, M. and Razzaque, M. A. (2011).