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Aid for Trade:

What does it mean? Why should aid be part of WTO negotiations? And how much might it cost?

Lauren Phillips, Sheila Page and Dirk Willem te Velde

The number of proposals calling for Aid for Trade has increased markedly in the past year (Hoekman & Prowse, 2005; Zedillo, 2005; Page & Kleen, 2005; Dean, 2005), and there is a high degree of political will from developing, least developed and developed countries behind the Aid for Trade agenda. It is now regularly mentioned in speeches and submissions.[1] It is also explicitly mentioned in the 1 December Draft Hong Kong Ministerial Text (see Box 1). Thus, there is a real possibility that an Aid for Trade framework could be agreed during the Hong Kong ministerial meeting of the World Trade Organization (WTO) (13-18 December 2005) potentially bringing tangible benefits to developing countries, particularly to those who may gain little or lose in the negotiations on access. These include many of the Least Developed Countries (LDCs). Nonetheless, there is a great deal of uncertainty about what Aid for Trade is, and what it is not, as well as how much it would cost and how it would be implemented. This paper provides some initial answers to these questions in order to clarify the debate.

What is Aid for Trade?

Aid for Trade in the broadest sense is intended to help countries to trade, and in particular, to help them take advantage of WTO agreements. Its first formal appearance as a WTO negotiating issue was in the agreement in July 2004 (WT/L/579), which said that developing countries would be entitled to ask for assistance to implement the new element of the current Round, 'trade facilitation' – the simplification and harmonisation of trade procedures (including customs and procedures of transport). As well as identifying trade-related uses for such aid, research and policy statements have emphasised the need for new money in the form of predictable grant-based assistance, distributed through a credible international mechanism. Proposals cite both the long-term need to develop supply capacity and the immediate needs created by trade agreements such as implementation and adjustment costs.

Box 1. Aid for Trade in the WTO's words...

'We welcome the discussions of Finance and Development Ministers in various fora, including the Development Committee of the World Bank and IMF that have taken place this year on expanding Aid for Trade. Aid for Trade should aim 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. Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the DDA, particularly on market access. However, it can be a valuable complement to the DDA. We invite the General Council to convene a meeting before July 2006 dedicated to considering how Aid for Trade might contribute most effectively to a successful conclusion to the DDA. We also invite the Director-General to consult with Members as well as with the IMF and World Bank, relevant international organisations and the regional development banks with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate on concessional terms.' WTO Draft Hong Kong Ministerial Document (JOB(05)/298/Rev.1, Paragraph 51)

Meeting both long-term and short-term costs can be considered Aid for Trade, but these two sets of proposals have different objectives and in some cases are designed to help different types of countries. Additionally, the means of fulfilling these two types of Aid for Trade are likely to be different, some falling within the WTO and some outside of the WTO's mandate.

1. See, for example, the letter submitted by Dipak Patel, Minister of Commerce, Trade and Industry for the Republic of Zambia and coordinator of the WTO LDC Group on 14 October 2005 proposing an Aid for Trade package. See also 'Reclaiming Development in the WTO Doha Development Round' sent to the WTO Conference on Trade and Development by Argentina, Brazil, India, Indonesia, Namibia, Pakistan, Philippines, South Africa and Venezuela on 30 November 2005.

Short-term Aid for Trade: Grants to meet costs that can be directly linked to the negotiating Round, including preference erosion (the loss suffered by countries with preferential access to a protected market when that protection is reduced); terms of trade losses (for example if agricultural liberalisation raises the prices of food for food importers); and implementation costs due to compliance with WTO provisions (not only trade facilitation, as already agreed, but, for example, complying with Trade Related Intellectual Property (TRIPs) regulations or sanitary and technical standards).

Long-term Aid for Trade: Larger ongoing support to address infrastructure and other supply-side constraints in countries that cannot respond to new opportunities for trade.

Aid for Trade conceived in these manners would therefore benefit a diverse set of countries: LDCs, other low income countries, and some middle income countries who are not major recipients of overseas development assistance (ODA).

The provision of both short- and long-term aid may be facilitated by existing agreements providing technical assistance for developing countries (and LDCs in particular), though these are not sufficient to meet the current needs fully. For example, the Integrated Framework (IF) of the Trade-related Technical Assistance, brings together a number of multilateral agencies (the IMF, International Trade Centre, UNCTAD, UNDP, WTO and World Bank) as well as bilateral and multilateral donors to assist LDCs by undertaking diagnostic studies to identify actions that would improve their trade and investment environment. To date, the IF operates in 28 countries, and another 9 countries are likely to participate in the near future. The limitations on the relevance of the IF to provide Aid for Trade are that countries require additional financial resources to implement the findings of the diagnostics, and that the studies are only available for LDCs. It has been agreed that the IF will be 'enhanced', meaning more money, either for existing countries or, in some formulations, extending the scheme to non-LDCs.

Furthermore, the IMF has introduced the Trade Integration Mechanism (TIM) designed to assist member countries to meet balance of payments difficulties that might result from trade liberalisation by other countries. But only two countries have taken advantage of the TIM so far – Bangladesh ($78 million) and the Dominican Republic ($32 million). This money was made available as a loan, not as a grant, which has limited its attractiveness.

Is this aid?

Yes and no. The arguments for long term Aid for Trade fall within traditional definitions and provisions of aid and can therefore be met by increases in normal aid, as promised, for example, in the G8 Gleneagles agreement of 2005 (see www.g8.gov.uk). But the arguments for providing aid to meet implementation costs, terms of trade losses and preference erosion are based instead on meeting the costs of negotiation. They are derived from the benefits other developing countries and the world as a whole receive from liberalisation, and aim to ensure that costs to a few countries do not derail a negotiation whose net benefits exceed the costs. This need, therefore, should be met by grants, not loans (because it is primarily for the benefit of others); it must be clearly allocated to particular countries, not subject to normal aid criteria; it should therefore not come out of traditional ODA budgets. Some of the beneficiary countries are not normally priorities for aid, and this newly identified need requires resources additional to traditional ODA (see Page, 2004 and Page, 2005 for more details on who should pay for preference erosion and how this aid should be administered).

Should Aid for Trade be discussed within the WTO?

Yes, though there are limits to the extent to which the WTO can administer and supervise the provision of Aid for Trade. The WTO could deal with all the types of 'aid for the WTO' (not just preference erosion), though to date there has been no aid for meeting implementation costs channelled through the WTO. However, the WTO can also focus and place priority on discussion on longer term types of Aid for Trade as well as ensure that long-term Aid for Trade is included in the Doha Round declarations, with a high level of responsibility for coordinating progress on such aid provision.

How much could it cost?

The costs of 'short-term' Aid for Trade depend heavily on the outcome of the Round. However, it is possible to come to some estimates about the costs of certain short-term elements of Aid for Trade, as well as a general scope of the cost for long-term assistance. Costs for short-term Aid for Trade are principally the result of three types of change: implementation costs, terms of trade loss, and aid for preference erosion.

Short-Term Aid for Trade

Implementation Costs: Estimates of implementation costs are difficult. High estimates based on extrapolation from one or two examples were made for implementation in the Uruguay Round (e.g. Finger & Schuler, 2000), but there are no empirical studies of actual costs incurred. What can be said is that for rule changes the costs are likely to be lower in the Doha Round than in the Uruguay Round for two reasons. First, fewer new initiatives are on the table, and thus commitments for developing countries are likely to be less. Second, the current state of negotiations makes it unlikely that those new proposals will be implemented in an ambitious way within the Round.

The above caveats aside, costs may be high for new commitments as part of services trade liberalisation for the relatively limited number of LDCs and greater number of developing countries that are preparing to make service commitments in the Doha Round. There are studies that estimate the costs of establishing appropriate

Table 1. Estimations of the benefits of preferences or cost of preference erosion 2001–2005 in US$

Study	Countries / Industries Covered	Methods of Estimation and Assumptions	Estimated cost of preference erosion
(Ianchovincha, Mattoo, & Olarreaga, 2001)	Impact of duty-free quota-free (DFQF) access for sub-Saharan African (SSA) countries on other developing countries	PEM Considers 5 scenarios (inc. DFQF from all Quad). Does not consider neg. impact of Rules of Origin (RoO) on ability to utilise preferences.	Estimates are only provided for general impact on exports rather than on preference erosion. General developing country exports would decline 0.04% (US$650 million)
(Hoekman, Ng, & Olarreaga, 2001)	Impact of DFQF access for LDCs under the EU Everything But Arms (EBA) agreement on other developing countries	PEM Considers the impact of a 5.0% reduction in peak tariffs from OECD countries. It does not consider the impact of non-tariff barriers in estimates.	Similar to above; total exports from developing countries to decline 0.01% ($162.5 million)
(ODI, 2003)[2]	Agricultural exports from African LDC and developing countries	Assessment of the proposed tariff reductions on agricultural exports under the Harbinson modalities. Looks at bilateral losses for African LDCs and developing countries when competing with Brazil.	Losses for Malawi ($70.6 million), Tanzania ($7.6 million), and Uganda ($11.9 million) are greater than 2% of their exports when competing with Brazil; in the case of Malawi, considerably more
(IMF, 2003)	LDCs	PEM – Calculates impact of a 40% reduction of tariff preferences for LDCs in manufacturing and agriculture. Elasticity of export supply is one.	Aggregated losses to LDCs are US$530 million or 1.7% of exports. Five countries face losses exceeding 5.0% of total exports (Malawi, Mauritania, Haiti, Cape Verde, São Tomé and Príncipe) and by value losses are highest in Bangladesh ($222.4 million), Cambodia ($53.6 million), Malawi ($48.6 million), Mauritania ($40.4 million) and Tanzania ($23.6 million)
(Milner, Morgan, & Zgovu, 2003)	African Caribbean and Pacific (ACP) Sugar Protocol countries	4 scenarios considered: 1. Reducing subsidised exports by 68.8% 2. Scenario 1 + reducing subsidised exports by 90%, out-of-quota tariffs by 30% 3. Scenario 2 + CAP reform including export subsidies eliminated, out-of-quota tariffs reduced by 50% 4. Full OECD liberalisation	1. $13.4 million loss 2. $70.7 million loss 3. $158.3 million loss 4. $447.5 million loss
(Alexandraki & Lankes, 2004)	Middle Income Countries	PEM – assumes complete utilisation of preferences, constant world market prices, and full appropriation of rents by the exporter. Also disregards gains from multilateral liberalisation.	Between 0.5% and 1.2% of total exports of middle income countries (US$924 million), depending on elasticities, which are estimated from 0.5 to 1.5. Economies most affected are banana and sugar exporters. Mauritius to have highest value losses ($201 million) along with the Dominican Republic, Morocco and Tunisia. Countries with loss in excess of 5.0% of exports include St Lucia, Belize, St Kitts and Nevis; Guyana; Fiji, and Dominica.
(NERA / OPM, 2004)	Caribbean ACP Countries – Bananas	PEM of the EU banana market assuming perfectly elastic supply for Latin American producers and different supply elasticises for Belize (1.4), Dominica (11.2), St Lucia (4.8), St Vincent (6.3) and Jamaica (3.5); Ignores inter-country variations among Caribbean ACP countries. Ignores any supply side responses.	Aggregated cost for Belize, Jamaica, Dominica, St Lucia and St Vincent under 'high' tariff scenario (200 per ton) is 56.4 million; 'low' tariff scenario (125 per ton) is 90.7 million; zero tariff scenario is 101.4 million.
(Francois, Hoekman, & Manchin, 2005)	Looks at impact of OECD liberalisation at all developing countries under preferences schemes.	GEM and the latest version of the Global Trade Analysis Project database. Assumes away compliance costs and assumes that developing countries do not liberalise.	The gains associated with MFN tariff reductions by non-EU OECD countries will partially offset losses due to EU liberalisation. In SSA, they conclude that overall losses will be reduced to $110 million. Complete preference erosion due to Most Favoured Nation (MFN) reforms in the EU (including agriculture) would impose a welfare loss of some $460 million on African LDCs and an additional $100 million on Bangladesh.
(Limao & Olarreaga, 2005)	LDCs	Calculates income transfer to LDCs so as to be equivalent to the transfer implied by the existing preference programmes. One year, short-run effects.	$266 million losses to LDCs
(Low, Piermartini, & Richtering, 2005)	Evaluates losses to developing countries preferences in manufactured products (Non Agricultural Market Access or NAMA) to US, EU, Japan, Canada and Australia	Determines the impact of erosion of 'competition- adjusted preference margins' (the difference between the MFN and the preferential tariff rate, adjusted to account for other countries that receive the same preference). Also corrects for utilisation of preferences (in case of US).	$2.1 to $3.3 billion loss for developing countries (0.2 to 0.4% of imports) depending on adjustment of preference margin; $170 to $840 million loss for LDCs (0.8–3.8% of imports) depending on preference margin. Largest LDC losses using upper estimates are Bangladesh ($335.2mn), Cambodia ($215.6mn), Myanmar ($79.7mn), Lesotho ($49.6mn) and Haiti ($40.3mn); Amongst other developing China, Honduras, Dominican Republic, Guatemala, El Salvador and Thailand.
(UNCTAD, 2005)	LDCs	PEM, assuming a scenario of total erosion of trade preferences (excluding sugar). Inter-sectoral effects and non-tariff barriers are disregarded.	Net impact on LDC trade across products = $52.6 million

2. See also Gillson, Hewitt, & Page, 2005 which provides estimates of banana and sugar preference erosion.

References for studies cited in the table can be found online at www.odi.org.uk/publications/opinions/61_aid_for_trade_dec05_refs.pdf regulatory capacities to manage the possible effects of taking a commitment e.g. in telecommunication services (Mattoo, 2005). Some aid for services trade may be long-term costs, including meeting supply-side constraints and increasing effectiveness of working groups on trade policy processes (te Velde, 2005), but some costs are short-term including: aid for addressing the regulatory framework and capacities (e.g. to establish regulatory agencies in the telecommunications sector) required to facilitate implementation of commitments; aid for translating the services regulatory framework into GATS language; and aid directly and appropriately for negotiators (sectoral and Geneva based).

Terms of Trade Loss: An additional short-term cost of the Round is terms of trade losses, mainly on food for net importing food countries. These were identified as entitled to support in the last WTO Round, and the World Bank has estimated that total losses for net food importers would be between $300 million and $1.2 billion per year (Mitchell and Hoppe, 2006). Depending on assumptions, between 7 and 16 countries risk having food import bills increase by 5% or more, though the authors note that total food price increases will be about half of annual average variations in price of basic products. At present, the prospects are for a very limited agricultural settlement, which should minimise costs. Negotiators could work to agree methods for estimating such losses during Hong Kong and beyond.

Preference Erosion: A number of studies have used global and partial equilibrium models (GEM/PEM) to estimate the total losses for countries suffering from preference erosion. While cost estimates have varied owing to a diversity of modelling assumptions, the total cost for this section of the proposal in all estimates has been relatively minor on a global economic basis, ranging from less than $100 million for LDCs to just less than $1 billion dollars for all developing countries affected. Most of the estimates are between $400 and $600 million. Estimates from previous studies attempting to quantify preference erosion are presented in Table 1 at the end of this paper. Again, the actual costs cannot be known until the end of the Round, but the more expectations for major reforms are lowered, the lower will be the negative effect of the reforms.

The largest beneficiaries from Aid for Trade for preference erosion would therefore include LDCs (in particular Bangladesh, but also including Cape Verde, Haiti, Malawi, Mauritania, São Tomé and Príncipe) and non-LDC developing countries – most notably Mauritius and many Caribbean states (which stand to lose from preference erosion in sugar and bananas), and some North African states including Morocco and Tunisia. The total estimates of loss for LDCs range from $170 million to $840 million, of which Bangladesh accounts for approximately one half to two thirds in most estimates.

Long-Term Aid for Trade

The cost of the longer term aid for trade could be very high, but needs to be seen in the context of the general increases proposed for aid, not in relation to the WTO negotiations. Such aid would be spread over a large number of countries, and over a longer period of time, and requires greater cooperation and coordination among developed and developing countries to fund. Some estimates have been made for this pillar: the Commission for Africa report (2005) estimated that in the case of Africa, improving infrastructure could cost some $20bn. The Commission's recommendations for meeting sanitary and phytosanitary standards, improving trade-oriented productive capacity and meeting costs of trade facilitation are estimated to cost $100 million. However, costing such aid remains a potential agenda for further research in the post-Hong Kong period.

What Next? An Agenda for Hong Kong and Beyond

As was mentioned in the opening paragraph, there is a strong chance that an explicit mention of Aid for Trade will be included in the Hong Kong ministerial document. But at present, its meaningful inclusion is complicated by 1) the different interpretations of what Aid for Trade is or should include; 2) fears that countries will demand that all their long-term trade capacity needs be met before they agree to a WTO settlement, and 3) reluctance by some developing countries as well as the World Bank to mix aid instruments and trade.

An additional negotiating problem is that countries affected by preference erosion (and some of those affected by food costs) do not fall into any of the current negotiating groups. This means that progress on Aid for Trade requires that new alliances and new 'champions' be found to push the topic forward at Hong Kong and beyond. Efforts can be made by negotiators to define explicitly what is meant by Aid for Trade, to take stock of current Aid for Trade initiatives and to set a timetable for further negotiation of aid for trade structures, levels and recipients. If there is no progress, those with little to gain on access may decide to obstruct the negotiations.

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Short-Term Aid for Trade

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(Francois, Hoekman, & Manchin, 2005)	Looks at impact of OECD liberalisation at all developing countries under preferences schemes.	GEM and the latest version of the Global Trade Analysis Project database. Assumes away compliance costs and assumes that developing countries do not liberalise.	The gains associated with MFN tariff reductions by non-EU OECD countries will partially offset losses due to EU liberalisation. In SSA, they conclude that overall losses will be reduced to $110 million. Complete preference erosion due to Most Favoured Nation (MFN) reforms in the EU (including agriculture) would impose a welfare loss of some $460 million on African LDCs and an additional $100 million on Bangladesh.
(Limao & Olarreaga, 2005)	LDCs	Calculates income transfer to LDCs so as to be equivalent to the transfer implied by the existing preference programmes. One year, short-run effects.	$266 million losses to LDCs
(Low, Piermartini, & Richtering, 2005)	Evaluates losses to developing countries preferences in manufactured products (Non Agricultural Market Access or NAMA) to US, EU, Japan, Canada and Australia	Determines the impact of erosion of 'competition- adjusted preference margins' (the difference between the MFN and the preferential tariff rate, adjusted to account for other countries that receive the same preference). Also corrects for utilisation of preferences (in case of US).	$2.1 to $3.3 billion loss for developing countries (0.2 to 0.4% of imports) depending on adjustment of preference margin; $170 to $840 million loss for LDCs (0.8–3.8% of imports) depending on preference margin. Largest LDC losses using upper estimates are Bangladesh ($335.2mn), Cambodia ($215.6mn), Myanmar ($79.7mn), Lesotho ($49.6mn) and Haiti ($40.3mn); Amongst other developing China, Honduras, Dominican Republic, Guatemala, El Salvador and Thailand.
(UNCTAD, 2005)	LDCs	PEM, assuming a scenario of total erosion of trade preferences (excluding sugar). Inter-sectoral effects and non-tariff barriers are disregarded.	Net impact on LDC trade across products = $52.6 million

2. See also Gillson, Hewitt, & Page, 2005 which provides estimates of banana and sugar preference erosion.

References for studies cited in the table can be found online at www.odi.org.uk/publications/opinions/61_aid_for_trade_dec05_refs.pdf regulatory capacities to manage the possible effects of taking a commitment e.g. in telecommunication services (Mattoo, 2005). Some aid for services trade may be long-term costs, including meeting supply-side constraints and increasing effectiveness of working groups on trade policy processes (te Velde, 2005), but some costs are short-term including: aid for addressing the regulatory framework and capacities (e.g. to establish regulatory agencies in the telecommunications sector) required to facilitate implementation of commitments; aid for translating the services regulatory framework into GATS language; and aid directly and appropriately for negotiators (sectoral and Geneva based).

Terms of Trade Loss: An additional short-term cost of the Round is terms of trade losses, mainly on food for net importing food countries. These were identified as entitled to support in the last WTO Round, and the World Bank has estimated that total losses for net food importers would be between $300 million and $1.2 billion per year (Mitchell and Hoppe, 2006). Depending on assumptions, between 7 and 16 countries risk having food import bills increase by 5% or more, though the authors note that total food price increases will be about half of annual average variations in price of basic products. At present, the prospects are for a very limited agricultural settlement, which should minimise costs. Negotiators could work to agree methods for estimating such losses during Hong Kong and beyond.

Preference Erosion: A number of studies have used global and partial equilibrium models (GEM/PEM) to estimate the total losses for countries suffering from preference erosion. While cost estimates have varied owing to a diversity of modelling assumptions, the total cost for this section of the proposal in all estimates has been relatively minor on a global economic basis, ranging from less than $100 million for LDCs to just less than $1 billion dollars for all developing countries affected. Most of the estimates are between $400 and $600 million. Estimates from previous studies attempting to quantify preference erosion are presented in Table 1 at the end of this paper. Again, the actual costs cannot be known until the end of the Round, but the more expectations for major reforms are lowered, the lower will be the negative effect of the reforms.

The largest beneficiaries from Aid for Trade for preference erosion would therefore include LDCs (in particular Bangladesh, but also including Cape Verde, Haiti, Malawi, Mauritania, São Tomé and Príncipe) and non-LDC developing countries – most notably Mauritius and many Caribbean states (which stand to lose from preference erosion in sugar and bananas), and some North African states including Morocco and Tunisia. The total estimates of loss for LDCs range from $170 million to $840 million, of which Bangladesh accounts for approximately one half to two thirds in most estimates.

Long-Term Aid for Trade

The cost of the longer term aid for trade could be very high, but needs to be seen in the context of the general increases proposed for aid, not in relation to the WTO negotiations. Such aid would be spread over a large number of countries, and over a longer period of time, and requires greater cooperation and coordination among developed and developing countries to fund. Some estimates have been made for this pillar: the Commission for Africa report (2005) estimated that in the case of Africa, improving infrastructure could cost some $20bn. The Commission's recommendations for meeting sanitary and phytosanitary standards, improving trade-oriented productive capacity and meeting costs of trade facilitation are estimated to cost $100 million. However, costing such aid remains a potential agenda for further research in the post-Hong Kong period.

What Next? An Agenda for Hong Kong and Beyond

As was mentioned in the opening paragraph, there is a strong chance that an explicit mention of Aid for Trade will be included in the Hong Kong ministerial document. But at present, its meaningful inclusion is complicated by 1) the different interpretations of what Aid for Trade is or should include; 2) fears that countries will demand that all their long-term trade capacity needs be met before they agree to a WTO settlement, and 3) reluctance by some developing countries as well as the World Bank to mix aid instruments and trade.

An additional negotiating problem is that countries affected by preference erosion (and some of those affected by food costs) do not fall into any of the current negotiating groups. This means that progress on Aid for Trade requires that new alliances and new 'champions' be found to push the topic forward at Hong Kong and beyond. Efforts can be made by negotiators to define explicitly what is meant by Aid for Trade, to take stock of current Aid for Trade initiatives and to set a timetable for further negotiation of aid for trade structures, levels and recipients. If there is no progress, those with little to gain on access may decide to obstruct the negotiations.

References can be found online at www.odi.org.uk/publications/opinions/61_aid_for_trade_dec05_refs.pdf

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