



Future directions for Aid for Trade

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Key messages

The future of Aid for Trade includes the following priorities:

1. Maintain commitments at 2010 level or above
2. Increase effectiveness
3. Build productive capacity
4. Reduce the cost of trading
5. Strengthen capacities to benefit from global value chains
6. Leverage other financial flows
7. Deepen regional integration
8. Improve management to deliver results on the ground

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This report is a summary of research findings by the Overseas Development Institute (ODI), European Centre for Development Policy Management (ECDPM) and German Development Institute (DIE) on the factors that determine the effectiveness of Aid for Trade. This report builds on the Aid for Trade research carried out by Dirk Willem te Velde, Jodie Keane, Jane Kennan, Isabella Massa, Marie-Agnes Jouanjean, Jakob Engel, Bruce Byiers, Dan Lui and Clara Brandi. The author is thankful for the support provided by Gail Wilson, Katy Harris, Victoria Cox and Angela Hawke in the production of this report. The author is grateful to Mohammad Razzaque for the suggestions in presenting these ideas, and to Dirk Willem te Velde for the comments and guidance that helped improve the report.

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1. Introduction

The world has changed since the launch of the Aid for Trade initiative in 2005. Aid is under stress, and the centre of gravity for trade and investment is shifting to the global south. New actors from the south are influencing the architecture of global economic governance. Meanwhile, economic growth poles in the developing global south and the shifting pattern of trade present opportunities in the form of new sources of both growth and markets. Despite the emergent context of global trade, trade-related development issues for the least developed and low-income countries remain the same in many respects – low productive capacity, the high cost of trading, and shallow regional and global integration (Basnett, 2013a).

Aid for Trade has evolved since its genesis in 2005 when the focus was largely on trade-preference loss. It is now directed at addressing a menu of trade and development challenges (Basnett, 2013b) but the existential question – what is Aid for Trade for – has blurred. Debates have emerged on what counts as Aid for Trade, how should it be delivered, and whether the initiative should shoulder an enlarged development agenda or focus on delivering specific results.

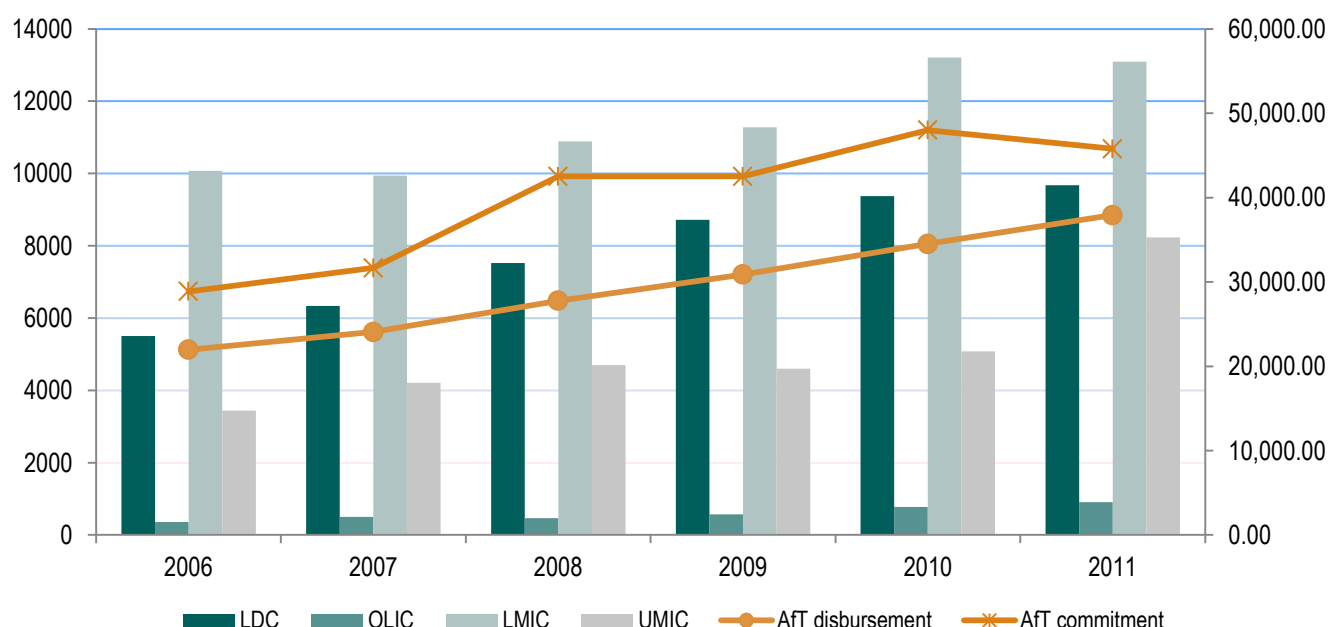
In responding to the needs and challenges on the ground, the Aid for Trade agenda – what it does or should do – has ballooned. It now does a lot of things and is effective in most of these, but further improvements could be made on others. The problem with this broader direction is that a point will come when it will be difficult for the initiative to stake a claim on development results, which could undermine momentum over time. Aid for Trade cannot be expected to solve every development problem; other effective aid instruments are also available. So, in the arsenal of these instruments, we need to ask where is Aid for Trade most effective, what specific problems should the initiative solve and how? We at ODI have contributed to the growing body of evidence on its effectiveness, but what Aid for Trade should focus in the future remains open for debate.

Our research suggests that Aid for Trade should focus on helping developing countries trade more by building their productive capacity (impact level), reduce the cost of trading (outcome level) and increase trade infrastructure (output level). It should do this by increasing its connectedness to other financial flows as well as solving challenges in concert with other aid initiatives – what has been referred by Dirk William te Velde (2013) as the ‘third generation Aid for Trade’. Going forward, this note shares ideas on the elements that would enable the Aid for Trade initiative to travel in this direction.

2. Maintaining commitments

Aid for Trade (AfT) constitutes up to one-third of all official development assistance. Annual commitments to AfT increased rapidly from 2005 to 2010, reaching \$48 billion. In 2011, AfT declined for the first time since the launch of the initiative in 2005 (Figure 1). It is time to focus attention on reversing this decline and maintaining AfT flows.

Figure 1: Aid for Trade flows (constant prices, 2011, \$ millions)



Notes: Disbursement by income group (left axis). Total Aid for Trade disbursement and commitment (right axis). LDC = Least- developed countries. OLIC = Other low-income countries. LMIC = Lower middle-income countries. UMIC = Upper middle-income countries. Source: Authors' calculation based on OECD Creditor Reporting System (CRS) disbursement data (downloaded November, 2013).

Figure 2: Aid for Trade sectoral allocation (constant prices, 2011, \$ millions)



Source: Authors' calculation based on OECD CRS disbursement data (downloaded November, 2013)

While other financial flows (e.g. foreign direct investment and remittances) are becoming increasingly important (more on this below), AfT remains a vital and relatively stable source for bridging the saving-investment gap in least-developed countries (LDCs) and low-income countries (LICs). The recent G-20 pledge to maintain AfT flows is to be welcomed, as it is important that AfT commitments be maintained at or above 2010 levels.

3. Improving effectiveness

There is growing evidence that AfT has had a positive impact in improving trade capacity in developing countries (te Velde and Razzaque, 2013). Aid to trade-related infrastructure has helped promote recipient countries' exports and has had a significant positive impact on recipient countries' trade costs, as has aid for trade facilitation. Indeed, the benefits from AfT tend to increase with more targeted flows.

Table 1: Overview of empirical literature findings on Aid for Trade effectiveness

Type of aid flows	<ul style="list-style-type: none"> Evidence on the effectiveness of different types of AfT flows is mixed, in part because results are not always comparable as different definitions of specific categories of AfT are used. However, there is some evidence that highly targeted aid flows (e.g. trade facilitation) are more effective. A few studies find that aid to trade-related infrastructure is particularly effective in promoting recipient countries' exports. Evidence on the effectiveness of aid to trade policy and regulations in improving trade-related performance is more mixed. Evidence on the effectiveness of single-export promotion instruments is still scarce.
Recipients' income levels	<ul style="list-style-type: none"> There is some evidence that certain types of AfT flows (e.g. aid to infrastructure such as aid flows to transportation) are more effective in low-income countries, while other aid flows, such as those directed to the business sector, are more effective in higher-income countries. Much more evidence is needed in this area with respect to different types of AfT (especially aid to trade policy and regulations, aid to trade development and trade facilitation) and different recipient sectors of aid.
Recipient sector of aid	<ul style="list-style-type: none"> The impact of AfT is found to vary among sectors. Evidence is still mixed and the different sector classification used in the studies prevents comparability of results.
Geographical regions of recipient country	<ul style="list-style-type: none"> There is evidence that the same type of AfT may have varying effects depending on the geographical regions of recipient countries. It appears that sub-Saharan Africa is one of the regions that could benefit the most from AfT.

Source: Basnett et. al.(2012).

In systematically reviewing these various stages we found the following donor/recipient-specific factors influencing the effectiveness of AfT (Basnett et. al., 2012).

- The present ways of identifying AfT do not always align with the trade-related and binding constraints of the recipient country/region.

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- The choice of instruments and modalities for delivering AfT vary. AfT is desirable in addressing transnational and regional, rather than national constraints to trade. Blended financing mechanisms and corridor approaches to delivering AfT are found to be particularly effective.
 - Coordination failures inhibit the design and implementation of AfT investment programmes. Coordination failures exist at various levels – inter-donor, intra-donor, between donors and recipients and as part of economic development in recipient countries.
 - The monitoring and evaluation of AfT tends to be based on a stretched results chain and the lessons do not feed adequately into the future design of AfT programmes.

We find that AfT works best when:

- it is targeted at reducing the cost of trading, for example through investment in infrastructure, improving trade facilitation and strengthening value chains.
- it addresses the binding constraints to growth.
- there is effective coordination between donors and recipients around the design, implementation and monitoring of AfT Trade programmes, as well as coordination among different donors.
- the selection of instruments and modalities for delivering AfT are able to address trade-related constraints at the transnational and regional level.
- the monitoring and evaluation of impacts, outcomes and outputs is realistic (the achievement of objectives can be traced along a feasible results chain) and based on the collection of baseline data, and where lessons contribute to the design of future projects.

4. Building productive capacity

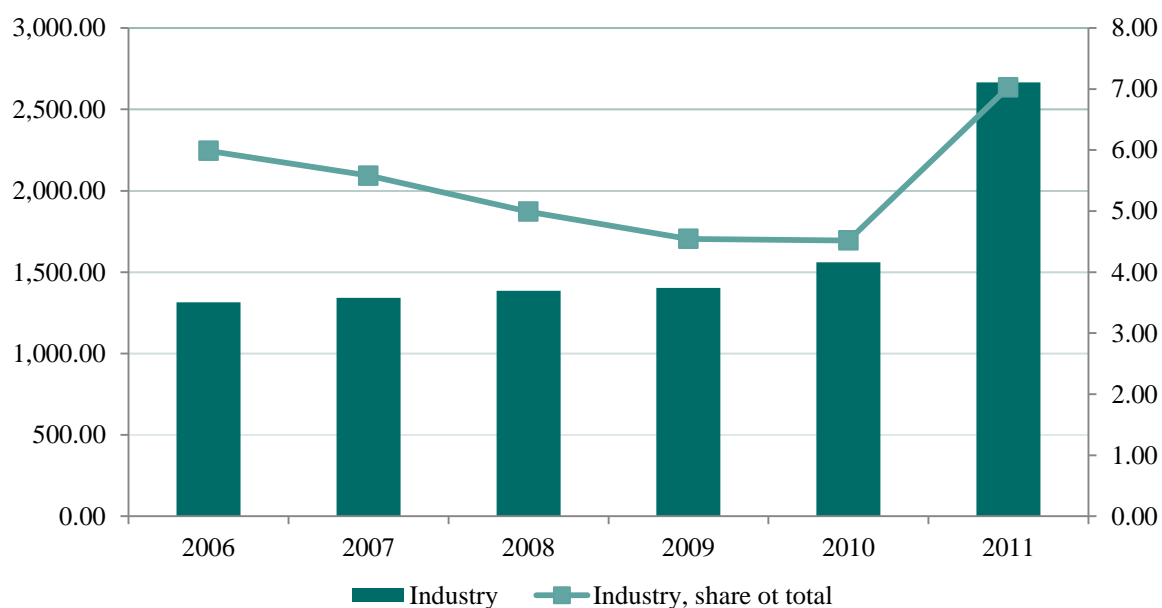
The initial premise of the Aid for Trade initiative ([paragraph 57 of the Hong Kong Ministerial Declaration](#)) was to help developing countries implement trade agreements, and to support them to increase their supply-side capacity. However, merely producing more of the same products cannot be counted as being developmental. More of the same doesn't help to build sufficient governance capacity to achieve and sustain high investment, or to implement policies that encourage the acquisition and learning of new technologies. Instead, developing countries need help to build productive capacity to produce better and higher value products (Basnett and Martins, 2013).



Men assemble women's coats in a textile factory in Chimaltenango, Guatemala. Source: [Flickr](#)

AfT commitments for building productive capacity have been increasing (Figure 3). In 2011 they increased by \$171 million to reach \$18 billion (OECD, 2013: 63). This increase is a positive response by donors to a clear need in developing countries. Much of the aid in this category was allocated towards areas such as 'banking and financial services', 'banking and other services' and 'agriculture'. Industrial policy and development, a central component of building productive capacity, received a declining share until 2011 when the trend was reversed. The momentum created by this new trend in AfT flows must now be maintained.

Figure 3: Aid for Trade allocated towards industries (constant 2011 prices, in \$ million (left axis) and in percentage (right axis))



Source: OECD (2013).

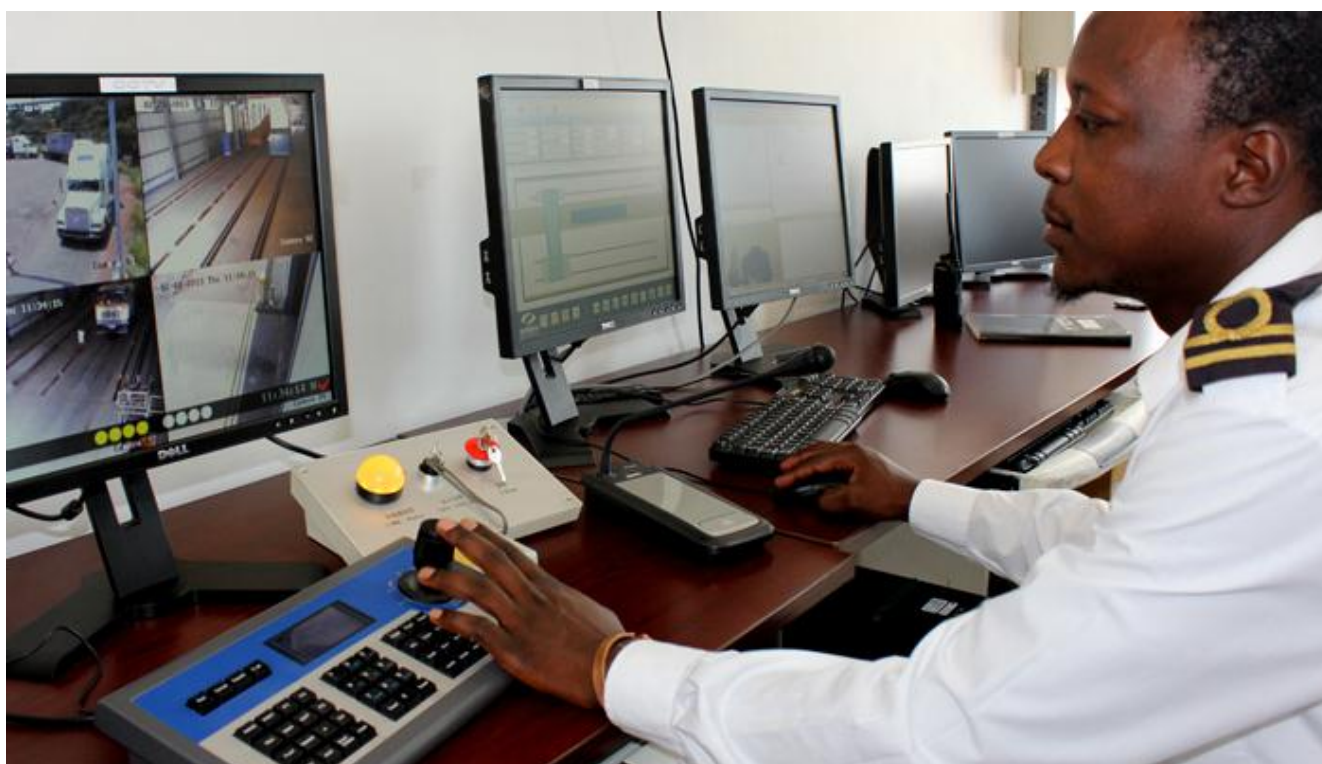
Improving industrial policy and increasing industrial development will be important in terms of achieving economic transformation in LDCs, which is a key development agenda for such countries as reflected in the Istanbul Programme of Actions. The experience of economic development, of the road to prosperity and stability, is one of countries successfully managing the process of economic transformation to modern economy (Chang, 2012; Lin and Chang, 2009). Industrialisation of the economy, and in particular an increase in the share of manufacturing (given the scale of its impact), will be important in the structural transformation of the economy (Rodrik, 2008).

How can Aid for Trade help build productive capacity?

- Identify value-chain bottlenecks that undermine incentives to invest, trade and that block economic transformation.
- Address market failure to increase productive capabilities.
- Improve learning by doing. In the absence of transferable blueprints a lot depends on learning from trial and error.
- Make markets work by removing governance failure.

5. Reducing the cost of trading

The implications of the high cost of trading are considerable for developing countries where the appropriate infrastructure is absent, where capacities are weak and where regulations are inefficient and ineffective. Trade facilitation seeks to reduce the costs and burdens arising from cumbersome procedures and controls that regulate the movement of goods crossing national borders. In many instance, reforms to improve trade flows are undermined by difficulties in finding a balance between security and health concerns, on the one hand, and improving efficiency of border regulations on the other.



Scanner operator compares a scan with a truck's manifest. Source: <http://trademarksa.org>

Developing countries, and LDCs in particular, face a double burden – on the home-front and in their export markets. Inefficient and outmoded border procedures and regulations at home increase the cost of trade, while weak technical capacities make it difficult to meet the standards in export markets (Basnett, 2010). The cumulative effect reduces the growth potential of trade, and its ability to contribute to broader economic growth and development. Improving trade facilitation will involve modernising procedures and regulations and upgrading infrastructure and technology, as well as building the technical capacity of trade standards institutions (Brandi, 2013; Basnett, 2013c).

Table 2: Trade facilitation performance by development status

	Least-developed country average	Middle-income country average	OECD average
Burden of custom procedure (1= extremely inefficient to 7 = extremely efficient)	3.56 Range: 4.6 (Rwanda) – 2.4 (Haiti)	3.78 Range: 4.7 (Hungary) – 2.1 (Venezuela)	4.9 Range: 6.1 (Finland) – 3.8 (Greece)
Documents to export (number)	10 Range: 11 (Nepal) – 5 (Djibouti, Samoa)	6 Range: 10 (Iraq, Kazakhstan) – 3 (Panama)	4 Range: 7 (Slovak Republic) – 2 (Ireland)
Time to export (days)	33 Range: 81 (Afghanistan) – 18 (Tanzania)	20 Range: 81 (Kazakhstan) – 8 (Dominican Republic)	10 Range: 19 (Italy) – 6 (United States)
Documents to import (number)	9 Range: 17 (Central African Republic) – 5 (Djibouti)	7 Range: 12 (Kazakhstan) – 3 (Panama)	4 Range: 7 (Australia) – 2 (France, Ireland)
Time to import (days)	39 Range: 98 (Chad) – 21 (Kiribati, Madagascar, Gambia)	23 Range: 82 (Iraq, Venezuela) – 8 (Malaysia)	10 Range: 18 (Italy) – 5 (Denmark, Estonia, United States)
Quality of trade and transport-related infrastructure (1=low to 5=high)	2.72 Range: 1.51 (Djibouti) – 2.78 (Malawi)	2.67 Range: 2 (Gabon) – 3.79 (South Africa)	3.68 Range: 2.79 (Estonia) – 4.26 (Germany)

Source: Author's calculation based on World Development Indicators (accessed November 2013).

A recent econometric analysis by Massa (2013) provides new insights on the determinants of Aid for trade facilitation effectiveness. The study finds that 'aid for trade facilitation on its own is important for fostering export flows, but it is its combination with good-quality institutions in recipient countries that allows aid for trade facilitation disbursements to unfold their positive effects' (Massa, 2013: 9).

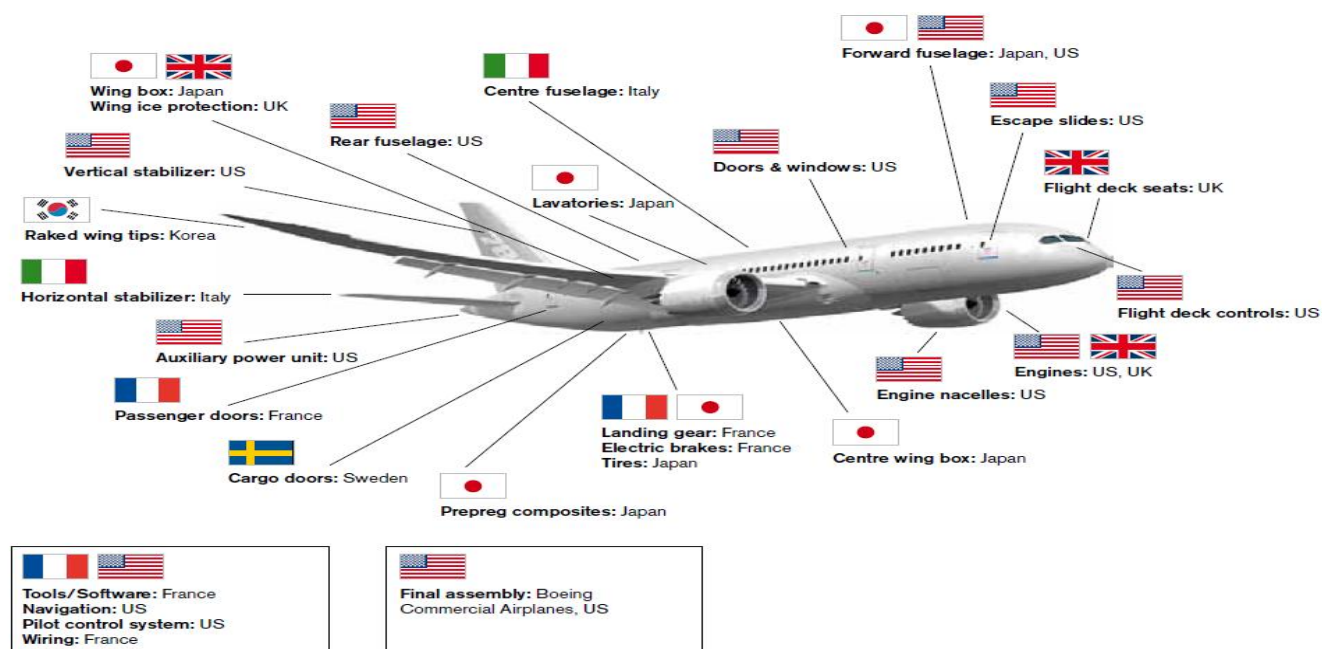
How can Aid for Trade help reduce cost of trading?

- Modernise customs, and facilitate technology transfer to improve border procedures.
- Improve capacity to meet technical barriers to exports, and leverage investments for trade infrastructure.
- Improve the quality of trade-related institutions and trade-logistics services.

6. Strengthening capacities to benefit from global value chains

Production processes are organised increasingly around global value chains (GVCs); the lead firms that drive GVCs determine the location of the various stages of production across countries. Hence, countries, and firms located within them, are *trading in tasks* – in other words, providing inputs in a larger GVC. More than half of manufacturing inputs are intermediate goods, and more than 70% of service imports are intermediate services (OECD, 2013). Figure 4 shows the inputs into the production of Boeing 787 Dreamliner and highlights the importance of technological development for participating in high value GVCs.

Figure 4: Source of inputs for the production of Boeing 787 Dreamliner



Source: http://www.oecd.org/about/membersandpartners/publicaffairs/Wyckoff_Parliamentary%20Days_12%20Feb%202013.pdf

GVCs have been around for some time, but have gathered importance as a result of their increasing relevance in global trade. Developing countries do not have to produce final products, freeing them from the complexities of doing so. The emergence of GVCs presents both opportunities as well as challenges to developing countries.

They can benefit from insertion in a GVC through a specialisation in one stage of production, or task, which can provide a fast route towards global integration. However, participating in a GVC means overcoming barriers to entry and climbing the value chain can be a challenge for LDCs (Nissanke, 2010). Some GVC governance structures can facilitate this process but others may hinder it (see Keane, 2013). For example, there may be particular challenges for those countries that find themselves situated within a GVC characterised by an overall captive structure of governance. This structure may arise when a few buyers can source from many suppliers, reducing their bargaining power.

How can Aid for Trade help developing countries benefit from global value chains?

- Support diversification and increased value-added exports.
- Support strategic industrial policy to address market failures.
- Provide logistical infrastructure to reduce trade costs and improve trade competitiveness; new evidence suggests that the costs of trading matter even more now than in the past.
- Alleviate non-tariff barriers to trade, and help build developing countries' capacities to meet technical barriers to exports.
- Promote coordination between countries to alleviate inefficiencies at the 'whole of the value-chain' level.

Table 3: How can Aid for Trade help address market failures affecting entry and participation with global value chains?

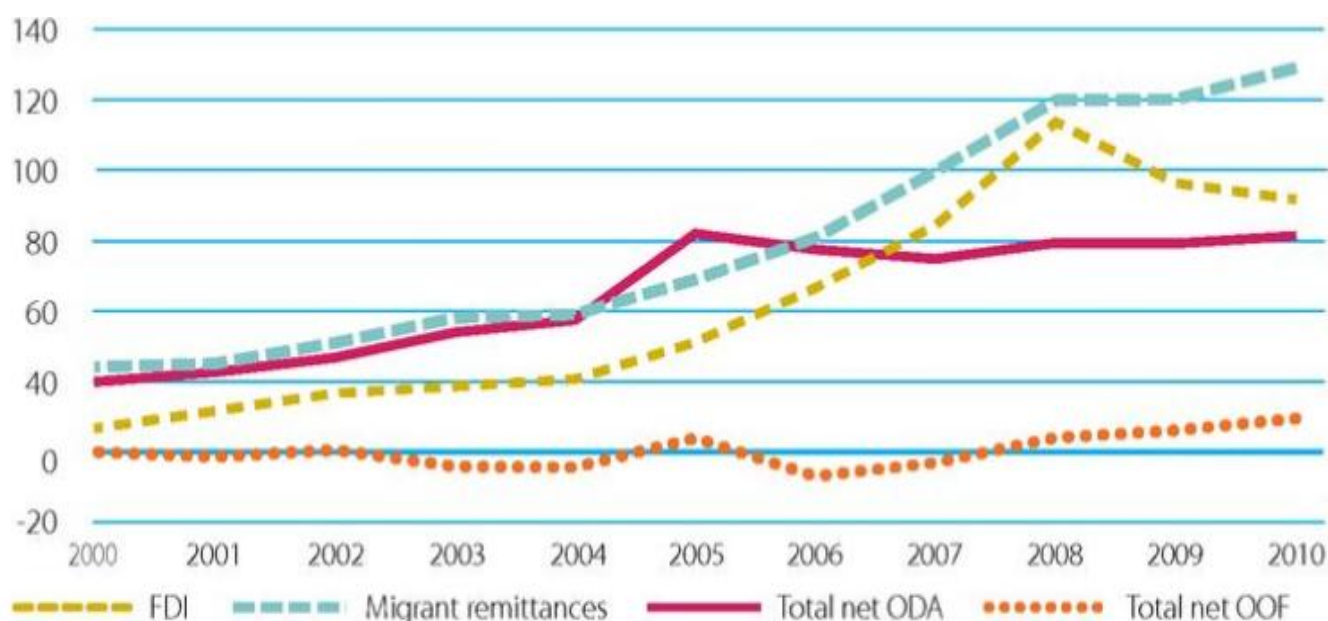
Type	Examples	Responses	Aid for Trade category
Coordination	Externalities and complementarities ignored; linkages not exploited; no policy coherence	Capacity building for industrial policy	Trade development; Trade-related infrastructure; Building productive capacity
Technology: developing, adapting and adopting	Incomplete and imperfect information; network externalities	Promotion of technology transfer and adoption	Trade development and Trade-related infrastructure
Skills formation	Externalities, imperfect information	Coordination and/or subsidies for training	Building productive capacity
Environment: protection, conservation, cleaner technologies	Negative externalities not accounted for	Product and process standards and regulations	Trade policy and regulations

Source: Keane and Page (forthcoming), adapted from te Velde and Morrissey (2005).

7. Leveraging other financial flows

The importance of aid in comparison to other flows is decreasing. In developing countries, foreign direct investment (FDI) and remittances have emerged as the largest financial inflows, and are substantially more than aid flows. In low-income countries, remittances are the largest financial inflows followed by FDI and aid, which increased between 2000 and 2005, but has since remained at 2005 level (Figure 5).

Figure 5: Development finance flows in low-income countries (\$ billions, current prices)

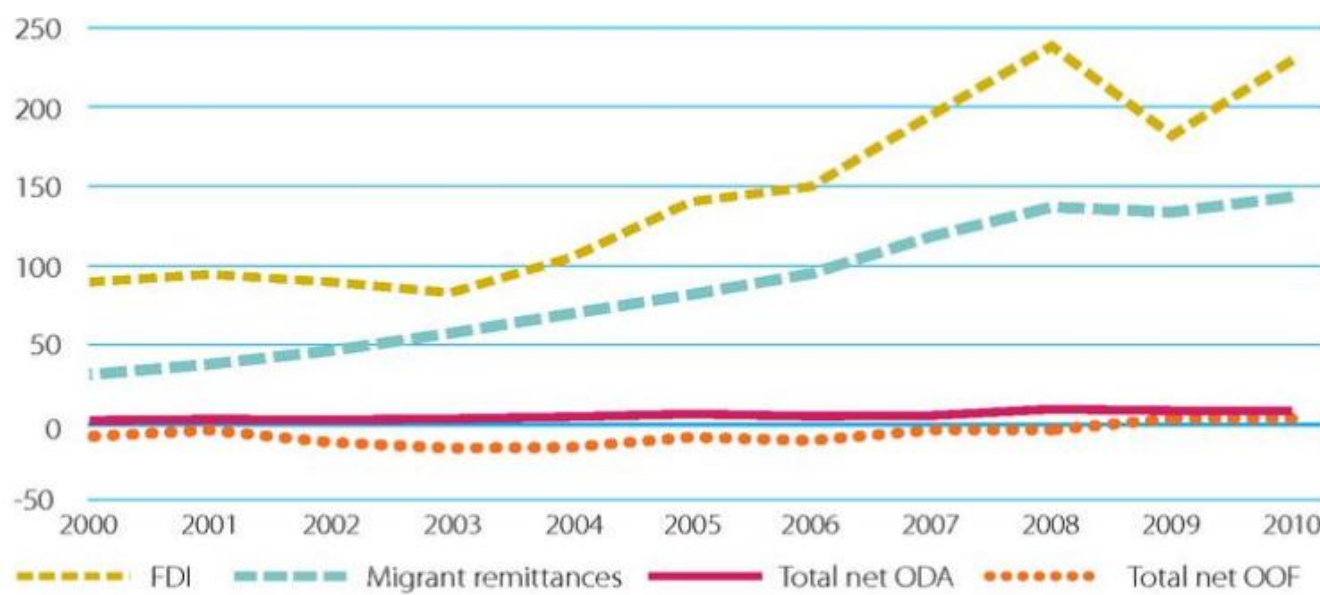


Notes: ODA = official development assistance. OOF = Other official flows. Source: OECD (2013).

Aid is likely to remain important in low-income countries. The linkage between remittances and productive capacity is not well established, although remittances tend to help build productive capacity at household level through investments in education and skills. Remittances tend to be small in size and are dispersed across remittance-receiving households. The absence of appropriate financial instruments in low-income countries means that remittances do not translate into large-scale investment (in the proportion of their inflows) (Jones and Basnett, 2013). FDI, which had been increasing until 2008, remains concentrated in a few resource rich, low-

income countries (UNCTAD 2012). In comparison, FDI and remittance flows are vastly greater than aid flows in middle-income countries (Figure 6).

Figure 6: Development finance flows in middle-income countries (\$ billions, current prices)



Notes: ODA = official development assistance. OOF = Other official flows. Source: OECD (2013).

AfT can help leverage other financial flows¹ in building productive capacity and improving trade competitiveness. Some of the key constraints faced by low-income countries, such as inadequate provision of infrastructure, weak manufacturing base and limited technology demand capital investments that are unlikely to be met by aid alone. Low-income countries also face problems arising from coordination failure, and here traditional aid could play an important role at the national level, while AfT could focus at the regional level. Greater impacts on productive capacity could be realised by building linkages between aid investments and other financial flows. By working with the private sector across borders AfT provides a unique vehicle to achieve such objectives. However, this will require AfT to address context-specific constraints that reduce incentives for private investments in the productive sectors of the economy.

How can Aid for Trade help leverage other financial flows?

- Alleviate coordination failure.
- Improve regulatory frameworks and help reduce investment risks.
- Support the design of innovative financial instruments to leverage private financial flows, particularly remittance, for trade infrastructure development.

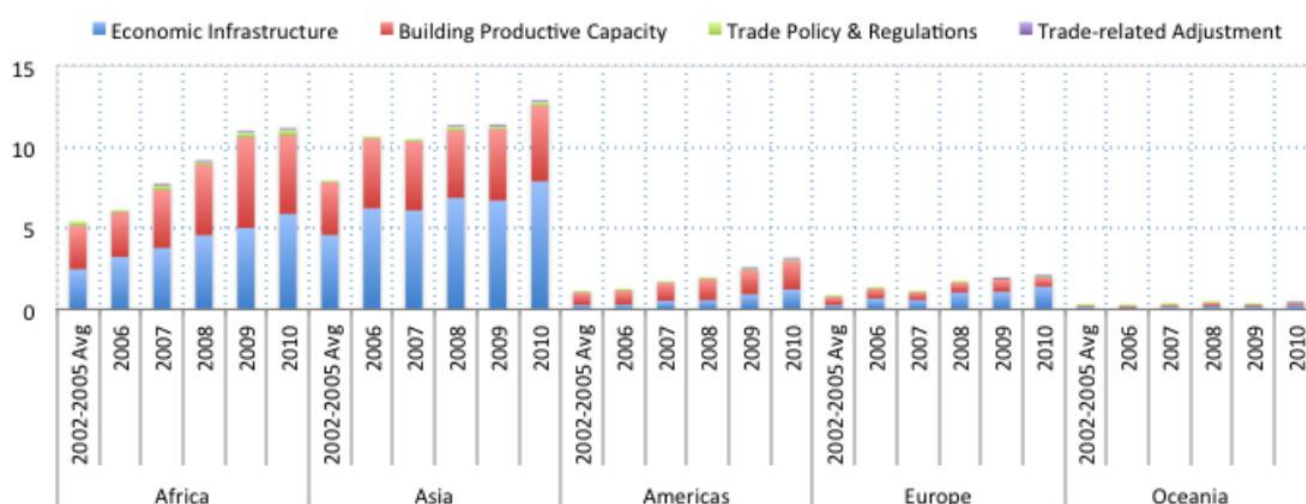
¹ For further discussion see <http://www.odi.org.uk/opinion/7600-aid-trade-structural-transformation-investment>. Also chapter 16 in te Velde and Razzaque, 2013.

8. Deepening regional integration

Regional integration makes it possible to overcome trade constraints and leverage the benefits of scale as well as from the enlarging of markets. For instance, regional integration can help to improve access to ports, allocate resources, harmonise custom procedures and regulations, build trade infrastructure and increase investment flows. In doing so, it can help to facilitate the emergence of regional value chains, and provide a better footing for global integration.

Bilateral and multilateral development partners have been engaged in support to regional and cross-country initiatives, with recent trends suggesting a scaling up of AfT efforts at the regional and global level (Byiers and Lui, 2013). Total disbursements under regional and sub-regional AfT were about \$1.5 billion on average between in 2002-2005, increasing to \$5.5 billion in 2010 (Plummer, 2013). The share of regional and sub-regional aid for trade in total AfT has grown from about 9% in 2002-2005 to 12% in 2006 and 17% in 2010.

Figure 7: Total Aid for Trade disbursement by region and category (\$ billion, 2010, constant)

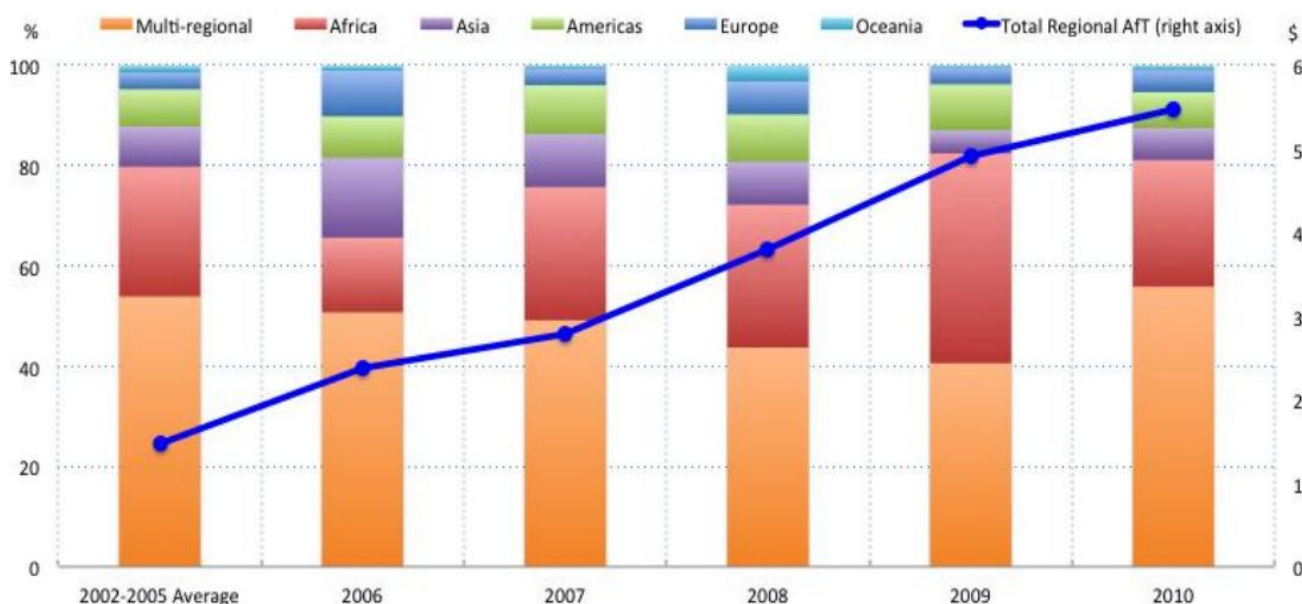


Source: Plummer (2013).

AfT that is delivered at a regional level is most prominent in Africa, where it has more than quadrupled in terms of overall resources available – and tripled as a share of total Aid for Trade delivered – in just the three years

from 2007 to 2009, to reach around 10% (Byiers and Lui, 2013). In contrast, AfT to Asia, which stands at an overall level comparable to that going to Africa, is almost exclusively delivered at national level (99%), with the regional dimension being quite marginal.

Figure 8: Share of regional and sub-regional Aid for Trade disbursement (per cent = left axis and \$ billion 2010 constant = right axis)



Source: Plummer (2013).

How can Aid for Trade help deepen regional integration²?

- Encouragement of greater regionalisation of trade-related projects, which will benefit from economies of scale and potential administrative streamlining, scaling up success, and improving knowledge-sharing and best practice.
- Creation and operation of better regional AfT instruments, particularly in the areas of infrastructure development, trade facilitation and building productive capacity.
- Regional AfT could help to strengthen the implementation of regional trade commitments.
- Regional AfT strategies could improve vertical coherence to ensure that national trade policies and regional priorities reflect each other.

² See: Byiers and Lui (2013).

9. Managing for development results

A review of the growing number of country-level case studies suggests that AfT is subject to the same failures of collective action that affect aid in many other sectors, which relate to political economy dynamics among donors, recipients, regional economic communities and their member-state governments. Country experiences highlight the importance of national ownership throughout the programming and policy cycle, and of recognising that institutional and organisational structures and relationships may affect the sustainability of investments. We have identified success criteria at each stage of Aid of Trade programme design and implementation that influence results (Basnett and Engel, 2013), as set out in Tables 4, 5 and 6.

Table 4: Selecting the most effective structure for the delivery of Aid for Trade

Key processes within stage	Success criteria to increase effectiveness
Developing AfT objectives and strategies	<ul style="list-style-type: none"> • Familiarity among officials with donor’s own AfT strategy and priorities. • Linkages between AfT and other related development strategies (e.g. agriculture, infrastructure, development of small to medium-sized enterprises). • Understanding at country level of AfT as a concept and its objectives (and what projects are considered to be AfT).
Selection of appropriate aid instruments and modalities	<ul style="list-style-type: none"> • Assessment of the relative benefits and risks of loans and grants (and blended finance). • Pooling of funds to help improve efficiency (although this may create too much uniformity in provision).
Structuring trans-national programmes	<ul style="list-style-type: none"> • Effective coordination between regional recipients and/or member states of Regional Economic Communities (RECs). • Capacity among RECs to design, implement and monitor AfT investments. • Potential linkages/conditionality between AfT and regional trade agreements. • Donor structures to deliver regional and transnational AfT.

Source: Basnett and Engel (2013).

It remains important to have effective coordination and identification of AfT needs and strategies in developing countries and between donors and recipients. In some countries, the needs assessment process is seen as owned by the Ministry of Trade and by donors, and does not incorporate the cross-cutting significance of these

constraints for other ministries. Ultimately, it lacks the necessary cross-governmental prioritisations and there is a lack of follow-up by governments or donors.

Table 5: Design and implementation of Aid for Trade

Key processes within stage	Success criteria to increase effectiveness
Developing programmes that reflect AfT priorities	<ul style="list-style-type: none"> • Coordination between donor agencies to avoid duplication. • Effective recipient focal point and coordination mechanism. • AfT awareness among donor field offices. • Joint planning between donors and recipients on trade-related constraints.
Implementation of programmes	<ul style="list-style-type: none"> • Coordination among ministries, and between implementing agencies and ministries. • Stable tenures of officials on both sides to improve coherence and consistency. • Improvements and utilisation of country systems to deliver AfT.

Source: Basnett and Engel (2013).

There has been a broad spread of AfT coverage but, as a result, some areas are under-supplied. Shifting donor priorities mean a lack of funding consistency for recipients. Recent moves towards more pooling of funds, as well as more trans-national and corridor approaches to AfT could address some of these concerns. The impact of the North-South corridor initiative in Africa and the Greater Mekong region initiative in Asia illustrate the potential of regional actions in boosting trade.

Table 6 Monitoring and evaluation

Key processes within stage	Success criteria to increase effectiveness
Developing a clear results framework	<ul style="list-style-type: none"> • Set objectives that have direct impacts on trade-related constraints and that are both deliverable and measurable. • Use empirically tested results chains.
Selection of appropriate indicators	<ul style="list-style-type: none"> • Develop quantifiable indicators that translate to national priorities. • Establish clear indicators, particularly on institutional capacity.
Impact assessment	<ul style="list-style-type: none"> • Develop baseline data. • Use of sophisticated evaluation methods. • Effective control for other policy variables.
Ensuring that monitoring and evaluation, and impact assessment inform ongoing and future projects	<ul style="list-style-type: none"> • Invest in the lesson-learning process. • Incentivise programme managers to ensure rigour in evaluations. • Overcome barriers to joint monitoring procedures.

Source: Basnett and Engel (2013).

An understanding of the nature and causes of coordination failures and information asymmetries specific to the political economy of recipient countries and regions, as well as donor agencies, will increase the likelihood of Aid for Trade programmes delivering development results on the ground.

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