AID FOR TRADE: A MISPLACED INITIATIVE?

Arne Wiig

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Summary
Given that the motivation for aid is poverty reduction, I argue that consequently aid for trade measures need to document that they are efficient and have a potential impact on poverty. The debate about aid for trade measures lacks a focus on the poverty dimension of trade. Trade is an indirect instrument for poverty reduction and in the Sub-Saharan context, SADC in particular (which is the focus of this paper), trade has a low impact on poverty. Trade reduces poverty only if it takes place in sectors or occupations where the poor are numerous (e.g., agriculture and unskilled labour), the income distribution is not too unequal and the poor are able to take advantage of the expanding trading opportunities.

While the overall motivation for providing aid for trade is poverty reduction, I argue that such aid should only be given if there are market failures such as in coordination and public goods. After a discussion of the motivation for providing aid for trade, I analyse how aid for trade can promote international trade that reduces poverty. Aid for trade is particularly important for countries that already have market access (as is mainly the case for SADC countries) but face supply constraints that restrict their utilisation of this market access. In this case, aid and trade might serve as complementary activities. I highlight the importance of complementary activities that reach the poor. From a donor perspective, support to the agricultural sector, improvement of sanitary standards in agriculture and the ease of transmission mechanism in agriculture should accordingly be more important than manufacturing support or standards in sectors in which the poor are hardly involved.

> "For poor developing countries it is not a case of aid or trade, nor of more aid or more trade, it is a case of more effective aid and a better composition of trade. Aid can support the costs of economic structuring and trade facilitation to improve the composition of trade. Trade can then promote growth"
>
> (Morrissey, 2006, page 86)

1. Introduction and background

Although there is some evidence that trade, growth and poverty reduction are correlated in SADC countries, trade has so far not played the catalytic role in Sub-Saharan countries that it has in East Asian countries.

The Asian experience was based on the use of a deliberate industrial policy combined with an increasing opening up of international markets and trade. A main challenge for SADC is to enable member countries to reap the benefits from liberalisation by removing trading costs, facilitating infrastructural development, improving institutions and reducing tariff and non-tariff barriers. Complementary reforms are necessary in order to reap the gains from trade and aid for trade (AfT) might play an important catalytic role in facilitating these complementary reforms.

Since the Doha Ministerial Declaration in 2001, the total commitment for trade for aid assistance has increased tremendously (22% from 2002 to 2005), although its share of total aid has decreased. G-7 countries have pledged to double Aft by 2010. Multilateral donors have also scaled up their activities. These include the Integrated Framework for Trade Related Assistance (IF), the IMF's Trade Integration Mechanism (TIM) and the World Bank.[1] The *scaling up* has been linked to the Doha outcome, but the delivery of Aft is generally presumed to be the *responsibility* of aid and finance ministries and international agencies – not the WTO. Asia receives over half of total Aft (support to infrastructure constitutes the main part) while Africa receives 30% (OECD, 2007). There are no Sub-Saharan African countries among the top 10 receivers of Aft. Tanzania is the largest receiver within SADC but it receives seven times less than Vietnam.

There is a convergence between the trade and development agendas (Suwa-Eisenmann, 2007). There are different institutions and motivations behind the trade and development agendas and aid and trade has consequently been geared towards a different group of countries, The dominance of private capital flows and trade in today's globalisation might suggest a new role for aid. Rather than being a substitute for trade, the new idea is that aid can be used as a complement to trade.

The discrepancies between the key motivations for providing aid and increasing trade might impede the effectiveness of Aft. Whereas the key motivation for providing aid is poverty reduction, this plays only a minor role in the trade agenda. Poverty can be seen as a public bad, and a reduction of world poverty requires financial support. Poverty reduction is also a key ingredient of what we normally characterise as development. In light of this, I argue that the legitimacy of Aft depends on whether increasing trade leads either directly or indirectly to poverty reduction.

[1] The World Bank has completed an overview and assessment of its trade for aid activities http://www.globalpolicy.org/socecon/bwi-wto/wbank/2006/06tradeevaluation.pdf.

In the Suwa-Eisenmann review (2007) of the relationship between aid and trade, it is, however, remarkable that the poverty issue is not discussed at all. In a review of current Aft programmes, the OECD reports that few donors have a link to poverty in their Aft programmes (OECD, 2007). Part of the reason for this lack of documented links to poverty is the blurred concept and motivation for providing Aft.

Trade is no panacea for development and trade is no better than aid unless there are externalities in international trade (Adam, 2004).[2] If these externalities take place in imports (through technological spillovers) rather than exports, supporting imports rather than exports might be more effective, but probably not from a poverty point of view unless the poor can reap some of the benefits (e.g. through imports of fertilisers or modern technology for agriculture). This paper highlights a situation where part of donors' aid is channelled towards trade promotion in a way that the poor gain from, but we refrain from analysing the terms of trade effects of Aft.

Two vital conditions need to be established in order to succeed on the trade route to development. First of all, there must be a *potential to increase trade*, including intraregional trade. I argue that there is such a potential partly because of prevailing trading costs within SADC while at the same time most SADC countries have market access to developed countries. I discuss how Aft can be tailored towards reducing such trading costs. The second condition for a successful trade route to development is that trade either generates *pro-poor economic growth* or that it influences the welfare of the poor through its impact on the prices and wages of what the poor produce (and the prices of their consumption goods).

This paper is structured accordingly to the two criteria of success referred to above. In section 2, we discuss conditions in which trade reduces poverty. If trade takes place in sectors where the poor are numerous, it might have an impact on poverty. In section 3, we discuss the rationale for providing Aft and how such aid can contribute to trade and a reduction in poverty – either directly or indirectly by reducing trading costs or improving the transmission mechanism. Section 4 concludes.

2. What type of trade can lead to poverty reduction?

Trade influences poverty indirectly through economic growth and directly through prices and wages. First, we explore the growth mechanism and we then proceed to analyse the impacts on prices and wages.[3] The types of sector that expand and income distribution in the country play an important role in how trade reduces poverty through economic growth. Generally, if more trade leads to higher

[2] In fact, the normal case is that aid is better than trade. Johnson (1967) shows a special case where trade is better than aid. If aid is provided and there are imperfections in the receiving country (for instance protection) and the additional support leads to more production of import-competing products, it might lead to immerising growth (through a Dutch disease impact or a distortion in the terms of trade in the recipient country). This will lead to more domestic production of importable products (reduced imports) and exaggerate an existing overproduction and underconsumption of importable products. Tokarick (2008), on the other hand, finds evidence that aid contributes to an expansion of net imports and to increasing prices for non-traded goods (non-traded goods are substitutes for imports). The price increase in non-tradeables reduces the demand for these products, but increases the demand for imports. The main point is that aid for trade might have general terms of trade effects that influence its impact on welfare. Here we follow a partial approach, analysing as if it is less costly to export.

[3] See Winters et al. (2004) for a review of the literature.

production of agriculture, rising wages for the unskilled and/or increasing employment, the poor are likely to gain from this process.

2.1 Trade, inequality and economic growth

Trade and liberalisation of trade, both unilateral and multilateral, are thought to influence poverty through their *effect on economic growth in the long run* and on *wages and prices* (and therefore household welfare) in the short run.

Economic growth can be achieved through the accumulation of physical and human capital and technological change. *Institutions, international trade and geography* are referred to as the deeper determinants of growth that drives physical and human capital accumulation and technological change. Without the accumulation of capital or technological change, trade is unlikely to influence economic growth.

Openness promotes competition in domestic markets. Competition increases the pressure on firms to be innovative and provides consumers with a wider choice, ideally at lower prices. To exploit their comparative advantage, firms need to bring in new skills and technologies. Integration eases the transfer of technology between firms. Trade expands the market for domestic firms and thereby the return on infrastructural investments characterised by high fixed costs (roads, telephones, ports and so forth).

It is, however, hard to map out the exact relationships between trade and growth due to the interdependencies of all these variables and the income level. Both good institutions and higher trade volumes are associated with growth and higher income levels. *A major challenge in the literature is to disentangle the impact of trade on growth from that of institutions*.[4]

Even though trade is found to increase growth, the impact on poverty is not a one to one relationship, as growth may increase *inequality*. The structure of the growth and its initial distribution are important for poverty reduction. Ravallion (2006) found that growth in agriculture in China had a four times higher poverty impact than growth in the secondary sectors. The higher the initial inequality in a country, the less the gains from growth tend to reach the poor (Ravallion, 1997, 2001; Kraay, 2005). Ravallion (2001) finds that among the growing economies the median decline in poverty (US$1 a day) is 10% in countries where inequality also declined, and only 1% for countries where growth was accompanied by rising inequality. Ravallion (2001) finds that a 1% increase in mean income results, on average, in a fall of 2.5% in the proportion of people in absolute poverty (the poverty elasticity is equal to -2.5). Inequality increases about half the time (between countries) and there are gainers

[4] Sachs and Warner (1995), Frankel and Romer (1999), and Dollar and Kraay (2001) all conclude that trade has a positive effect on growth. Rodriguez and Rodrik (2000) criticise this work, suggesting that methodological problems leave results open to misinterpretation. Acumoglu et al. (2001) find that institutional quality is the more important determinant of income. Easterly and Levine (2002) state that institutions trump trade as a determinant of growth. Rodrik et al. (2004) suggest that institutions not only trump trade but even geography. Dollar and Kraay (2002a), however, conclude that when both trade and institutions are included in regressions it is difficult to distinguish the effects of the two. In a meta-study of cross-country growth regressions (with not more than seven independent variables), Sala-i-Martin et al. (2004) report that trade volume is significant in two thirds of the regressions, though it is not among the 18 most robust predictors of economic growth. See Tøndel and Wiig for an overview of the literature.

and losers at all income intervals within countries. Individual country experience varies around the average growth elasticity of poverty, and the poverty elasticity ranges from -4.3 to -0.6 depending on how the growth process performs. Anderson et al. (2006) claim that Sub-Saharan Africa (SSA) has an even higher poverty elasticity (that means trade-induced growth will have a larger impact on poverty reduction in SSA) than in many other countries, partly because agriculture plays such an important role in SSA. Removing the strict assumptions applied in Anderson's analysis (full employment), Polanski (2005) finds a low impact of multilateral trade liberalisation on poverty in SSA.

Empirical evidence in SADC on the trade-growth-poverty nexus: positive but small, partly due to increasing inequality

Within SADC the overall empirical evidence fits the picture of more trade being associated with lower levels of poverty. Lesotho, Malawi, Mozambique and Swaziland experienced both increasing trade and a reduction in poverty during 1990-2001. Zimbabwe and Zambia experienced an increase in the poverty rate and a decrease in trade over the same period. So the evidence from these countries also supports the notion that more trade is positively associated with poverty reduction while less trade is associated with higher levels of poverty. Madagascar, South Africa and Botswana show diverging experiences in trade and poverty. Both poverty and trade have decreased for Botswana and Tanzania while for South Africa and Madagascar the increase in trade has not been associated with poverty reduction (see Tøndel and Wiig 2007 for an overview).

When we consider the trade inequality relationship, the countries appear to be in two groupings, Mozambique, Madagascar, Malawi, Zambia, Zimbabwe and Tanzania in the first group and the SACU countries Swaziland, Lesotho, Botswana and Namibia in the second group (South Africa is an outlier with lower trade shares than the other SACU countries). Within the two groupings there does appear to be a pattern where more trade is associated with less inequality (lower GINI coefficient). Thus, cross-country statistics suggest that for the SADC countries trade does not appear to be harmful in terms of increasing inequality within the two groups of countries and that more trade is associated with lower levels of poverty. If we do not distinguish between these two groups of countries, there is a tendency that increasing trade is associated with rising inequality – a factor that offsets some of the gains in poverty reduction via trade-induced growth. The increasing inequality is a factor that should be recognised by governments and donor communities when designing a policy for increasing trade.

2.2 Trade, prices and household welfare

In addition to its impact on economic growth, trade can also have more *direct impacts* on poverty through its effect on the *wages* of the unskilled in developing countries. It might also lower (raise) the *prices of consumption goods* and raise (lower) the *prices of goods produced* by the poor. Trade affects the prices that the poor face both as producers and consumers. If the (consumption) prices of the goods they consume fall and the (production) prices of the goods they produce increase, trade will have a positive effect on poverty. If increasing trade leads to both increasing (decreasing)

consumer and producer prices, the total effect depends on the net budget share of the consumed and produced goods. As SADC countries are net exporters of agricultural products, they will accordingly gain from an increase in the price of agricultural products (for instance, the removal of subsidies on cotton and sugar in developed countries), a general price increase of agricultural commodities or from a reduction in the domestic taxation of agriculture. Whether the poor will gain depends on their net position (whether their production is higher than their consumption of the good).[5]

It is also well documented that the earnings-side impacts dominate the consumption-side effects of trade reform. The importance of factor market effects is due to the fact that households tend to be much more specialised with regard to income sources than they are with regard to consumption. Income normally comes from a few sources while the consumption pattern is more diversified. It is also easier to switch consumption patterns than production patterns.

According to factor endowment theories (H-O framework) of international trade, liberalisation will be pro-poor both in the short run and in the long run. In the short run, poverty will be reduced because the wages of unskilled labour will tend to increase. This happens because countries will tend to export commodities that are using abundant (and therefore relatively cheap) production factors intensively in the production process. This will drive up the demand for and therefore the price of the abundant factor. In the long run, when both capital and labour are mobile across sectors, this effect will be reinforced by the reallocation of capital into labour-intensive sectors. When a higher share of the capital stock is used in the labour-intensive sectors, the scarcity of labour will increase even more, and so will the wages of unskilled labour. These results are modified if input markets are inflexible.

If unskilled labour, machinery or farm technology are less mobile and are 'attached' to a specific sector (or crop), a reduction in protection for that sector will lead to a fall in income for workers (farmers) who are not able to relocate. However, an increase in the export activity of a sector would be beneficial to the workers (farmers) attached to that sector.

In order to reap the gain from a trade reform, the poor must be able to move out of the contracting sectors and into the expanding ones. The way the labour market is organised is vital for the impact of trade reform on poverty (see for instance Harrison, 2006).

Empirical evidence on the trade-price-welfare nexus: Complementary policies needed

Entrepreneurs involved in international trade are generally richer than those who are not (Bigsten and Soderbom, 2005; Wiig and Seleka, 2008), but it is unclear whether they are richer due to trade or because being rich plays an important role in whether you are trading or not. Being rich provides capabilities for trading. The impact of

[5] All SADC countries from which we have data are net exporters of agricultural raw materials and food (WDI, 2007). This includes Madagascar, Malawi, Mauritius, South Africa, Tanzania, Zambia and Zimbabwe.

increasing trade on poverty might therefore reflect a self-selection of traders rather than that trade by itself leads households out of poverty.

Normally poor entrepreneurs do not have enough assets to participate in international trade. Participating in international trade requires a number of assets that the poor lack, such as human capital, networks, or social capital, information and credit. There is thus an entry cost of trade that might impede the poor from participating in international or domestic trade transactions. If, for instance, local markets are not well developed, a farmer faces a risk when switching from subsistence farming to cash crop production. This risk restrains him from adjusting to new market opportunities. Similarly, the removal of trade barriers has a limited impact on trade patterns and poverty when there is unemployment as the effect of trade on unskilled wages is lower than when there is full employment (Polanski, 2005).

A low impact of trade on poverty can also partly be explained by an inefficient transmission mechanism. If a change in border prices does not transmit to the producer due to large domestic transport costs or other obstacles to doing business, the producer will not gain from potential trading opportunities.

The transmission mechanism diminishes with distance from the border and is lower in rural areas than in urban areas. That means people living in urban areas may notice the impact of liberalisation while in rural areas business is as usual.

Many studies find that a trade reform works best if complementary reforms are introduced simultaneously (see for instance Balat and Porto, 2006). These policies would include extension services, infrastructure, irrigation, access to credit, and education and health services. Arndt (2006) finds that in Mozambique, one third of rural households will be unaffected by Doha as international price changes will not transmit into changes in domestic prices. He concludes by underlining that complementary reforms are needed in order to transmit price changes to rural areas and improve supply constraints.

The overall conclusion of this section is that increasing trade has a minor impact on poverty, but its impact increases when:

- Trade barriers (tariffs and trade costs) are removed
- Trade occurs in sectors where the poor are intensively involved (e.g. agriculture)
- Income distribution is not too skewed
- The labour market is flexible
- The transmission mechanisms are working well
- Producers respond to the potential market opportunities

3. How can Aft contribute to poverty reduction?

(Short intro)

3.1 Is there a potential for increasing trade that is pro-poor?

Low-income countries within SADC already have market access to the EU through the Everything but Arms Initiative (EBA), while the African Growth and Opportunity Act (AGOA) provides preferences in the US. So market access to developed countries is probably not the key problem – at least not for those SADC countries that fall within the group of LDCs that are favourably treated in preferential arrangements. Although market access to developed countries and various sanitary standards represent obstacles to increasing SADC trade, there are internal measures – not only tariff barriers but also other trading costs – that impede trade. While tariffs are discussed in Tøndel and Wiig (2007), a comprehensive review of trading costs is given by Tøndel (2008).

Tøndel (2008) finds that Sub-Saharan African countries, including SADC and landlocked countries in particular, comprise the most costly region to export from measured both in money and time. The cost of trade increase as the quality of physical infrastructure, human capital and institutions deteriorates while exports as a percentage of GDP are higher when the time needed to export is lower. Thus, exports increase as the time needed for exporting decreases. There are accordingly internal trade barriers in addition to domestic tariffs, such as transportation costs, business obstacles to trade (inadequate infrastructure, lack of credit) and a low quality labour force, that serve as binding constraints on increasing trade. Without addressing these obstacles and trading costs, removing tariff barriers will probably have a minor impact on trade patterns as the transmission mechanism is not changed (see Tøndel and Wiig, 2007; Tøndel, 2008). On the other hand, the prevailing existence of obstacles indicates that there might be room for increasing trade through a reduction of trading costs and Aft measures can play a role in doing so.

Even if the cost of transport is relatively high in SADC, however, reducing the time needed to prepare documents and harmonise procedures might matter relatively more in terms of improving export performance. For agricultural products and products that are produced within a global supply chain network (clothing for instance), time matters for their exports.

There has been a shift over the last decade such that fresh and processed fruit and vegetables, fish, meat, nuts and spices account for more than 50% of total agri-food exports from developing countries. Traditional commodities such as coffee, tea, cocoa, sugar, cotton and tobacco have declined in terms of export share. This implies that proper facilities for storage and packing are of increasing importance, as is the time aspect of exporting. If countries wish to meet the growing demand for these products and thus reap their share of revenues, trade facilitation measures have to be addressed (Tøndel, 2008). Measures to improve the sanitary standards of agricultural products are also important for increasing agricultural exports (Wiig and Kolstad, 2005).

Timely delivery is also important for manufactured goods. A rising share of world trade is so-called 'vertical' specialisation, i.e. specialisation in the production of intermediate products.[6] When the production of final goods can be fragmented into several stages of production, we should find that some stages are capital-intensive but others are labour-intensive. A reduction in tariff barriers and technological innovation (lower costs of communication, information and transportation) encourage multinational companies to locate capital-intensive stages of production at home but labour-intensive stages of production in low-wage countries. A product (say clothing) can be broken up into separate intermediate products (or tasks) whereby each task (say design and assembly) can be produced across multiple firms, countries and times. Each firm participating in the supply chain specialises in tasks in which they produce most efficiently, and information technology is the glue that holds the different parts of the supply chain together.

In this new global economy there are additional gains from specialisation as firms take advantage of differences in the cost of labour and skills across countries to allocate tasks in time and space. Vertical specialisation and global outsourcing of intermediate products represent a growing export opportunity for developing countries, including SADC countries, but taking part in this trade requires the liberalisation of services and infrastructural development. Penetrating existing global supply chains based on vertical specialisation requires, for instance, timely delivery of high quality products. A concerted effort by SADC in many sectors at the same time may be necessary in order to participate in global outsourcing systems (Wiig et al., 2007).

There is an obvious poverty impact to be gained by reducing trading costs and improving the transmission mechanism of agricultural products within SADC (the poor are mainly in agriculture in SADC, as elaborated in Wiig and Seleka 2008), and concerted efforts should be taken to achieve this. There is not a similar obvious impact to be gained by removing trading costs within manufacturing unless such trade generates increasing employment of the poor or increasing the wages of unskilled labour. In many cases a reduction in trading costs in one sector does not prevent other sectors from reaping the benefits (it is a non-excludable good) and trade-offs between sectors are not needed. But if the reduction of trading costs is not a public good but restricted to particular sectors, from a poverty perspective the focus should be on the sectors where the poor are numerous.

From a donor perspective, support to the agricultural sector, improvement of sanitary standards in agriculture and measures that ease the transmission mechanism in agriculture should accordingly be more important than manufacturing support or the improvement of standards in sectors where the poor are hardly involved.

[6] Vertical specialisation occurs when i) goods are produced in multiple, sequential stages; ii) two or more countries provide value added in the production process; and iii) at least one country uses imported inputs in its stage of production process and some of the resulting output is exported.

Theoretical motivations for aid

In a non-distorted economy, the potential for exports is highest in sectors with comparative advantages. If the firms know the cost structures and there are no market failures (e.g., public goods, externalities and information asymmetries) or government failures (e.g., macroeconomic instability, distorting government regulations or taxes, or corruption), there may be no reason for the government or donor agencies to get involved. If there are market failures or government failures, the focus should be on removing these failures.

Gains from liberalisation are a public good - Compensation

To achieve the potential gains from global liberalisation, there is a need for tariff reduction. Participation in WTO negotiations, the implementation of WTO rules (for instance, rules on veterinary standards) and the reduction of MFN tariff rates have some of the characteristics of a *public good***.** Trade policy reform has positive external effects that are not appropriately internalised by member countries, for instance on technology, human skills and the quality of institutions in a country and on other countries. Thus, benefits from liberalisation are not sufficiently internalised by individual countries, leading to underinvestment in trade reform. Aft increases the incentives for developing countries to participate in and enhance the world trading system. Aft might also enhance the possibilities of achieving FTA within (and across) regional groupings.

The policy consequence of the public good perspective is an increase in Aft. The world's (or the regional) welfare gain from liberalisation provides room for increasing aid and aid should be used for i) integrating developing countries into the WTO and in regional organisations; ii) compensating those who lose from liberalisation at the multilateral or regional level. The first principle is acknowledged in Aft and is covered under the umbrella *aid to trade development*, while regarding the second principle there is so far no common agreement. Countries are as yet not being compensated for their loss from liberalisation.

From a public good perspective, those countries bearing the costs but achieving only minor gains should be compensated. As has been pointed out both in empirical studies and predictions of Doha effects, trade liberalisation has *adjustment costs*. Adjustment costs are related to preference erosion, tax erosion and the loss of jobs in some parts of the economy. For SADC countries, at least for those which are net exporters of agricultural production, it is less likely that they will lose from multilateral liberalisation (see Tøndel and Wiig, 2008; Wiig and Seleka, 2008). However, a loss of tax revenue from international trade might be particularly harmful for some SADC countries where tariffs constitute a significant and reliable source of government revenue. It takes a long time to develop an ordinary taxation system (based on taxing firms' profits and households' income). Also, SADC countries with preferences will lose their preference margins and trade-related aid may compensate for this.[7]

[7] Trade preferences were originally given as an aid mechanism (trade as aid), while the argument has now been turned on its head (aid for lost trade). See Hoekman and Prowse (2005).

Government and market failures

In addition to the (international) public good argument, another motivation for Aft is that of *government and market failures*. Market access is not a panacea for export growth. Government and market failures make it difficult to reap the benefits of freer trade. Investment in potential new export products requires a 'good' investment climate characterised by a flexible labour market, a competitive product market, a low tax burden, non-arbitrary regulations and licensing procedures, and lack of corruption. The absence of these qualities is frequently pointed to as instances of government failure, restricting investment opportunities. Foreign aid agencies lack power to influence these government failures apart from underlining the *important role that good governance* plays for business activities. The situation is different for market failures such as *information asymmetries* in export markets and external effects (spillover impacts or increasing returns to scale in production).

The successful development of East Asian countries indicates that what is exported may have a *spillover impact* on overall economic growth and that in order to produce goods with spillover impacts, government targeting and infrastructural investment play an important role. That said, spillover impacts do not arise only from exports and these spillover impacts are in many cases related to specific activities across sectors (learning spillovers). Promoting knowledge, learning and technology transfers is important for facilitating these spillovers. One technological spillover is related to infrastructure, which is analysed as a coordination failure.

There are also *information externalities* in exports, and production in general. For new products, technological success partly depends on the number of other investors making similar investments. The Desh company of Bangladesh was the first exporter of clothing from Bangladesh and paid the burden of entry into a new market. Based on its experience, other clothing companies were established in Bangladesh that were able to penetrate new markets at lower cost. Without any entrepreneur taking the risk of producing new products, a country will not move up the quality ladder. Early entrants may therefore provide valuable information spillovers for the rest of the economy. This externality provides a rationale for government (or foreign aid) support in order to produce new goods that may improve productivity. Within SADC, Lesotho has probably played a similar role in its clothing products for export to the American market while … (other examples of firms taking the risk????). The promotion of technology transfer, adoption of technology and standardisation support are some relevant Aft elements that reduce these asymmetries.

The other point is related to *coordination failures* induced by scale economies. The competitiveness of domestic industries can often be promoted through large investments in infrastructure and the like. Poor roads, port facilities and telecommunications are among the factors that impede exports from developing countries. To overcome these barriers, large investments are needed. While profitable for the country as a whole, these investments will normally not be profitable for any single investor. Hence, coordinated action is needed. When these barriers occur at a regional level, no single country has incentives to provide the good and regional coordinated action is the appropriate solution. Coordinated efforts to improve infrastructure are important for addressing the cost side of export procedures.

Landlocked countries depend not only on their own performance, but also on the infrastructural quality and customs operations of the transit country. Harmonisation of procedures and documentation requirements would therefore be of even greater benefit to landlocked SADC countries. This can be achieved through harmonisation across countries, simplification of documents and setting up agencies to assist firms preparing products for export. Donors pay little attention to regional public goods.[8]

Trade for aid measures are blurred and have low development impact

Trade-related assistance (TRA) can be divided into three *types* of aid policy.[9] The first is *trade policy and regulations* (assistance to trade facilitation and to achieve appropriate veterinary standards are examples). This constitutes around 1.1 % of ODA. The second is *trade development* (export promotion and support to e-commerce are examples). The third and largest category of TRA is economic *infrastructural support* (to transport, communications and energy). Infrastructural support constitutes around 18 % of total aid commitments. If we include capacity building in productive sectors (18.1 % of total ODA in 2005 was spent on productive capacity building, including trade development),[10] Aft constitutes 31 % of donors' ODA.[11]

Comparing Aft with other aid initiatives, more emphasis is put on private sector development while traditionally aid has been targeted on the public sector or directly towards the poor. Including infrastructural support under the umbrella of Aft, the borders between Aft and other aid mechanisms have diminished but not been completely eliminated. In the debate about Aft, there is no clear consensus about what distinguish Aft from other aid measures that promote the private sector. Should, for instance, compensation for adjustment costs related to trade liberalisation be characterised as Aft? Above, I argue that it should, but there is no consensus on this. What about infrastructural investments that have no direct impact on trade, or sector support for building capacity in banking that is not directly related to international trade? Investment in infrastructure such as transport is, for instance, termed Aft independently of whether the infrastructure is used for marketing the goods abroad or not. The same confusion applies for sector support. There are unclear borderlines between different aid categories and their motivations and there is accordingly a risk that we do not know exactly what we are measuring and the impact of the various aid initiatives. The blurred concept of trade for aid takes away

[8] According to Arce (2002)), much of the focus in the public goods literature has been either on the national or the global level, not on the regional level.

[9] *Trade policy and regulations* cover support to aid recipients' effective participation in multilateral trade negotiations, analysis and implementation of multilateral trade agreements, trade policy mainstreaming and technical standards, trade facilitation, including tariff structures and customs regimes, support to regional trade arrangements, and human resource development in trade.
Trade development covers business development and activities aimed at improving the business climate, access to trade finance, and trade promotion in the productive sectors (agriculture, forestry, fishing, industry, mining, tourism, services), including at the institutional and enterprise level.
All aid to infrastructure (transport, storage, communications and energy) is categorised as assisting international trade. See http://tcbdb.wto.org/publish/2005%20Report-Final.pdf
The OECD (2007) also includes building productive capacity under the umbrella of trade for aid.

[10] OECD (2007).

[11] That means, aid for trade constitutes nearly one third of total aid and it is accordingly problematic to assume that it does not influence the terms of trade.

the focus on poverty reduction as the key motivation for providing aid, which is evident from figure 1. There is no reference to poverty reduction.

Figure 1. Key elements of aid for trade according to OECD (2006)

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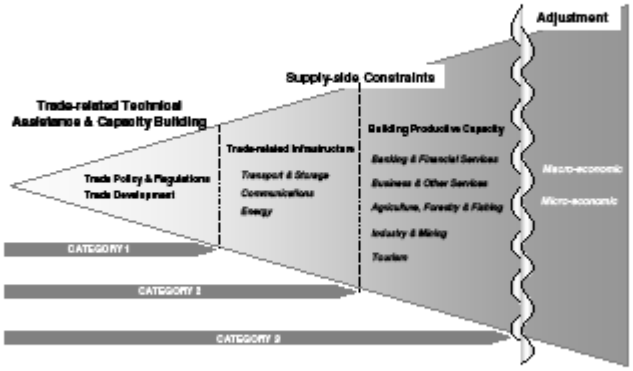
Figure 1. Aid for trade: The expanding agenda



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It is also noticeable from figure 1 that it does not directly relate to the market or government failures arguments discussed above. Current initiatives (at least supply-side capacity building policies) focus on sectors (five sectors) rather than market failure. Externalities can, for instance, occur across sectors, which makes a sector approach less efficient. Targeting a specific sector requires that the policy maker is able to identify a country's comparative advantage. Such identification is difficult, particularly if existing trading patterns are distorted due to government interventions such as trade restrictions or because of other market failures. On the

other hand, a sector approach makes it easier to support sectors in which the poor are located. But since the selection of a sector is not based on where the poor are located but on whether it is a 'productive' sector, the sector approach will only randomly target the poor.

One of the weaknesses of past initiatives for promoting trade liberalisation is the lack of investment in complementary initiatives (see, for instance, the evaluation of past trade for aid initiatives by the World Bank (2006)). That said, one problem with the argument for complementarities is finding the right mix of complementary investments (in telecommunications, roads, port facilities, energy, and also in human capital) and governance conditions that facilitates trade and exploits complementarities. These investments will vary across countries and sectors and require in-depth, case-specific competence, including competence on governance issues.

The OECD (2007) provides an overview of recent evaluations of Trade Related Assistance (Trade policy and Regulations and Trade Development, but not aid to infrastructure). The main conclusion from this study is that there are two preconditions for success:

i) the existence of a favourable domestic business environment;
ii) political will to use trade as an engine for development.

Other factors, such as adequate governance, market access and international competitiveness, also greatly influence effectiveness and impact.

The study emphasises that trade-related assistance programmes should be implemented after a review of initial internal (through a needs assessment) and external conditions in the potential country to support. Up to now, there has been a lack of such assessment and trade-related assistance has been fragmented with insufficient synergies with broader development assistance programmes and weak linkages to poverty reduction. The study mentions Mozambique as one of the few developing countries committed to making openness to trade an integral part of its strategy for sustaining rapid economic growth and alleviating poverty. Aft has accordingly been instrumental in helping Mozambique mainstream trade and other trade-related measures effectively and include indicators in its medium-term poverty reduction strategy. Aft has also helped Mozambique to stimulate public and private dialogues and partnerships, addressing supply-side constraints and integrated it into the multilateral trading system.

Since before the slogan of Aft was coined, the International Trade Centre has been dealing with policies to help developing countries to increase trade, partly based on the perspective of overcoming market failures. Similarly, export promotion agencies in developing countries have been put in place for some of the same reasons. Experiences from these activities are mixed but give important insights into targeting exports from developing countries. Lederman et al. (2006) found that some characteristics are particularly important for export promotion agencies (EPA) in developing countries. They are more efficient when the export promotion activities are shared with other activities such as investment promotion and export financing. Their onshore export support services (exporter training, technical assistance,

capacity building, including regulatory compliance, information on trade finance, logistics, customs, packaging, pricing) are more important than country image, marketing and market research activities. Finally, the presence of EPAs' offices in foreign markets does not appear to help exports from developing countries. They also find that for the median agency, $1 of export promotion creates $300 of exports. For every $1 in the EPA budget there is an additional $490 dollars of exports in Latin America, $227 in Asia and $137 in SSA. These figures are quite impressive and are supported by others. Rose (2005) found that for each additional consulate abroad, exports increase by 6 to 10 percent. There is, however, a lack of evidence that the poor reap any of these benefits.

The main conclusion of this section is that the reduction in trading costs and the time needed for exports in SADC is vital for promoting trade that also favours the poor. Improvement of infrastructure in sectors such as agriculture and a reduction in transport costs are important to increasing trade. Coordinated efforts among SADC countries should be made to undertake these investments. Aft measures should be applied explicitly to dealing with market imperfections with the main purpose of improving the welfare of the poor. At the global level, there is currently a lack of focus on Aft measures. With this lack of focus, the risk arises that foreign aid may be unnecessary spent on groups or tasks that do not need such support. Given the high population within SADC that is poor, it is therefore important that not only donors but also regional organisations like SADC tailor their aid programmes towards reaching the poor in their Aft programmes.

Conclusion

There is no evidence that trade liberalisation – even if it is comprehensive trade reform – will alone be able to achieve the Millennium Development Goal of halving poverty rates. There are high trade costs in SADC that constrain reactions to price signals from trade liberalisation. Export responses are slow. At the same time, poverty is so widespread in most SADC countries that what can be achieved from trade liberalisation alone will be modest.

Aft can support complementary reforms in the SADC countries and thereby increase the impact of increasing trade on poverty reduction, but believing that increasing trade by means of Aft is THE solution to poverty reduction is misplaced. When discussing the scale of a future Aft programme, the importance of other policies, such as safety nets for the poor, education and a pro-poor industrial policy, must not be forgotten. Increasing Aft will necessarily have alternative costs and there is a risk that Aft might reduce other more targeted poverty measures. Like other types of foreign aid, without proper *needs assessment and implementing capacity* Aft may lead to an inefficient use of aid funds. Similarly, as trade cannot solve the poverty problem for low-income countries, neither can aid alone compensate the poor countries.

Donor agencies and SADC should enhance the positive effects of their trade-related assistance by creating synergies with broader development assistance and poverty reduction programmes. Needs assessments can help identify the mitigating measures or complementary activities required to protect the poor. Furthermore, trade-related

assistance could target sectors or activities in which poor people are strongly represented and remove market failures in trade.

The discrepancy between what Aft should do (fighting poverty and reducing imperfections in trading) and what it does indicates that there is a need for further research on the donors' motivations for providing Aft and what specific aid initiative is needed for that purpose. This needs more country-specific analysis.

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