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Operational Modalities for the Aid for Trade Initiative

Background Brief No. 11

April 2006

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Related ILEAP papers

ILEAP (2005). “Aid for Trade: Why and How?” Prepared by Dominique Njinkeu and Hugo Cameron, ILEAP. Presented at a forum organized in parallel to the WTO Hong Kong Ministerial Conference.

ILEAP (2006a). “Aid for Trade: How We Got Here, Where We Might Go”. Prepared by Michael J. Finger.

ILEAP (2006b). “An African Perspective on Aid for Trade”. African Union. Prepared by ILEAP.

ILEAP (2006c). “Aid for Trade Facility: Lessons for the Tanzanian Experience on Trade Related Assistance”. Prepared by Bede Lyimo and Edward Sungula.

ILEAP (2006d). “The Financial Architecture of Aid for Trade”. ILEAP. Prepared by Massimiliano Calì, Sven Grimm, Sheila Page, Lauren Phillips and Dirk Willem te Velde.

ILEAP and German Marshall Fund (2006). “Aid for Trade After the Hong Kong Ministerial – An Introductory Text”. Prepared by Claire Healey, Dominique Njinkeu and Hugo Cameron.

These papers can be accessed on the ILEAP website, www.ileap-jeicp.org.

I. Introduction

Aid for trade (AFT) only recently made its entry into the World Trade Organization (WTO) as an issue not only for debate but probably also as a complement to various market access elements of the Doha Development Agenda (DDA) negotiations. Hence, many aspects of the initiative are neither fully known nor fully accepted by all stakeholders. This applies, in particular, to the appropriate modalities which should guide its full articulation, structuring, operationalization and implementation. This presentation offers a survey of the debate on AFT, with particular reference to issues of operational modalities. Much of this is presented in section IV. As a background, however, some preliminary issues are discussed briefly, in sections II and III. Clearly, both the problems that the AFT will be designed to address and the objectives to be targeted may have a bearing on the operational modalities of the initiative. Hence section II examines the problems and corresponding objectives. For the same reason, section III explores the question regarding whether AFT should include only one or several different “funds”, given the multiplicity of problems and objectives to be dealt with, as well as the variety of sources and beneficiaries of the fund(s). Concluding comments complete the presentation in section V.

II. Objectives of Trade-Related Assistance

It is now generally understood that trade liberalization in and of itself does not automatically lead to economic growth and development. It is also broadly accepted that many low-income countries have not been able to fully benefit from enhanced market access opportunities because of inadequate knowledge of these opportunities, non-competitive production capacity, lack of the necessary exporting infrastructure, inability to meet prevailing standards (e.g. sanitary and phytosanitary standards (SPS), and technical barriers to trade (TBT)) in high value export markets and being crowded-out of some markets by the domestic support and export subsidies of the developed countries. Trade-related assistance is justified by, at least, two considerations. One is the need to enhance the trading capacity of the low-income countries as a means of ensuring that they benefit from both existing and new market access opportunities. In this context, trade-related assistance is designed to address supply-side constraints. This recognizes the reality that market access does not necessarily result in actual market penetration; it is only a necessary but not sufficient condition for successfully expanding exports. The other concern is to mitigate some undesirable or detrimental effects of trade liberalization. In other words, trade-related assistance may help in coping with the inevitable but transitional adjustment costs of trade liberalization.

Current discussions appear to cast the AFT initiative in the form of an expanded, more sharply focused and more specifically targeted version of all existing trade-related assistance schemes. Some suggest, however, that rather than bring a blank cheque, the AFT initiative is aimed more directly at achieving a high level of ambition, in terms of market access liberalization, in the DDA negotiations by encouraging low-income countries to agree to substantial trade liberalization by the developed countries and undertake similar significant reform themselves. It is argued, in this context, that an ambitious market access outcome from the DDA negotiations will need to be accompanied by a comprehensive AFT targeted at helping low-income countries take advantage of new export opportunities by building up their capacity to trade, and assisting them to cope with any adjustment costs that may be incurred. This direct link between the AFT initiative and the DDA negotiations arises also from the concerns expressed by low-income countries that drastic trade liberalization on their part could entail significant negative impact in the form of loss of tariff revenue, closing down of industrial plants due to increased import competition and the associated loss of output and jobs; while similar levels of liberalization by developed countries could also negatively impact on low-income countries through preference erosion and increased prices of food imports.

This link can be interpreted in more than one way. For instance, AFT may be perceived as a device to entice low-income countries into making ambitious liberalization commitments with the promise that assistance will be made available to help them cope with the resulting adjustment costs. But AFT may also be viewed as a complement to, rather than being conditional upon, ambitious market access commitments in the DDA negotiations.

African countries (and the groups in which they are heavily represented) have offered various proposals for dealing with some of the possible negative impacts that may arise from the DDA negotiations. With respect to preference erosion, for instance, the African Group at the WTO, with the support of the least-developed countries (LDCs) and the African, Caribbean and Pacific (ACP) group, has argued for maintaining “to the maximum extent technically feasible” nominal margins of tariff preferences by requesting preference-granting countries to treat relevant tariff lines as “special products” for which tariff reduction would be limited. On its own, Mauritius has suggested the establishment of a fund to compensate low-income countries which suffer preference erosion as a result of DDA-related liberalization. To address the same problem, the LDCs and the ACP have called for technical assistance to improve infrastructure and thus enhance productivity and diversification of exports of the affected countries. A second type of compensation fund has been suggested. In this case, it is to deal with the negative impact of the domestic support and export subsidies for agriculture in the developed countries. African cotton exporters which are negatively affected have requested financial compensation until these distortions are fully eliminated. It is recognized that this elimination may also negatively affect net food- importing low-income African countries. Clearly, therefore, there may be divergences in the African position on these issues, since the impact of the problems tends to vary across African countries.

III. Existing Trade-Related Assistance Schemes

The articulation of the AFT initiative is, as suggested earlier, a recent event; it is preceded by several trade-related assistance schemes. A brief review of these may offer some insights with respect to the desirability, feasibility and operational modalities of the AFT initiative.

One of the earliest of these schemes is the Joint Integrated Technical Assistance Programme (JITAP). This joint initiative between the WTO and the International Trade Centre (ITC) assists low-income countries in establishing a trade policy process through which they can identify their trade interests in the framework of their overall development and poverty reduction strategies. Based on this identification, JITAP assists further in developing specific strategies for trade policy formulation, negotiation and implementation.

The six-agency Integrated Framework (IF) focuses on assisting LDCs to identify their national trade reform and investment priorities and seek funding for their implementation from donors. In effect, the IF provides assistance for trade policy adjustment through a programmatic approach and within the context of each country’s national development programme. This assistance is financed through the mechanism of consultative group and round table pledging sessions periodically organized for each country. The two critical elements of IF modalities are (a) the identification of trade priorities by the country itself, with the assistance of the IF and (b) donors financing the trade priorities that are identified. Given the nature of these modalities, there is no real guarantee that the additional funding needed for trade-related investment will always be available. Hence, in practice, the IF has had limited resources while its focus on the trade dimension of its mandate has also been limited.

Compared to grant-based trade-related assistance schemes such as JITAP and IF, the IMF has established the Trade Integration Mechanism (TIM) on normal IMF terms (i.e., interest bearing loans) based on criterion of balance-of-payments difficulties. TIM is designed to “mitigate concerns that the implementation of WTO agreements might give rise to temporary balance of payments shortfalls”. TIM will provide funding to eligible countries within the existing facilities of the IMF to tackle problems arising from preference erosion, increased import bills due to higher food prices for net food-importing low-income countries, as well as import surges associated with significant trade liberalization by these countries.

It is important to bear in mind that trade-related technical assistance is provided by more than forty bilateral donors and multilateral agencies using varying modalities. Much of this assistance emanating particularly from bilateral donors is embedded in general development assistance. Specific trade-related assistance can be grouped into three categories. The first focuses on trade policy and regulations and is directed at helping countries reform their trade policy regimes with a view to preparing for closer integration into the multilateral trading system. The second concerns itself with trade development and its aim is to help enterprises to trade more efficiently and effectively by creating a favourable business climate. The third deals with infrastructure, which helps countries to build and/or strengthen the physical infrastructure they need to produce goods competitively, and move and export them efficiently. In spite (or, perhaps, because) of the multiplicity of these schemes, there is increasing recognition of the need to improve the provision of trade-related assistance by increasing its volume, making better use of available resources, making resource availability more predictable, and targeting the provision of assistance more closely and directly at individual country constraints and circumstances. In its Communiqué of 25 September 2005, the Development Committee of the World Bank and the IMF appears to have picked up on these deficiencies of the existing trade-related assistance schemes and suggests remedial actions in the following areas:

- endorsement of the proposal for an enhanced IF, including expanding its resources and making it more effective;
- examination by the World Bank and IMF of the adequacy of existing mechanisms for addressing regional or cross-country aid for trade needs;
- support for a strengthened framework for assessing adjustment needs so that the International Financial Institutions and donor assistance mechanisms can be better utilized; and
- advice that the World Bank and the IMF should better integrate trade-related needs into their support for country programmes.

Partly in response, the World Bank and IMF have articulated a proposal to establish a multilateral fund that would provide predictable multi-year funding for investments to enable low-income countries to take advantage of open export markets. At the heart of this proposal is a dedicated fund which is contributed by a like-minded group of donors for a limited period of time to jump-start delivery of aid for trade.

IV. Elements of Operational Modalities

The discussion above shows that trade-related assistance not only deals with a multiplicity of problems and objectives but it is also provided through a patchwork of different mechanisms and agencies. Under this arrangement, the resources provided are inadequate and the focus on the trade dimension is limited. The call for a comprehensive AFT initiative seeks to address these deficiencies. Many among the likely beneficiaries would ask that a comprehensive AFT initiative

should operate under the full ownership of the recipient countries, that its activities be demand-driven, and that it be adequately financed through a grant-based fund which is predictable and available in the long term without crowding-out other existing general development assistance schemes. Clearly, the supply-side and capacity building components of such an AFT initiative may require long-term investment for which an appropriate mix of loan and grant financing may apply in varying proportions depending on the peculiarities of individual countries. But other elements related to adjustment costs may be more short-term. In particular, while losses associated with preference erosion, decline in fiscal revenue, and deterioration in terms of trade which emanate from trade reform may be permanent, countries normally adjust to such changes. Hence, any financial compensation required for altering productive capacity would be for a transitional period; although its length may vary across countries depending on their structures and flexibilities.

In broad organizational terms, the ideal scenario would be to create a comprehensive AFT initiative which supports all aspects of trade adjustment in low-income countries, using more efficient assistance mechanisms that recognize individual recipient-country characteristics and ownership and target priority trade areas defined in national development plans and strategies. At least two other features are critical: one involves the coordination and harmonization of different bilateral and multilateral trade-related assistance arrangements. The other is concerned with the appropriate alignment of the management and implementation of AFT activities with the policies and programmes of individual recipient countries.

The mobilization of the resources for a comprehensive AFT initiative raises several important questions. From what sources and through which mechanisms would the additional funds be mobilized? There are justifiable concerns, in this context, regarding whether there is enough political commitment from donors to provide adequate funds for AFT, given the need to cover projects in a large number of low-income countries that need trade-related assistance. There is also the concern for “crowding-out”: what impact would the funding of enlarged trade-related assistance scheme have on the availability of resources for more general development assistance?

For analytical convenience, it is useful to decompose the elements of AFT assistance by type and source of problem in relation to the financing of the corresponding compensation. For example, the funding of general enhancement of supply response capacity should continue as it is now in the context of existing trade-related assistance schemes. With regard to the negative impact of countries’ own trade liberalization (i.e., fiscal revenue loss, de-industrialization, output and job losses), it is not entirely clear that external financial assistance can provide an adequate compensation when a drastic policy change occurs. A gradual and carefully programmed trade reform sequence yields much better results; it provides firms the time needed to adjust, provides government the space required to implement complementary policies and it helps to minimize adjustment costs. In the past, adjustment financing has been sourced from the World Bank and the IMF in the context of structural adjustment programmes.

The successor growth and poverty-oriented adjustment programmes also continue to have trade-related assistance components. Mobilizing resources for financing compensation for losses incurred by low-income countries as a result of the policies of the developed countries can be more directly related to the basic principle that those imposing the costs should bear the burden of offsetting them. For instance, to the extent that preference erosion losses derive from the reduction of specific trade barriers in particular preference-granting countries, it can be argued that they should compensate the preference-receiving countries for their losses. Since this would be compensation for the elimination of a prior benefit, it can be further argued it is not, in fact, aid but an entitlement. Hence, the appropriate compensation fund should be contributed to by

preference-granting countries in relation to benefit removed, and the commitment to contribute should be legally bound in WTO terms. A similar line of argument could provide the basis for mobilizing compensation funds in respect of losses imposed by developed-country domestic support and export subsidies in agriculture on both low-income country exporters (in terms of export revenue losses) and net food-importing low-income countries (in terms of increased food import bills arising from rising food prices).

A comprehensive AFT initiative which addresses these problems holistically necessarily “aggregates” funds that are made up of different components. Some of these could take the form of loans and others would be largely grants. But as argued in the preceding paragraph, the “compensation” element would represent entitlement rather than aid. It is presumed that the LDCs would receive their allocation from the non-compensation component of the funds in the form of grants, while the non-LDCs would receive a mix of loans and grants depending on their particular circumstances and the associated eligibility conditions of the various components of the funds that they choose to access.

How should AFT funds be allocated among the eligible low-income countries? This is an important question which requires a concrete and generally acceptable answer. Experience shows that the allocation of any “free” fund generates a “race for aid” which could threaten the “solidarity” of the group of recipients. It is clear, in this context, that both JITAP and IF have generated tensions between African LDCs and non-LDCs. Hence, clear and objective criteria should be established for allocating AFT funds before the initiative becomes operational. Since different countries are likely to be eligible for different components of these funds, it is useful to discuss the criteria in relation to each of these components.

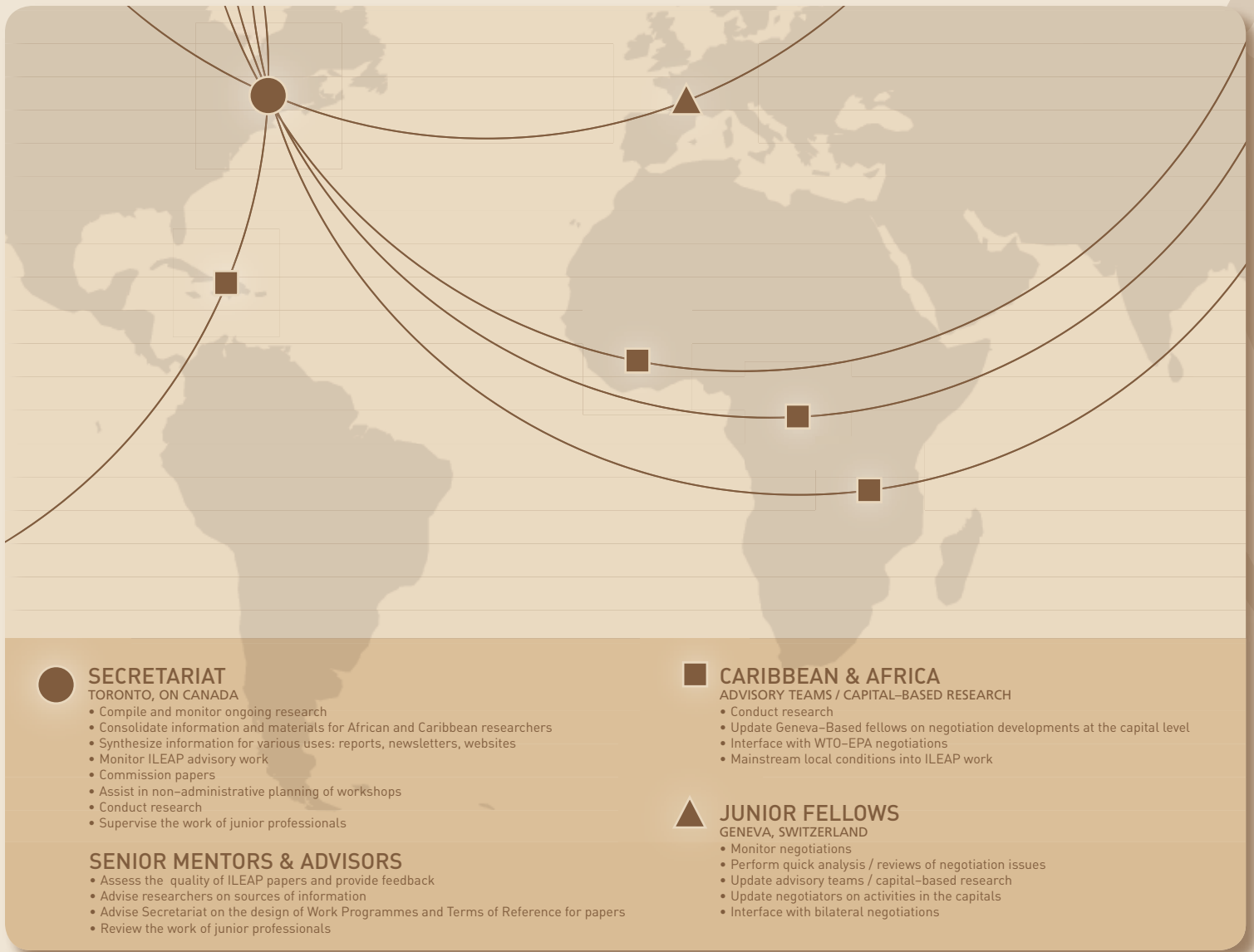
First, access to assistance for relaxing supply response capacity constraints should be open to all low-income countries rather than being restricted only to the LDCs. This component of AFT funds can most appropriately and effectively be allocated and disbursed through the consultative group and round table processes used in the IF. These processes may also be modified to reflect additional “conditionalities”, including the dedication of part of a country’s allocation to priority private sector development activities while the remaining part is used by the public sector for trade-related infrastructure investment. Recipients of AFT funds in respect of adjustment costs of own trade liberalization will, by and large, be self-selected. To the extent that the relevant facilities are managed by the World Bank and the IMF the relevant policy conditionalities and other terms will obviously apply. Finally, recipients of compensation for preference erosion, export revenue loss and increased food import bill will be countries which suffer from these specific problems. What they receive is not aid but entitlement. Hence, there would be no justification for imposing any conditions on the funds. The principle of allocation is also clear: each eligible country should receive compensation which reflects the amount of its loss in terms of prior benefits. The discussion so far has been limited to the broad principles and criteria for allocating and disbursing various components of AFT funds. Hence, there will be further details of operational modalities to be attended to in the process of developing the full architecture of the AFT initiative.

V. Concluding Comments

In discussing possible modalities for the AFT initiative, it is quite easy to gloss over the fact that the initiative has emerged in the process of negotiating the DDA. Once this context is factored in then it becomes difficult to ignore its possible (misuse) as a “bargaining chip” in the negotiations. It is worth restating, however, that no matter how attractive any AFT may be it cannot effectively substitute for a DDA outcome which substantially enhances the development of African

countries. In other words, African countries should be wary of accepting promises of aid in exchange for a DDA outcome which may be incompatible with their own development priorities. In particular, it is important to ensure that the offer of trade-related assistance to eliminate supply response capacity constraints is de-linked from the pressure for trade liberalization. In general, trade liberalization tends to yield greater dividends when it follows the build-up of effective supply response capacity. Therefore, in developing their perspectives on AFT, African countries should bear this critical sequencing issue in mind. As they will, no doubt, remember this is the broad principle which they successfully applied in the decision to negotiate trade facilitation; i.e. that developing and least-developed countries will not be obliged to implement any liberalization commitments in respect of which they either lack the capacity and/or they fail to receive adequate and appropriate assistance.

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