Aid for trade: aiding trade or trading aid – either way not much of a deal

By Bob Warner
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In January this year, Pascal Lamy, Director General of the World Trade Organization delivered a keynote address to the OECD *Aid for Trade Policy Dialogue* held in Paris. Mr Lamy stated that some $US 200 billion had been mobilised for the Aid for Trade initiative since its launch in 2005, with some US$60 billion directed to least-developed countries, and argued strongly for continued funding for the initiative. Should we be heeding his plea?

We know that removing impediments to international trade and investment have been critical ingredients for the success that many developing countries have had in reducing poverty and improving levels of well-being — China, Viet Nam, Lao PDR and Cambodia are examples that come quickly to mind.

And we also know that even in countries where a trade-driven growth path is less likely to deliver spectacular results, such as Pacific Island countries, there is no point in making trade and investment any more costly than it already is by nature of geography, size and location.

So it would seem that helping governments and their people to realise the gains from international trade and specialisation could be a useful area for development assistance. But in practice, much of the effort devoted to aid-for-trade has been irrelevant at best, and very often harmful.

A significant proportion of aid-for-trade funding has been targeted at assisting developing countries in the process of accession to the WTO, and at helping develop the institutional capacity to meet commitments made as a result of becoming members of that organisation.

While leaders in some countries were very clear-sighted about using WTO accession to achieve internal commitment to market oriented reforms (Viet Nam) or to avoid damage to key employment generating industries (Cambodia), most must now be wondering if the effort was worth it. But the process has left a more damaging on-going legacy. It has inculcated a terribly distorted mercantilist view of the benefits of trade and a corrupted understanding of the extent to which we need other countries to act collectively to reduce trade barriers for liberal trade policies to be in the national interest.

(Thirty years ago, in an address to the ACT Economics Society, Jan Tumlir, then Chief Economist at the secretariat of the precursor of the WTO, the GATT, elegantly described the misconception pervading the GATT/WTO and all other negotiations-based approaches to trade liberalisation. Tumlir pointed out that people accepted the argument that when every country protects its economy, all countries suffer. But instead of drawing the correct conclusion—that 'liberal (free) trade is the best policy for all countries', an alternative that 'liberal (free) trade is the best policy when all countries practice it' was put forward, which was ultimately corrupted to 'liberal (free) trade is a good policy only if all countries practice it'. This combined with the one-time 'fruitful lie'—as Clive Crook called it in a 2006 article in *The Atlantic*—that the gains from trade come primarily from the exports you sell rather than the imports you buy, have been the false premises on which the complex edifices of international trade agreements have been built.)

There are not entirely apocryphal stories of senior advisors suggesting to governments in transition economies that they needed to put in place restrictions on trade so that they would have something to put on the negotiating table during the process of WTO accession. And I have personally had conversations with developing country officials who have said that an important element of negotiating access to the WTO was learning how to protect local industries in a way that is consistent with the WTO. These are hardly the main messages we would like governments to take on board about trade policy.

Linking aid-for-trade to WTO accession has also meant that it has supported countries to build institutions that in all other circumstances would have been at the bottom of the priority list.

Many years ago, Mike Finger, who was (among other things) the World Bank's initial Coordinator for The Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries (LDCs), calculated that complying with just a couple of the new agreements that emerged as a result of the Uruguay Round Agreement and creation of the WTO would cost many LDCs 100% or more of their annual development budget (see here [pdf]). Mike, for the sake of argument, accepting the perverse notion built into trade negotiations that trade liberalisation was all about agreeing to reduce one's own trade restrictions in exchange for other countries agreeing to reduce theirs, made the point that LDCs were persuaded to accept these costs, but got very little in return in terms of market access in areas that really mattered to them. Much aid-for-trade has been targeted at assisting LDCs bear these costs, which might make sense if implementing the agreements was beneficial. But it is hard to see, for example, that putting in place a system to protect intellectual property rights is a priority in countries which have a really poor system for protecting rights to real property.

Other assistance has been targeted at helping to negotiate and implement bilateral trade agreements: the United State and the European Union have been very active in this arena, but has this assistance helped recipients reap the gains from trade? One not entirely cynical observation is that it has been designed more to teach developing countries favoured methods of restricting trade and enlisting local bureaucratic support for accepting these methods (for example, use of anti-dumping assistance, application of sanitary and phyto-sanitary approaches to restricting trade in agricultural products). At the very least, it has often been targeted at helping countries deal with rules of origin to take advantage of trade preferences: surely one of the dottiest consequences of non-multilateral trade agreements.

The real tragedies of much aid-for-trade have occurred where it has:

- obscured the fact that for many LDCs the big gains came from their unilateral reforms of trade and investment regimes, and that engagement with the international trade policy architecture has seldom come close to delivering benefits of that magnitude; and
- exacerbated the problem that interacting with the international trade architecture, negotiating trade agreements and engaging with the WTO diverts scarce human resources in LDC governments away from doing much more important things.

This is not to say that all aid-for-trade has been bad: it is just that where it has perpetuated a misunderstanding of where the gains from trade come from, and has not been aligned with an honest assessment of the legislative and institutional priorities of developing countries, it has done damage. A recent ODI assessment of aid-for-trade suggests that it works best when it is targeted at reducing the costs of trading (for example, helping with investment in infrastructure, improving trade facilitation and strengthening value chains) and addresses binding constraints to growth. The report also suggests that work at the regional level can be beneficial, when it works in areas such as overcoming physical barriers to trade flows. These seem like reasonable rules of thumb to use when assessing aid-for-trade initiatives. It is a shame that so much aid-for-trade doesn't conform to them.

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