

FINANCING ECONOMIC AND TRADE REFORM IN THE CONTEXT OF LIBERALISATION: CONCEPTUALISING AND ACCESSING AID FOR TRADE

Introduction

Trade has been an important engine for growth and development for many countries and there is now a growing consensus that trade liberalization may be the route to global prosperity especially if properly sequenced and accompanied by the necessary support measures. As the international community wrestles to bring the Doha Development Agenda (DDA) to a successful conclusion, there is still uncertainty about the financing of adjustment costs facing countries prepared to embark on major trade reform to better integrate into the world economy. While resources are available to address capacity constraints in least developed countries, with mixed results at best, the question of meeting trade-related adjustment costs such as infrastructure or social safety nets remains to be addressed.

In this regard, Aid for Trade (AfT) could well be the instrument that responds to those needs provided the activities to be financed are not ring-fenced. As the WTO Task Force in Geneva finalizes its recommendations for submission shortly to the WTO General Council by the end of this month, it is hoped that an opportunity will not be missed to respond to the genuine requirements of countries that are willing to carry out ambitious trade reform programs. After all, trade liberalization is a global public good.

The case for Aid for Trade

Paragraph 57 of the Ministerial Declaration of the Sixth WTO Ministerial Conference held in Hong Kong states, *inter alia*, that, “Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade. Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the DDA, particularly on market access. However, it can be a valuable complement to the DDA. We invite the Director-General to create a task force that shall provide recommendations on how to operationalize Aid for Trade. The Task Force will provide recommendations to the General Council by July 2006 on how Aid for Trade might contribute most effectively to the development dimension of the DDA. We also invite the Director-General to consult with Members as well as with the IMF and World Bank, relevant international organisations and the regional development banks with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate through grants and concessional loans.”

Aid for Trade (AfT) can therefore be defined as the provision of financial and technical assistance aimed at helping developing countries negotiate, implement and monitor trade agreements as well as build trade-related infrastructure to better integrate into the world economy.

As trade is liberalized in a country and the domestic market opens up, there is, initially a burst of cheaper goods from foreign producers which leads to a period of consolidation among domestic producers resulting in factory closures and loss of employment. Firms must be properly equipped for them to stand any chance of competing with the more efficient producers elsewhere. In the transition period, assistance also needs also to be provided in the form of social safety nets, workfare and empowerment programmes, including reskilling of the unemployed and boosting the entrepreneurial and managerial capabilities of businesses. This would be very costly and is likely to stretch beyond budgetary resources of most countries.

The point being made here is that trade liberalization is difficult to sustain in the absence of adequate accompanying measures. This is why both the US and the EU have had, at different times, to set up specific financing facilities to cope with the adjustment costs resulting from the liberalization of trade in goods and services. Developing countries implementing trade reform need similar instruments probably more than the industrialized countries.

This is why a support package, Aid for Trade, in the form of accompanying measures is needed to assist them benefit from liberalized trade. Effective Aid for Trade will enhance the growth and poverty reduction prospects of developing countries and complement multilateral trade reforms. Aid for Trade can increase the benefits of integration into the world economy, distribute the global benefits more equitably across and within developing countries, and facilitate the lowering of trade barriers.

Accessing Aid for Trade

Access to Aid for Trade funds could be considered in the following circumstances :

- Countries that are hit by terms of trade shocks, from changes in partners' trade policies, sharp swings in commodity prices, and other sources, including through voluntary market opening measures including implementation of regional Free Trade agreements such as the COMESA Free Trade Area and market opening measures in the context of the ACP-EU Economic Partnership Agreements (EPAs);
- The countries have formulated a reform program to respond to trade shocks which in the case of LDCs could be in the context of PRSPs and for middle income countries in their national development programs and/or Country Strategy Papers presented to the EU, the World Bank and/or other external partners;

Modalities

The following modalities may be considered regarding the utilisation of Aid for Trade Funds:

- general budget support and/or infrastructure financing to ease supply-side constraints, perhaps on a co-financing mode by multilateral development banks and agencies
- use of existing tools and channels pending the setting into place of new instruments, if required
- funds may come through a reallocation from existing low-performing funding instruments, for instance, slow disbursing programmes, particularly financed by and through regional funds
- each donor would use its own criteria and its own existing instruments to decide on the nature and extent of financing for a particular reform programme under Aid for Trade
- in order to ensure that Aid for Trade financing does not become a permanent feature for any country, access could be time bound. This may facilitate devoting exceptional financing for the transition period and also convey a sense of urgency to implement the trade liberalization package while external support is available

Accompanying measures

In trying to free their international trade, however, developing countries face capacity constraints as well as the need for a package of specific accompanying measures. The

capacity constraints are being or could be addressed by the Integrated Framework (IF) or an Enhanced Integrated Framework. However, even if capacity constraints were fully relaxed, a package of accompanying measures would be necessary to enable the significant lowering of trade protection. Accompanying measures are needed to:

- develop mechanisms to implement restructuring plans. These need to be adequately funded and there may be synergies in approaching this issue on a regional scale
- develop a critical trade-related infrastructure (ICT, Ports and Airport) and bring down ICT-related and freight costs
- meet the social and labour market adjustment costs of restructuring specifically in cases of dismissals and layoffs through a combination of social safety nets, workfare and empowerment programmes.
- develop regional mechanisms that will allow greater regional trade and economic integration

Possible funding sources

The case of the European Commission

The Commission could align resources for trade-related adjustment in the context of both Regional Funds and EPA negotiations. Proposals for a Regional Integration Budget Support Mechanism and for adjustment support in the context of the EPA could be folded into one facility along the lines of the COMESA Fund currently being set up.

Left over funds from previous EDFs might be an initial source of funding pending availability of 10th EDF resources. Additionally, the AFT funds promised by the EC and EU member states could be used to replenish any AFT financing for accompanying measures that could facilitate embarking on trade liberalisation measures.

Aid for Trade Financing could, if necessary, be limited to 10th EDF and the period between now and the availability of the 10th EDF. For other agencies, a period reflecting their own cycles for appropriating and/or allocating resources may be appropriate.

The COMESA Fund (and its equivalent for other regions) could have two windows: one for general budget support and another for infrastructure including, in addition to traditional road/corridor projects, an emphasis on regional communications and trade facilitation. This would involve financing, for example, the regional information highway (e.g. the EaSSy project for a high speed ICT cable), ports and airports. Since the COMESA Fund would have little capability to evaluate and implement projects, co-financing of projects by bi-lateral and multi-lateral financing organizations may be an attractive means to access these resources.

While the 10th EDF could devote resources to a facility with budget support and infrastructure windows, we should start up the facility right now with a budget support window. This would be achieved by reprogramming a significant share of unused regional and ACP funds from 9th and previous EDF to provide budget support under Aid for Trade. Such a reprogramming maximizes chances for countries to access the funds prior to the December 2007 cut off date. Moreover, adding a regional trade liberalization component in the context of a wider opening of the economy to existing PRSPs, for example, could be a mechanism to make the funds rapidly available while channelling to those most committed to reform. For countries that do not have PRSPs, the endorsement of their programme by the IMF and World Bank would have the same validation as enhanced PRSPs.

Possible funding sources outside the EU

Similar approaches could be taken outside the EU context with an emphasis on focusing additional resources within existing instruments to support a combination of accompanying measures and associated trade liberalization including within the region in terms of making Regional FTAs effective.

The United States provides significant amount of funds for trade-related activities through the Millennium Challenge Corporation (MCC) and it is expected to double its commitment to trade capacity elsewhere. Trade capacity is also being elevated into a high priority area at USAID while the Foreign Assistance Bill is being consolidated into one focusing on equally on the subject. However, access to MCC funding needs to be relaxed to include middle income countries carrying out trade reform.

Other bilateral donors and International Financial Institutions might also re-design and modify some of their programs and existing instruments to jointly co-finance reform programs under Aid for Trade.

Conclusion

Starting an Aid for Trade window now would allow an early working out of procedures to access Aid for Trade funds and would also facilitate the response to shocks by the worst hit nations. The expansion of the Integrated Framework (IF) to enhance the capacity of LDCs to more fully participate in the international trading system and to implement regional integration programs including negotiation of the Economic Partnership Agreements is commendable. However, the IF and the enhanced IF would be necessary but not sufficient to support trade liberalization by developing countries. They must be supplemented by accompanying measures that emphasize reduction of barriers, particularly within sub-regions; financing of infrastructure to relax supply side constraints; resources to allow the socialization of labour costs associated with restructuring; and mechanisms and money to pay for development and implementation of restructuring plans by import-substituting industries and sectors hit by trade shocks.