5

How Aid for Trade Could Help SVEs Integrate into the Global Economy

How can AfT address the typical constraints of SVEs? There are a number of theoretical models that could account for the role that AfT may have in promoting the export competitiveness of SVEs. One such model is developed by Limao and Venables (2002). They combine a traditional Hecksher-Ohlin model of trade with a spatial economics model in von Thünen spirit to show that regions located far away from the economic centre tend to develop import-substituting activities and few exports, due to their transport cost disadvantage. A generalised reduction in the cost of trading (due for instance to globalisation) leads the regions far from the centre to gain, with a more than proportionate increase in export activities. If AfT was able to reduce transport costs (i.e. the geographic remoteness in the model), the country's income would benefit. Limao and Venables' model is more concerned with incomes than export activities per se. This focus makes the identification strategy of the effects of AfT difficult. In fact, a review of a large number of empirical studies on the impact of aid on income growth (Doucouliagos and Paldam, 2007) concludes that this literature is fairly inconclusive. A number of factors may explain the inconclusiveness of these research efforts. Bourguignon and Sundberg (2007) argue that these mixed results are not surprising, given the heterogeneity of motives for giving aid and the complex causality chain linking aid to growth. Further, the impact of aid might depend on domestic economic policies, institutions and other conditions. The channels linking aid to economic growth are very complex and it is difficult for any reduced form equations to capture all these links. In particular, AfT is related specifically to trade-related performance; thus a more appropriate way to identify the impact of AfT is to measure it on trade-related variables.

5.1 A simple model

We present a simple export demand model borrowed from Fontagné *et al.* (2002) to show some channels through which AfT may help countries (and SVEs in particular) to increase their level of exports. In the model each country produces only one good, differentiated from the others by the place of origin; the supply of each good is fixed and consumers have identical and homothetic preferences represented by a constant elasticity of substitution (CES) utility function. The collective utility function of individuals in country *j* is denoted by:

$$U_j = \left(\sum_{i=1}^{N} \alpha_i^{1/\sigma} c_{ij}^{(\sigma-1)/\sigma} \right)^{\frac{\sigma}{\sigma-1}}$$

(1)

where σ is the elasticity of substitution between all goods, α is the share of goods from i in total expenditure in j and c_{ij} is the value of consumption of the good produced in country i by individuals in country j, with $i, j \in [1, N]$.

The utility function is subject to the budget constraint stating that the value of goods consumed by individuals in country j needs to equate national income of j.

$$y_j = \sum_{i=1}^{N} c_{ij} p_{ij} \qquad (2)$$

where p_{ij} is the price in j of the good produced in i. Defining p_i as the exporter's supply price, then where and includes all types of trade costs, e.g. transportation, tariffs, administrative costs of trade, information costs. These costs are modelled as the standard iceberg-type.[11]

Maximising equation (1) subject to the budget constraint (2) and after some manipulation we obtain the total (real) consumption (i.e. import) of good i by country j:

$$C_{ij} = \frac{\alpha_i Y_j}{\tau_{ij} p_i} \left(\frac{\tau_{ij} p_i}{\Pi_j} \right)^{1-\sigma} \qquad (3)$$

where

$$\Pi_j = \left(\sum_{i=1}^{N} \alpha_i \tau_{ij}^{1-\sigma} p_i^{1-\sigma} \right)^{\frac{1}{1-\sigma}} \qquad (4)$$

is a CES index of the trade costs faced in exporting to j, i.e. an index of trade remoteness of country j; Y_j is total income in country j ($Y_j = p_j Q_j$). Following (3) the actual – free on board – value of exports of country i to country j is given by:

$$X_{ij} = C_{ij} p_i = \frac{\alpha_i Y_j}{\tau_{ij}^{\sigma}} \left(\frac{\Pi_j}{p_i} \right)^{\sigma-1} \qquad (5)$$

If we aggregate all bilateral exports from one source as defined in (5), we obtain the equation for the total value of exports from country i:

$$X_i = \frac{N \alpha_i}{p_i^{\sigma-1}} \sum_{j=1}^{N} \frac{Y_j \Pi_j^{\sigma-1}}{\tau_{ij}^{\sigma}} \qquad (6)$$

This implies that the exports from i are positively related to countries' preferences for goods from i (i.e. a measure of how appealing good i is in the global market), to the demand capacity of all potential importing countries j (Y_j) and negatively related to trade costs faced by i in exporting to all other destinations. The direction of influence

of the price of i on exports depends on σ: in particular if $\sigma > 1$ then $\partial X_i / \partial p_i < 0$. This condition states that when the elasticity of substitution (between goods) is high, an increase in price yields a more than proportionate reduction in export volumes.

AfT enters the picture in (6) essentially by influencing two parameters of the equation τ_{ij} and α_i. Following Bouet *et al.* (2008), the former can be expressed as a function of administrative and legal barriers, distance and infrastructure:

$$\tau_{ij} = (1 + t_{ij}) b_i b_j f(I_i, I_j) d_{ij} \qquad (7)$$

where τ_{ij} is the bilateral import duty applied by country j on exports from i, b_i (b_j) is the cost of processing exports (imports) in the exporting (importing) country; transportation costs are assumed to be a positive (linear) function of d_{ij} and a negative function of the level of economic infrastructures I in country i and j (i.e. $\delta f / \delta I_i < 0$ and $\delta f / \delta I_j < 0$). AfT to country i may affect both b_i and I_i. In particular trade facilitation (TF) may reduce the time and costs of processing trade (b_i); and aid to economic infrastructure (A_{INFRA}) may increase the level of I_i. To the extent that these types of AfT affect these variables, from (7) we have that $\delta \tau / \delta TF < 0$ and $\delta \tau / \delta A_{INFRA} < 0$. It is important to note that our empirical analysis looks at the effects of AfT on total country exports (rather than bilateral exports) over time. Thus we are able to use country fixed effects, which take care of the effects of bilateral distance in (7) (i.e. the country's location in our framework). In addition, given the framework we use we are not interested in bilateral trade costs but rather in unilateral trade costs, i.e. the costs of trading of country i with all other countries. Because of this, the other determinants of trade costs in (7) specific to the importing country j (i.e. b_j and I_j) can be approximated by time dummies in a panel data analysis (which capture the average level of these determinants across countries in any year). Finally, we would ideally need to have the bilateral tariffs faced by country i in each country; such tariffs have a fairly high variation across countries, but a relatively small one over time; thus country fixed effects should be able to capture most of the variation in this case.

The other channel through which AfT may affect exports is by strengthening country i's production competitiveness, which would in turn raise α_i. This is the kind of assistance that aid to productive capacity (Apc) could provide. We can think of this as an improvement in the quality of good i which induces a relative increase in the preference of the rest of world towards i. Given equation (6), other things being equal, this would translate in an increase in exports.

Using this framework, we can speculate on the possible SVE-specific effects of AfT. One of the main features of SVEs is that d_{ij} is usually higher than average; thus the effects of any reductions in the other parameters in (7) may yield above average decrease in trade costs. Thus AfT aimed at reducing the value of b or increasing the level of I_i has the potential to yield substantial gains for SVEs. Another way in which (some of the) SVEs may be characterised in the model is through a comparatively high value of α in (6) for those preference receiving countries. This follows from the fact

that preferential market access (in markets like banana and sugar) guarantees artificially high preferences from goods from some SVEs (i.e. high values of α_i). As these preferences are going to be phased out, the value of α_i is likely to fall in those countries receiving preferences, thus reducing the value of exports from them. AfT could help counter this reduction in α_i (through aid to productive capacity).

5.2   How effective have the programmes been?

After analysing the possible effect of AfT interventions, it is worth examining to what extent this assistance has been effective in removing the constraints to trade development faced by developing countries, and by SVEs in particular.

This examination is challenging because of the difficulty of isolating the impact of AfT programmes on the recipient's economy. It is methodologically complicated to discern, for instance, what part of the changes in the export performance of a country can be attributed to more micro-level technical assistance programmes. This attribution problem has often resulted in a lack of clear and measurable objectives and indicators in programming documents (Lesser and Hayashikawa, 2006).

This may be an important reason why the general evidence on the evaluation of the effectiveness of trade-related assistance programmes has mixed results. OECD (2006) reviews the findings of various evaluations and identifies a number of problems across different donor programmes. The specific needs of a beneficiary country or programme have not always been properly assessed in advance, and even when such an exercise was carried out, the criteria tended to be too broad. This makes an accurate evaluation of the programmes more problematic. On the other hand, when AfT has been targeted at specific stakeholders (e.g. the private sector) or at particular participants – as in the case of certain USAID and UNESCAP programmes – the evaluators found better results. However, in some instances it is possible to attribute more general positive results to AfT programmes, such as an improvement in the trade negotiating environment or an increase in awareness and knowledge of trade policy issues, e.g. in UK Department for International Development (DFID) and JITAP projects.

Another common shortcoming of trade-related programmes shown in the OECD review relates to issues of governance – on the part of both the donor community and the beneficiary country. For instance, DFID's Africa Trade and Poverty Programme (ATPP) suffered from inadequate management and the absence of clear governance structures in the context of multiple agencies being responsible for the disbursement of funds and implementation of activities. Dutch multilateral trade assistance programmes also failed to take other bilateral and private sector partners into account to the detriment of the programme's effectiveness. There are also reports of lack of adequate communication between headquarters and field missions, with the result that the latter fail to take ownership of the programmes – as in the case of JITAP (OECD, 2006).

Conditions in the beneficiary country can also be held responsible for the lack of success of some AfT programmes. The OECD identifies two necessary preconditions

for aid to have a sustainable impact: the existence of a favourable domestic business environment and the political will to use trade as an engine for development. The case of Cambodia is a frequently cited success story – trade-related assistance provided by the WTO/ESCAP training programme has been credited with contributing to the country's accession to the WTO. However, it has also been pointed out that the determining factor was the involvement of the government and the level of interaction among officials across different ministries, who jointly took ownership of the entire process. This has not been the case in several trade-related technical assistance programmes, and a number of programmes are unsuccessful or unsustainable because of the lack of involvement of organisations from the beneficiary country.

Specific programmes

Evaluation of specific AfT programmes has tended to yield the same mixed results. A number of them are reviewed here, covering both national and multilateral evaluations. We address programmes that are more geared towards helping countries tackle the types of challenges faced by SVEs.

Zaken (2005) evaluates the success of TRTA programmes funded by the Netherlands – all programmes that aimed at strengthening trade-related negotiating capacity, national trade policy and/or the capacity to trade of developing countries. The main focus of the study was on multilateral programmes (IF, JITAP, UNCTAD technical assistance) and programmes funded through international organisations – the Advisory Centre on WTO Law (ACWL), Agency for International Trade Information and Cooperation (AITIC) and Quaker United Nations Office (QUNO). The results of the desk and case studies suggested that the funds disbursed by the Dutch Ministry of Foreign Affairs (a total of € 109.9 million in the period 1992–2002) were not very effective in achieving their intended aims.

The main finding of the study was that TRTA activities often lacked an adequate design and did not give due consideration to formulating and using measurable indicators to assess the success of the implemented programmes.[12] Large-scale multilateral programmes (such as the IF and JITAP) that specifically targeted least-developed economies were also considered mostly ineffective in achieving their stated objectives of enhancing trade negotiating capacities and strengthening the ability to formulate pro-poor national trade policies. The failure of the integrated multilateral programmes was related to limited absorptive capacity, a lack of political commitment on the part of the LDCs concerned and the weak involvement of the private sector and civil society in the programmes. The report (Zaken, 2005) also blamed poor communication between the Dutch embassies and the multilateral programmes, largely because the embassies concentrated mainly on bilateral funding mechanisms. On the other hand, funds that were channelled through small and single issue organisations to non-LDCs were considered to have been more effective, largely because some of these countries' representatives were already active within multilateral and other trade negotiations.

The mid-term evaluation of JITAP II was carried out by the ITC, the managing agency for the programme (Divvaaker, 2006). The beneficiary countries under study were a number of developing countries, including ten LDCs; the study period extended from 2003 to 2007.

The main findings of the evaluation exercise were that the authorisation and disbursement of funds from donors and the Trust Fund to beneficiary countries was efficient, but that the same could not be said for decentralised funds, the utilisation of which had been poor. The report found that JITAP's most important contribution was to enable a cross-section of stakeholders in its beneficiary countries to develop and better articulate their negotiating priorities at the WTO. In terms of strengthening national trade negotiating capacities, however, high staff attrition rates at such centres had dispelled any chance of further dissemination of knowledge. This was largely the result of the lack of ownership and a lack of conviction about the effectiveness of these programmes on the part of the beneficiary country.

As noted above, no external assistance programmes are specifically targeted at SVEs, but a number of programmes (described above) have addressed specific challenges faced by SVEs. Of these some assessment is available for the EU-funded banana and sugar special adjustment funds.

As far as the Special Framework for Assistance (SFA) for bananas is concerned, the Commission initially specified that funds should be used for investment in the affected industry and later insisted on diversification. The low share of SFA funds spent on diversification has been raised as an important factor in the low levels of growth experienced in traditional ACP banana-producing countries, despite substantial financing. Support has not been the critical factor in increasing investment in the industry: prospects for market access and prices have been a more important determinant. Most of the diversification projects funded under the SFA have been small-scale pilot projects within the agricultural sector. The approach has been rather ad hoc and has not addressed the key constraints in the wider business environment (e.g. public sector reform).

In designing its Sugar Action Plan, the EC and member states explicitly cited the precedent of the banana programme as an example of a badly designed programme. Gillson *et al.* (2004) refer to several critical evaluations. A major failure was the programme's tendency to support banana production in countries that have limited potential to become competitive. Several country programmes (e.g. those for Jamaica and for St Vincent and the Grenadines) have used the funds provided to subsidise farmers' operating costs rather than to finance new investment, thus hindering efforts to improve competitiveness. Only in some African countries has financing been effective in increasing productivity in the banana industry. This is largely because it was used by multinational companies to complement their own investments in productive facilities by funding the development of cableways, drainage and irrigation.

CTA (2006) highlights a further problem for these SFA programmes: that ACP governments face major constraints in providing a lead in responding to production

and trade adjustment challenges, while working through governments is central to the EC aid deployment process. With the growing emphasis on budgetary support and the distinct preference for the deployment of sugar protocol accompanying measures support in this form, working through government is a central component of the EC approach to the extension of production and trade adjustment support. Yet most ACP governments face constraints at two levels. The first relates to the understanding of ACP governments of the nature of the production and trade adjustment challenges (and opportunities) faced. This problem is particularly acute in those countries facing the greatest challenges to their competitiveness. The second relates to the administrative capacity of governments to effectively channel and deploy available support to restructuring efforts led by the private sector. The administrative constraints faced by ACP countries in dealing with EU procedures usually lead to very slow rates of aid disbursement, which may undermine the value of the assistance extended in support of time-sensitive adjustment processes. Table 5.1 illustrates the extent of this problem as far as SFA is concerned for a number of SVEs.

Table 5.1. SFA allocation and payments (as of December 2004)

Country 9th EDF NIP	1990–2005 SFA allocation	Total payments	% payments
St Vincent & the Grenadines	40,589,801	3,119,992	7.70
St Lucia	58,234,810	16,043,206	27.50
Dominica	43,513,625	4,531,201	10.40
Grenada	4,000,000	399,974	10.00
Total	146,338,236	24,094,373	16.50

Source: CTA (2008)

These results point to the importance of ownership, alignment and harmonisation as critical factors of success of AfT, much in line with the traditional aid effectiveness literature (Rogerson, 2005). The main implications are the need to involve stakeholders (e.g. the private sector and civil society) and trade and other officials in beneficiary countries from the very beginning – to help design programmes and devise specific objectives and implementation strategies, keeping country-specific conditions in mind. This ensures the evolution of better ways of measuring the impact of such programmes and also creates the necessary conditions for ownership of the programme within the partner country, which in turn ensures long-term sustainability. An inclusive consultative process also encourages partner country officials to be trained in assessing their trade performance through various toolkits provided by the World Bank and the ITC. This serves the dual purpose of developing skills and disseminating information.

Recommendations also include more specific targeting of sectors and activities which are aimed explicitly at poverty reduction or the inclusion of disadvantaged sections of society in trade: for example, DFID targeted small farmers in western Kenya

through its beekeeping project as part of its business partnership programme. Other more general recommendations are aimed at enhancing the quality of communication channels across and within donor agencies, so as to avoid confusion with regard to delivery channels and programme implementation.

It is important to note that the impact evaluation of AfT has been carried out almost exclusively through success stories (see e.g. UNIDO, 2008), which are usually self-assessed and through ad hoc case studies, such as those presented above, which look at specific projects or programmes. In any instance, lack of proper data and benchmarks (e.g. in terms of outcome variables to rate the project against) has often constrained the possibility of properly assessing the effectiveness of AfT. A relevant exception is the recent work by Brenton and von Uexkull (2008), who use quantitative techniques to study the systematic effect of product-specific aid for trade on countries' exports. They match data on technical assistance projects from the German development agency GTZ with data on developing countries' trade performance for the period 1975–2000. A partial equilibrium adjustment model is used to study the impact of aid for trade on specific export goods – 88 export development programmes across 48 developing and least-developed countries. The results strongly suggest that exports increased owing to the effect of donor-funded export development programmes in a number of countries. However, a few caveats apply: although the programmes preceded stronger export performance, causality cannot be expressly determined. As the authors point out, factors such as the initial size of the export sector or selection bias (i.e. technical assistance may target products with already promising prospects) may be the real reasons behind the better performance of the targeted commodities.

We aim to present new more systematic evidence, looking at the overall impact of different types of trade-related assistance on specific trade performance indicators. Our coverage is wider than that of Brenton and von Uexkull (2008) in that it accounts for all AfT disbursements rather than only a subset of projects. Also, we rely on more indicators than just exports as dependent variables. Importantly, we try to identify the impact of this type of assistance on SVEs and other developing countries.