Summary

Aid for Trade (AfT) has moved up both the aid and trade agendas. There is now a need for quantitative evidence which can be used to identify needs and inform an analysis of how AfT can best be provided.

The WTO Aid for Trade Task Force has identified six categories of AfT and builds upon the definitions used in the WTO/OECD trade-related and capacity building database (WTO database). They are: trade policy and regulations; trade development; trade-related infrastructure; building productive capacity (including private sector development); trade-related adjustment (including support for adjustment associated with changes in international trade regimes); and other trade-related needs. The aim of this study is to increase understanding of whether and how AfT can help developing countries to trade and improve their economic performance.

Section 2 discusses expected pathways of the effects of AfT. If it is used effectively, AfT can have a positive effect on trade by tackling both market and governance failures. It can:

- Improve trade policy co-ordination (*AfT category:* trade development);
- Develop standards to improve access for exports (*AfT category:* trade facilitation);
- Improve skill formation (*AfT category:* trade-related adjustment);
- Improve infrastructure (*AfT category:* trade-related infrastructure);
- Overcome governance failures, such as weak institutions or weak administrative procedures (*AfT category:* trade policy and rules).

The paper uses statistical evidence to examine the effects of AfT on the costs of trading and the level of exports. It goes beyond previous evidence on the effects of aid, and in particular of AfT, on trade. It examines specific aid categories and sectoral relationships. AfT reduces the costs of trading, an important investment climate indicator and one which is particularly relevant for importing and exporting. This result holds when controlling for other factors affecting trade costs, such as governance generally, being landlocked and income status. For a sample of 120 developing countries, it is estimated that an increase of 1 per cent in AfT (for trade policy and regulations) leads to a fall of approximately 0.15 per cent in the cost of exporting. Thus, an increase of US$15,000 (from the mean of US$1.48 million) is associated with a reduction of US$1.80 (from the mean of US$1324) in the cost of packing goods and loading them into a 20-foot container, transporting them to the port of departure and loading them on a vessel or truck.

Aid for trade fosters exports, although the relationship is non-linear and the effect depends on a careful specification of the types of aid and exports, in line with existing

literature on aid. We model aid to productive capacities by sector, while the effects of aid to infrastructure depend on empirical specifications. The paper uses a new estimation identification strategy based on inter-sectoral and intra-sectoral (over time) differences in exports and AfT. It divides aid to productive capacities into aid to the different sectors and then correlates sectoral aid to sectoral exports. The identification of AfT effects comes from analysing whether sectors that receive more aid relative to other sectors in the same country experience relatively faster growth in their exports, as well as whether exports of a sector grow faster in years in which that sector receives relatively higher levels of aid. The main advantage of this strategy is that it allows control for all time varying country factors which may influence exports, such as effective demand, policies, size of the economy, economic fundamentals and country-level shocks. The results based on this new identification strategy are clear: they show that aid has a robust, positive and non-linear effect on productive capacities in relation to exports.