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The Right to Trade*

A Report for the Commonwealth Secretariat on Aid for Trade

Joseph E. Stiglitz and Andrew Charlton

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* The views expressed in this report are those of the authors and do not necessarily represent those of the Secretariat or its Members.

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The World Trade Organisation's "aid for trade" initiative was launched at the 2005 Ministerial in Hong Kong to recognise the disadvantage of developing countries participating in the global trading system and bolster the development dividend of the flailing Doha Round. Seven years since the birth of the aid for trade initiative, huge resources have been mobilised. Fully 25 per cent of total ODA is now channelled, or at least labelled, as aid for trade.[1] But questions remain as to whether the coming together of aid and trade has delivered on the promise of additional resources for developing countries. If aid-for-trade has not been truly incremental to existing aid commitments, there is the further question: has the changed focus made aid more or less effective, resulting in stronger growth or reduced poverty?

Perhaps the greater concern is that aid for trade was initially offered as a complement to additional market access provided through the Doha Development Agenda - it was supposed to enhance, rather than replace, pro-development liberalisation on the part of the advanced countries. Unfortunately, as the advanced countries' commitment to the Development Agenda has faded, aid for trade is beginning to seem more like a pecuniary payoff for undelivered promises.

This paper outlines an alternative path for aid for trade as part of a pro-development multilateral liberalisation agenda. First, the World Trade Organisation would enshrine a "right to trade" operational within the dispute settlement system. This right would give developing countries legal recourse against advanced countries whose policies materially impact the development of poor countries by restricting their ability to trade. Second dedicated funds committed by rich countries to a Global Trade Facility would be administered by UNCTAD and dispersed through a transparent and competitive process based on need and impact.

From 'trade not aid' to 'aid for trade'

The institutions of the modern multilateral trading system were established at a time of relative, albeit far from uniform, consensus about the relationship between trade liberalisation and development. Tariff reduction was widely understood to have a clear and positive effect on trade flows. Trade flows were deemed to be positively associated with economic growth. And trade-induced growth was believed to enhance general welfare.

[1] OECD (2011), Aid for Trade at a Glance, Paris 2011.

Armed with these supposed certainties, developed and developing countries were emboldened to embrace the liberalisation of global trade. The Uruguay Round was struck and the World Trade Organisation was born.

The Uruguay Round was by far the most ambitious trade liberalisation in history. After effectively sitting out the first four decades of multilateral trade negotiations, developing countries' participation in the Uruguay Round led them to accept substantial liberalisation of their trade regimes. It covered tariff and non-tariff barriers in industrial and agricultural goods and extended multilateral rules to new areas, including services and intellectual property. International organisations including the World Bank, the Organisation for Economic Cooperation and Development strongly supported the round. They published estimates of large projected welfare gains in the order of $200 - $500 billion per year. A large share of these gains were predicted to accrue to the poorest countries and, on that basis, the international financial institutions urged developing countries to sign up.[2]

Almost as soon as the ink dried on the Uruguay deal, it became clear that the agreement was unbalanced. The final terms reflected, in large part, the priorities of the advanced countries. Market access gains were concentrated in areas of interest to the developed countries including services, intellectual property and advanced manufacturing. Far less progress was made in areas of interest to the poor countries such as agriculture (including subsidies to agriculture) and textiles. The effect was to concentrate tariff reductions on products exported by the rich countries. Laird (2002) estimated that after the implementation of the Uruguay Round Commitments, the average OECD tariff on imports from developing countries was four times higher than on imports originating in the OECD. Developed countries had also maintained non-tariff barriers and other protectionism including agricultural subsidies and phyto-sanitary conditions which effectively limited the competitiveness of farmers and some other producers in poor countries.

Even where the exchange of market access had been de jure reciprocal, it was de facto unbalanced. Exporters in rich countries were able to quickly take advantage of greater market access, but the poor countries found their ability to export to rich countries was limited by a range of constraints including non-tariff barriers, weak infrastructure and supply constraints. To make the 'Uruguay hangover' worse for developing countries, they quickly realised that as well as receiving only a small share of the gains from the Uruguay Round, they were now subject to a remarkable range of additional obligations and responsibilities. Finger and Schuler (2000) estimated the implementation costs of just three areas (customs valuation, TRIPS, and sanitary/phyto-sanitary measures) would cost each developing country around 150 million dollars - a huge sum for many least developed countries. Overall the agreement was not only unbalanced, it was unjust. Some estimates

[2] The importance of their doing so was even then becoming increasingly obvious, as their share of global GDP was increasing. Today, it is unimaginable for there to be a global trade regime without, for instance, China.

suggested the 48 least developed countries had actually lost a total of $US600 million a year as a result of the Uruguay Round (around 5 per cent of their GDP). There was increasing concern too of the high developmental and health costs of some of the obligations undertaken under the Uruguay Round and the Financial Services Agreement. Access to lifesaving generic medicines was restricted; countries' health budgets were hit badly and/or access to life-saving medicines was diminished. Newly flourishing generic drug companies in developing countries saw their prospects wane. Local financial firms found it difficult to compete with large multinationals, and local small businesses often seemed unable to gain access to credit from these multinationals. A growing body of literature suggested that financial market liberalization (as pushed by the Financial Services Agreement) did not promote growth, but did enhance instability.

Even after the results of the Uruguay Round were clear, the international financial institutions continued to advise the developing countries that liberalisation was in their best interests. Developing countries were encouraged to address their concerns through a fresh round of liberalisation. The acting European Trade Commissioner, Sir Leon Brittan, said 'the only way to address the issue is through a new round of negotiations. Indeed, I would ask all WTO members, including developing countries, whether they are entirely happy with the present trading system. If the answer is no, it is clear that the only way of improving upon that system is in a new round." The answer to the problems of liberalisation, was more liberalisation. But developing countries experience had made them wary of a repeat of the unfairness of Uruguay. Fresh from when they felt was a betrayal, developing countries were cautious about signing up to another round. The first attempt to establish a new round of trade talks in 1999 in Seattle was a debacle. Sceptical developing countries torpedoed the meeting. Outside on the streets some 40,000 people protested the injustices of the global trading system.

In 2001 at Doha, the advanced countries made a string of promises to put the poor at the centre of the new round - even naming the talks the Doha Development Agenda. The Ministerial Declaration acknowledged the unfairness of the past and promised to "place (the developing countries) needs and interests at the heart of the work program" for the new round. These assurances soothed the concerns of many developing countries. Ever hopeful, they signed up to a new round.

The goodwill lasted less than two years. When developing countries walked out of the 2003 meeting in Cancun, the Doha Round stumbled into a deadlock from which it never recovered. By July 2005, the negotiations had reached an impasse. Recognising the crisis, WTO Director-General, Pascal Lamy made a decision to suspend negotiations. The stalling of the Doha Round and the implacable sense that the world trading system was manifestly unfair to developing countries led the WTO, its members and civil society to search for alternative avenues to promote trade, bring development closer to the centre of the WTOs work program and mollify the concerns of developing countries. In this context, aid for trade --- an obvious carrot for the developing countries --- was an idea whose time had come.

At the same time as developing countries began to fear that the trading system was unbalanced, they also began to more critically question the benefits of trade liberalisation. This provided a second impetus for aid for trade.

The welfare impacts of free trade were formalised in modern economics by Paul Samuelson (1936) who showed that liberalisation leads to a change in the level of welfare (although not necessarily to a change in the long run growth rate). However the underlying assumptions that yield this conclusion are highly restrictive and often fail to reflect many of the relevant characteristics of developing economies.[3] Nonetheless during the 1980s, neoliberal policy prescriptions based on the positive welfare impacts of trade liberalisation gained support among the international financial institutions. Import substitution policies and managed trading regimes fell out of favour and developing countries were encouraged to rely more on market mechanisms.[4] Developing countries were told they must reduce their own tariffs if they were to reap the benefits of engagement in the global economy. Influenced by advice from the international financial institutions, many developing countries shifted their strategy to participate more actively with the WTO.

In the last decade, there has been a significant reappraisal of the Washington consensus and the relationship between trade liberalisation and economic development. Although some research in the 1990s appeared to confirm that trade liberalisation promoted economic growth, several subsequent studies cast doubt on these results on the basis that the key 'openness' variables poorly reflected trade liberalisation (Rodriguez and Rodrik, 2000). Recently, successive studies have emphasised the heterogeneity in developing countries experience with liberalisation and economic growth. Wacziarg and Welch (2003) found that roughly half of the countries in their survey experienced zero or even negative changes in growth post-liberalisation. Other studies have questioned the direction of causation – it may be possible that rather than being caused by liberalisation, successful development leads to integration into the global economy.[5]

[3] In particular, he made all the assumptions of what has since come to be called the neoclassical model—perfect competition, perfect markets, perfect information, no transactions costs, no frictions—which implied, in particular, that there was no unemployment. He also ignored risk. The neoclassical model underlies much of the neo-liberal policy.

[4] Latin America's lost decade, the 1980s, was often blamed on its pursuit of failed import substitution policies. More recent rethinking of the lost decade (and the subsequent lost half-decade under the influence of the Washington consensus policies, has shifted the emphasis away from failed import substitution policies towards excessive debt obligations undertaken in the '70s, and the flaws in the handling of the resulting debt crisis, both by Western creditor governments and institutions and by the developing countries. The World Bank, especially in the work of its chief economist, has in recent years been actively arguing for industrial policies, some of which involve trade interventions.

[5] The debates continue both in the interpretation of the cross country data as well as the experiences of individual countries. For instance, Rodrik and Subramanian (2004) argue that India's growth dates not to the period of trade liberalization, in the early 1990s, but much earlier, to the 1980s, when it engaged in internal liberalization, taking on a more pro-business stance.

If there are strong doubts about the relationship between trade liberalisation and growth[6], there is even less consensus on the causal link between liberalisation and poverty. The evidence is at best weak (see Bannister and Thugge, 2001; Winters, McCulloch and McKay, 2004) with many studies finding that trade liberalisation, even when it is associated with economic growth, also leads to an increase in inequality (World Bank, 2005).

Earlier theoretical literature had explained why these results should not have come as a surprise. Dasgupta and Stiglitz (1977) and Newbery and Stiglitz (1982) had noted that trade liberalization increased risk, so much so that everyone could be worse off. These concerns were especially relevant in developing countries where risk markets were imperfect. Secondly, the process of adjustment to liberalization was costly. Neoclassical theory (on which most of the pro-liberalization analyses were based) simply presumed that workers would move from inefficient protected sectors to efficient unprotected sectors costlessly. What often happened is that they moved from inefficient protected sectors into unemployment. Output was decreased, not increased. It should have been obvious that the neoclassical model did not describe economies in which there was, even before liberalization, high levels of unemployment. In these cases, trade liberalization simply added to the ranks of the unemployed. Again, this is a concern especially in developing countries, where financial markets often didn't work well, and where there was a scarcity of entrepreneurship. It was harder to create new jobs than to destroy old jobs. Moreover, trade liberalization took away one of the most important sources of government revenue. Most countries found it difficult to replace tariffs, say with a VAT (Aizenman and Jinjarak, 2009). The constraints in government revenues forced cutbacks in investments in education and infrastructure, thereby impairing development.

At first, the impacts on inequality came as a surprise, since the conventional model (the Samuelson-Stolper theorem[7]) predicted an increase in unskilled wages in developing countries. But three factors contributed to the increase in inequality typically associated with liberalization: (a) As we have already noted, it often was done in a way that resulted in increased unemployment. This had adverse effects directly on poverty and inequality (in particular, since it is typically those at the bottom who suffer the most from unemployment (Furman and Stiglitz, 1999). But it also has an indirect effect: higher unemployment puts downward pressure on wages. (b) Liberalization was often asymmetric, with capital and goods liberalization outpacing labor market liberalization. This adversely affected workers'

[6] That trade liberalization *by itself* would not ensure growth should have been obvious from the large disparities that exist within developed countries: There are no trade barriers between north and south Italy (no barriers even to the movement of capital), and yet there have been persistent large differences in income. So too for the United States, until the Federal government undertook actions (including assistance) which led to the narrowing (but far from eliminating) the gap in income between the North and the South.

[7] Stolper and Samuelson (1941). This theorem was based on the same assumptions that underlay Samuelson's earlier analysis of the welfare gains from free trade. At the extreme, Samuelson showed that if there was free trade, factor prices would be fully equalized between countries with the same technologies. That that has not happened should be obvious. Nonetheless, Samuelson and Stolper did identify an importance force that was at play: trade in goods was a (partial) substitute for the movement of factors.

bargaining position, and put pressure on governments to cut taxes on capital and, correspondingly, programs for those who were less mobile--unskilled workers. Before tax and transfer income thus became more unequal, and after taxes and transfers it was even worse. (c) The very unskilled didn't benefit from the creation of new export jobs, and they were often in agriculture, which could be hurt by subsidized agriculture exports from the developed countries.[8]

The reappraisal of the main tenets of the Washington consensus in the economic literature was an inevitable consequence of the mixed experience among the developing countries that had embraced trade liberalisation. One impetus for this reappraisal was that many countries that had, according to the neoliberal prescription, done the "right things" (that is, not only had liberalized, but followed other policy dictates of the Washington-based international institutions) had subsequently stagnated. And many countries that had not followed the Washington consensus had achieved considerable success. Rodrik (2001) argued that the three primary models of successful development in the 20th century all relied on managed trade regimes: import substitution as practised by a number of countries in the 1960s; outward orientated industrialisation as practiced in East Asia in the 1980s; and state directed capitalism of China in the 1990s).[9] Chang (2002) showed that almost all of today's rich countries used tariff protection and subsidies to develop their industries and "Britain and the USA, the two countries that are supposed to have reached the summit of the world economy through their free-market, free-trade policy, are actually the ones that had most aggressively used protection and subsidies."[10]

The ultimate refutation of the trade-not-aid mentality came with the introduction of very favourable market access preferences for least developed countries, including the EU's Everything but Arms initiative (EBA) and the United States' African Growth and Opportunity Act (AGOA). These initiatives, though a positive and important step, have had limited impact on beneficiary countries' exports. Sub-Saharan Africa's share of world exports decreased dramatically between 1980 and 2006, falling from 3.9% to 1.9%. African least-developed countries (LDCs) did even worse, seeing their average share fall from 0.06% to 0.02% over the same period. Multilateral tariffs, it turned out, were not the binding constraint on the ability of these countries to trade. Their capacity to export was hindered by a range of non-tariff trade costs and barriers as well as supply constraints.

These three factors -- the historical unfairness of previous trade agreements, the high adjustment costs and disappointing results from trade liberalization, and the broader

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[8] The problems just described arising from trade liberalization were often exacerbated by other liberalization measures that often accompanied them. Capital and financial market liberalization and banking deregulation often led to an increase in instability, with adverse effects on inequality and growth. See Stiglitz (2008, 2011, 2012a, 2012b).

[9] Rodrik, D., (2001), The Global Governance of Trade As if Development Really Mattered, UNDP.

[10] Chang, H. (2002), Kicking Away the Ladder: Development Strategy in Historical Perspective (Anthem)

reappraisal of the relationship between trade, trade liberalization, and development - - changed developing countries approach to multilateral trade liberalisation and their engagement with the WTO. If the gains from trade were not automatic, as the Washington consensus had implied, and the relationships were complex and contingent and the outcomes were heterogeneous, developing countries would be significantly less sanguine about multilateral liberalisation.

At the 2003 WTO meeting in Cancun, UNCTAD Secretary General, Rubens Ricupero, spoke for many when he acknowledged the shifting mood: “trade liberalization is no panacea for developing countries. For many of them, it involves considerable adjustment and social costs. There is a need for synergy and proper sequencing -- between the capacities of the developing countries, the level of obligations they are to take on, the cost of implementation, and the adequacy of financial and technical resources available to them.” The developing countries began to demand greater flexibility for policy space including greater freedom to pursue industrial policies and to address supply side constraints via government interventions, preferential market access and support for institution and capacity building.

Aid for trade was born in this context. Once the developing countries began to lose faith in the prospects for multilateral liberalisation, the rich countries had to put something else on the table. Aid for trade was a salvo. Some saw it as a recognition that previous agreements had been unfair, others said it was recognition that developing countries faced adjustment costs associated with trade liberalisation, others saw it as a means to increase the benefits of market access. It was all of these things, but the fundamental driver of the aid for trade initiative was that the trading system was in crisis. If the developing counties walked away from the round, the WTO’s agenda for expanding trade would grind to a halt.

In early 2005 at the IMF-World Bank spring meeting, the Development Committee put aid for trade firmly on their agenda and resolved “to work with others to develop proposals to help developing countries adjust to and take advantage of the round, for consideration by our next meeting.” A few weeks later at the Gleneagles G8 meeting in May, heads of government committed “to increase our help to developing countries to build the physical, human and institutional capacity to trade, including trade facilitation measures” and “called on the IFIs to submit proposals to the annual meetings for additional assistance to countries to develop their capacity to trade and ease adjustment in their economies”.[11]
By late 2005 the WTO had rallied behind the proposal. At the WTO Ministerial Conference in Hong Kong in December 2005, the “Aid for Trade Initiative” was officially launched. The Hong Kong Ministerial Declaration reflects the interests and objectives of both the WTO and donors: “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”.

[11] G8 Gleneagles Leaders Communique, 2005.

Shortly thereafter, aid for trade moved toward the centre of the WTO's work program. Director-General Pascal Lamy said in 2006: "We cannot ignore the costs of adjustment, particularly for the developing countries, and the problems that can arise with the opening up of markets. These adjustments must not be relegated to the future: they must be an integral part of the opening-up agenda. We must create a new "Geneva consensus": a new basis for the opening up of trade that takes into account the resultant cost of adjustment." [12]

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Aid for trade was born, at least in part, as a result of a crisis in the global trading system. But it would not have got off the ground with only the support of the trade community. Aid for trade received additional impetus from the aid and development communities who were faced with a parallel series of challenges to significantly scale up its disbursements and to demonstrate the effectiveness of its development programs. At the United Nations Millennium Summit in 2000, world leaders coalesced around eight goals for the poorest countries, which came to be referred to as the Millennium Development Goals. Two years later at the financing for development conference at Monterrey in Mexico, leaders recognised "dramatic shortfalls in resources required" to achieve these goals.[13] In subsequent years, major advanced economies made significant commitments to increase their aid budgets. Several major countries committed to a collective foreign aid target of 0.7% by 2015 but these targets have not, for the most part, been reached.[14]

At the same time the aid community faced a challenge to its legitimacy from those who questioned the benefits of aid. In the last two decades, researchers have scrutinised the conditions under which aid is effective. William Easterly argued that the $568 billion spent on aid to Africa over the last 40 years has not lifted average African incomes.[15] More recent cross-country analysis concludes that the relationship between aid and development is weak and often ambiguous (Rajan and Subramanian, 2005; Easterly et al, 2003; Hubbard and Duggan, 2009; Clemens et al, 2005). It is perhaps not surprising that the links between aid

[12] Pascal Lamy, Santiago de Chile, Chile 30 January 2006, "Humanising Globalization". It is noteworthy that he emphasized only the adjustment costs. Advocates of trade liberalization never fully understood that even in equilibrium, trade liberalization might have adverse effects, and especially so if it was pursued in an asymmetric way. And the term "adjustment costs" suggested that the costs were a short term problem: they didn't recognize that trade liberalization might actually impede longer term development.

[13] See the final text of agreements and commitments adopted at the International Conference on Financing for Development Monterrey, Mexico, 18-22 March 2002.

[14] ODA from Development Assistance Countries was $79.9bn in 2004, and it rose to $133.5bn in 2012, around 0.31% of GNI (and average country effort of 0.46%). If it had increased to 0.7% for all DAC countries, net ODA would have been $430.7bn. The shortfall between promised and delivered is some $297bn.

[15] Easterly, W., (2006) White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good (The Penguin Press: New York). He has since been joined by a host of critics making similar observations.
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and development are often difficult to discern. Aid has often been provided for with non-economic objectives, such as emergency assistance following disaster relief, or political or geostrategic reasons. During the cold war, billions of dollars of aid supported corrupt and tyrannical dictators such as Joseph Mobutu of Zaire (now the Democratic Republic of the Congo) and Jean-Bédel Bokassa of the Central African Republic. Many well-intentioned aid projects were rendered ineffective through poor conception and execution, or fettered by tenuous and sometimes counterproductive conditionality. In other cases, aid may have had a negative effect on growth through Dutch disease effects – where inflows of capital reduce the competitiveness of the export sector through the appreciation of exchange rates.

Critiques of the impact of aid have become more vociferous as the global campaigns to increase aid have gained momentum. Policymakers and researchers have responded, both in a commitment to make aid more effective and in analyses to enhance understanding of what is required to do so. At Monterrey, donors and developing countries alike wanted to know that aid would be used as effectively as possible before they agreed to increase their ODA budgets. In the last decade, significant resources have been devoted to understanding and improving the effectiveness of aid. In an early study, Burnside and Dollar (2000) showed that aid has no impact in countries with "poor" institutions and policies, but can support GDP growth in developing countries with "sound" institutions and economic policies.[16]

In 2003, aid officials and representatives met in Rome for the High Level Forum on Harmonization where donor agencies committed to work with developing countries to better coordinate their activities. Two years later, the Paris Declaration on Aid Effectiveness was endorsed - a comprehensive attempt to establish principles to improve the effectiveness of aid.

Aid for trade has been a beneficiary of these trends. It has been presented as an effective channel through which significantly increased aid can be disbursed. And linking aid to trade has enabled the development community to point to longer term impacts of assistance programs on growth and economic development. This became especially relevant as many in the development community shifted attention away from just poverty to growth, in the belief that it was only or mainly through growth that there would be long term, sustainable reductions in poverty.

Has bringing Aid and Trade together helped?

The concurrent challenges facing the aid and trade community led to a marriage of convenience from which aid for trade ensued. As the development promises of the Doha Round crumbled, the trade community had an urgent need to mollify developing countries by demonstrating a tangible development agenda. At the same time, the aid community of multilateral institutions, bilateral donors and NGOs were caught between the challenge to

[16] Burnside, C., and Dollar, D. (2000). "Aid, Policies and Growth", The American Economic Review 90 (4): 847–868.

ramp up their disbursements to absorb growing national ODA commitments and increasingly strident critiques of the effectiveness of existing aid programs. 'Aid for trade' enabled the trade and aid communities to leverage each other. The World Trade Organisation could point to significant development-focussed activity. The aid community accessed an expanded mandate to invest growing aid resources in productive capacity.

That aid for trade was an expedient product of circumstance is neither especially surprising, nor necessarily concerning – many positive initiatives have been born of pragmatism. As we wrote (Stiglitz and Charlton, 2006) aid for trade had the potential to complement trade liberalisation and increase the ability of developing countries to take advantage of market access opportunities delivered through multilateral trade negotiations.

But from the start, there were immediate fears that aid for trade was merely a semantic façade. After all, the concept of aid programs focussed on trade was not new. The International Trade Information Centre was established in 1964 under the GATT to provide trade related assistance. In the post-Uruguay era, trade-related assistance was stepped up through the Integrated Framework (IF) for Trade-Related Technical Assistance to Least-Developed Countries established in 1997 and the Joint Integrated Technical Assistance Program (JITAP) for Africa established in 1998. More broadly, to the extent that aid for trade covers wider assistance to developing countries to develop their supply side capacity, much development aid over the last 20 years – including infrastructure, institutions and other support for integration into the global economy – has been trade-related. Renaming this assistance 'aid for trade' would not deliver incremental benefit.[17] There were many warnings at the time of the launch of aid for trade, that it would only be beneficial if it were additional, predictable, and responsive to the needs of recipient countries (including the private sector), and increased the coherence of poverty reduction assistance. Without these qualities, aid for trade would be little more than a repackaging of existing commitments - another *legerdemain* on the part of the rich countries.

We believe that trade-related programs funded by bilateral donors *can* be effective. Indeed it is possible that aid for trade, by being more focused on removing supply constraints on trade, could have leveraged effects on growth, and thereby on poverty reduction. Several studies have demonstrated that aid spent on promoting trade is positively associated with global trade, particularly in poor countries with weak infrastructure (Portugal-Perez, Wilson 2012).

Trade facilitation projects in particular have demonstrated considerable benefits. Trade facilitation covers a range of behind the border actions including institutional and regulatory reform, infrastructure, customs and port efficiency. The total value of trade facilitation

[17] At the same time, it should be recognized that much of the broader "trade" agenda has, for the past two decades, consisted of cramming issues like investment and intellectual property into trade negotiations. TRIPS, trade related intellectual property rights, actually embraced virtually all of intellectual property rights.

funding has increased considerably in recent years. Funding by the World Bank has risen five-fold in the last seven years and trade facilitation projects make up around half of all trade related development assistance. Helble, Mann and Wilson (2011) used 16 years of trade and aid data for 40 donor countries to analyse the impact of trade facilitation on trade. Their results suggest that a 1% increase in aid-for-trade facilitation is associated with about US $290 million of additional exports from the recipient countries.

It is reassuring that aid spent to promote trade actually does what it is supposed to do. But even if such studies are convincing (and critics of aid suggest that they may not be), that doesn't answer two more fundamental questions: (a) Has the aid been as effective at promoting trade as it could be? And (b) has aid-for-trade increased the overall effectiveness of aid?

(*a) Has the aid been as effective at promoting trade as it could be?*

One would have hoped that aid-for-trade would have begun with an analysis of the major impediments facing developing countries with respect to trade, and then systematically gone about reducing those impediments. That kind of systematic analysis has not, for the most part occurred.

Had it occurred, it would have been realized that there are policies (such as escalating tariffs (see Charlton and Stiglitz, 2005) of the advanced industrial countries which impede developing countries trade and development that could be easily altered, in some cases with net positive benefits to the developed countries. It would have been realized too that the absence of small business finance has been a major supply constraint, and again, there are low cost policies and programs that might have facilitated the flow of credit to local small enterprises. Finally, a major barrier to trade (supply constraint) is the lack of infrastructure..

At the same time, as we noted earlier, support for trade facilitation (e.g. enhancing customs clearance) has been a cost-effective form of assistance.

(b) Has aid-for-trade increased the overall effectiveness of aid?

The problem with the 'aid for trade initiative' is that it is difficult to ascertain the counterfactual – i.e., what would have happened in its absence? Without evidence of additionality and a clear distinction between projects that would have occurred anyway under development programs, it is challenging to assess whether the initiative has delivered *incremental* benefits to developing countries.

The promise of aid for trade was that it would prove to be more than new nomenclature. When UNCTAD Secretary General, Rubens Ricupero, called for aid for trade at the 2003 Cancun WTO meeting, he specified that trade assistance must be additional, "developing countries need aid for trade, and such aid must not come at the expense of aid for development." The WTO Ministerial declaration in Hong Kong also called for "appropriate mechanisms to secure *additional* financial resources for Aid for Trade."[18]

But in the seven years since the initiative was launched, there is scant evidence that aid for trade as been additional. Certainly the volume of aid for trade has increased. According to the OECD and WTO's 2011 review, Aid for Trade at a Glance, aid for trade commitments reached USD 40 billion in 2009, a 60 per cent increase over the decade. The report claims that much of this increase is incremental to regular development assistance. But these claims are not fully convincing. For one thing, there is no clear framework for how additionality is measured. Second, many of the commitments made by governments in the last decade have been opaque and the amounts are re-announced several times in successive packages. Third, the line between aid for development and aid for trade is arbitrary (How close to a port does a road need to be in order to be aid for trade?). This blurring of categories means that it is easy for donor countries to count development projects as aid for trade projects[19]. Finally, since most countries have not reached their commitment to reach 0.7% of GDP in aid, it is hard to see aid for trade as additional. It is certainly not additional to what they had previously promised to deliver.

If aid for trade is not additional to existing aid commitments, then donors must answer some fundamental questions about its purpose and utility. Development assistance reclassified as aid for trade obviously cannot fulfil the compensation motive arising from the unfairness of the Uruguay Round. And developing countries will hardly feel better about the collapse of the Doha Round knowing that assistance that they would have otherwise been receiving is now labelled aid for trade.

They might be even more concerned: if aid for trade is less effective at poverty reduction than unrestrained aid, then the aid for trade movement could have been counterproductive, at least as far as that critical goal is concerned.[20] If aid for trade has not lead to more assistance, then it may create a high opportunity cost. By imposing an additional constraint on the way aid money is spent, aid for trade has the potential to have a negative impact on developing countries. While the OECD and WTO have invested significant resources in building an inventory of information on aid for trade flows, there remains no comprehensive analysis of aid for trade quality or its effectiveness (either in its direct mission of promoting trade or its more fundamental goals of promoting growth and poverty reduction) or the extent to which it represents additionality . For the most part, the measurement and evaluation framework relies on self-assessment. As donors provide their

[18] WTO (2005), Hong Kong Ministerial, Ministerial Text, 6 November 2005

[19] Sheila Page, *The Potential Impact of the Aid for Trade Initiative*, G-24 Discussion Paper Series, No. 45, Geneva, UNCTAD, April 2007, p.27.

[20] That is, in this case the "counterfactual" is that there would have been the same amount of aid, in the absence of the aid-for-trade movement, but that the aid-for-trade movement has imposed an additional constraint, diverting money that was more targeted at poverty reduction to other uses.

own financial and other reporting, there is little independent verification of additionality or impact. External measurement of the results of aid for trade is challenging. Many projects do not have defined baselines against which impacts can be assessed.[21] There is only a weak framework to evaluate the impact of Aid for Trade projects and programs on welfare, growth and inequality.

Indeed, despite evidence of success in case studies in specific areas, structural features of aid for trade as it has emerged give cause for doubts about its overall effectiveness. The model of bilateral disbursement (which has been de facto adopted by donor countries) has meant that aid for trade comes with all the challenges of traditional development aid. Priorities may be skewed toward the interests of preferences of donors and there may be limited country ownership and a range of explicit or implicit conditions.

[21] Thus the critique is far more fundamental than that there have not be appropriately designed "random trials."

A Proposal to Support Pro-development Trade Liberalisation

Aid for trade has failed to live up to its promise of additional, predictable and effective finance to support developing countries integration into the global economy. More importantly, aid for trade may not be addressing the fundamental concerns with the trading system and aid system that gave rise to it. Aid for trade has become a means for both the aid and trade communities to paper over their weaknesses without addressing the fundamental concerns of poor countries.

This paper proposes a novel approach to aid for trade that would go some way to address the underlying unfairness of the global trading system and aid arrangements. Our proposal is to make aid and trade liberalisation work for poor countries and tied directly to specific development objectives.

The 'Right to Trade'

There are significant parts of industrial countries' trade policy that materially restrain the development of poor people and constrain the ability of developing countries to participate in international trade. In fact, perversely, the global trading system is stacked against the poorest - the areas of trade where barriers are the highest (agriculture, textiles, etc) are also the areas of most importance to developing countries. As a consequence, the average tariff in OECD countries on imports from other OECD countries is significantly lower than imports from non-OECD countries. For example, in 2002, total exports from Bangladesh to the United States (total value of USD 2.5 billion) were levied the same amount of tariffs (around USD 300 million) on as total exports to the United States from France (total value ten times higher at USD 30 billion).[22] And it is not just the average level of tariffs that matter; it is their structure. Escalating tariffs are an impediment to development. And perhaps even more important than tariffs are the non-tariff barriers faced by developing-country exporters.[23]

Aid for trade cannot be a substitute for removing these inequities – it must be a complement rather than a replacement for fundamental change to the trading system. This was recognised in 2005 in the Hong Kong Ministerial Declaration "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."

[22] Heydon, K., (2012), Trade and Development: Some Implications for EU Trade Policy, Policy Department DG External Policies.

[23] The existence of these impediments, which lowers exports from LDC's to developed countries, heightens the imbalances in tariffs: if they had been able to export more, the tariff revenues collected from developing countries would have been even larger.

As the development promise of the Doha round has faded away - only to be replaced by concerns that what remains may even have an adverse effect on some of the poorest countries - it has become clear that there is no imminent prospect of a pro-development reform to the trading system through formal rounds of multilateral liberalisation. Instead, it is imperative to install alternative mechanisms to rebalance the global trading system and make trade work for poor people. To achieve this, we propose that members of the World Trade Organisation should adopt a general 'right to trade' operating within the dispute settlement body.

Developing countries should be able to bring an action against any advanced country where three conditions are satisfied:

- A specific group of poor people within a developing country (or the country or group of countries as a whole) can be identified as being significantly and directly affected by a specific trade or trade-relate policy (or policies) of an advanced country.

- The effect of the policy acts to materially impede the economic development of those poor people (or the country or group of countries as a whole);

- The impediment operates by restricting the ability of the people (or the country or group of countries as a whole) to trade, or gain the benefits of trade.

This right would enable any developing country to bring an action against an advanced country on the basis that a specific policy materially impedes the development of an identified community in a poor country by restricting their ability to trade.

Subject to appropriate safeguards, this right would transcend existing agreements and apply to all trade-related policies of advanced country member states. A developing country (or countries) bringing successful actions under the right to trade could access a range of remedies:

- Elimination or change to the offending policy as a result of mediation between the advanced country and the developing country.

- A range of bilateral sanctions including increase in tariffs against the advanced country (a remedy that would be available to all affected developing countries). This right to sanction would be tradeable (See Charlton and Stiglitz, 2005). Rather than merely raise tariffs, sanctions should be able to include suspension of other WTO commitments of interest to advanced countries, including the TRIPs agreement.

- Compensation from the offending advanced country or support from a multilateral aid-for-trade fund (outlined in the next section.)

Any dispute between a rich and a poor country is never a fair fight. Existing remedies under the WTO dispute settlement system suffer from a range of asymmetries which weaken the position of poor countries. Where a small developing country has been successful in a case against a large advanced economy, the remedies available to the small country are often ineffective. For example, raising tariffs against the larger country can be counterproductive if the bigger country represents a large share of imports. The effect on the bigger country may be small, while the population of the small country may face higher prices on imported goods. That is why it is important that the sanction be "tradeable" and that they include the suspension of other WTO commitments.

Who can bring an action?

Poor countries may find themselves subject to coercion as the bigger countries make implied threats to reduce aid or other benefits. This will reduce the likelihood that actions will be brought, eviscerating the force of the "right to trade." To address this problem, we propose three alternative mechanisms:

(a) Developing countries should be able to club together to impose joint sanctions where they are mutually affected by a developed country policy. Also, developing countries should have recourse to funds (described further in the following section) to support themselves in the action and provide compensation for any reduction in aid or other losses resulting from retaliation by the developed country.

(b) Bilateral investment agreements have recognized the right of private parties to initiate actions against states, when they are harmed. The private parties that bring suit under investment agreements are corporations. But the rights of poor people should be equally enshrined under the law. Indeed, the rule of law is supposed to be directed at protecting those who otherwise could not fend for themselves. Any group of poor individuals harmed by a trade policy of another country should therefore have the right to bring a case before the WTO.

(c) There should exist an office ("Defender of the Rights of Trade") located, potentially within UNCTAD, that would have the right to bring suit against any country seen as violating the Rights to Trade as defined above.

Global Trade Facility

In addition to the right to trade, we propose the creation of a Global Trade Facility – a dedicated fund established at the global level, to which all donors would contribute resources that would be allocated to developing countries based on their needs.
This new fund would retain the concept of the Integrated Framework – where international organisations effectively cooperate on aid for trade - but concentrate its management

within one institution. Dedicated funds for aid for trade should be allocated to a special facility to be administered by UNCTAD, much as the Global Environment Facility is administered by the Bank and supported by a small secretariat operating within but independent from UNCTAD.

This body would have oversight over the aid for trade program, support the allocation of funds according to an agreed set of principles, create and monitor a common set of performance criteria and report on effectiveness. (The aid projects themselves would be carried out by a variety of national and international institutions and organizations.)

This organisation would not directly manage the assistance programs, but would allocate resources based on proposals from a wide range of development organisations which could include multilateral institutions (including the World Bank and regional development banks), NGOs, and countries themselves. (It would necessarily also have to have some responsibilities for oversight and evaluation.) This would encourage transparency, needs based allocation and competition among aid recipients and deliverers to develop the most effective and efficient aid-for-trade projects and programs.

The Global Trade Facility would support the right to trade by providing resources to support developing countries' actions and fund genuine aid for trade assisting countries to maximise the benefits of new market access won through the dispute settlement system. The facility could also compensate developing countries for any losses – such as reduced aid or other retaliation – associated with any right to trade dispute. It would also provide some adjustment and ongoing support to third party developing countries that may be negatively impacted by as a result of changes to advanced countries' trade policies, for example where a developing country was receiving preferences whose value is eroded by liberalisation emanating from a right to trade case.

As we have proposed (Stiglitz and Charlton, 2006) the GTF should be supported by a funding commitment:

a) The advanced industrial countries would contribute 0.05% of their GDP to the GTF. This means that the aid to trade facility would comprise approximately 7% of the total commitment (of 0.7% of GDP) to developing countries, an amount that seems balanced within the framework of overall development needs.

b) There would be an *additional* commitment of a small percentage of the value of the advanced countries' exports to least developed countries. One can think of this as a partial substitution of the revenues that would have been received as tariffs; but it takes advantage of the greater administrative capacity of the developed countries, and avoids all of the distortionary and political economy "costs" associated with tariffs. The advanced industrial countries need not actually levy the amount as a tax on exports, but simply pay the amount (small relative to GDP of the advanced industrial countries) out of general revenues.

c) There would be an *additional* commitment of 5% of all agricultural subsidies and 15% of all arms sales to developing countries, partially reflecting the costs that these impose on developing countries.

Conclusion

Aid for trade was a pragmatic response to challenges facing the global trade and aid system. By 2005 the trade community faced pressure to increase the development focus of its agenda and provide tangible benefits to developing countries. At the same time the aid community was looking for avenues to disburse growing aid budgets and demonstrate greater long term impacts from funded projects. Aid for trade suited the political economy that both groups found themselves in.

Nonetheless, behind the aid for trade movement has been a recognition that trade liberalization by itself is not a sufficient condition for an increase in trade or economic development, and in the short run at least, trade liberalization can have serious adverse effects on developing countries, and particular groups within those countries. There has been a significant and welcome step forward by the international community towards a greater understanding of the complex relationship between trade liberalisation and economic development in poorer countries.

But while there is considerable promise in aid for trade, so far aid for trade has not delivered on that promise. It has not proved to be additional, predictable and effective. Indeed without additionality, aid for trade is just another form of conditionality, and may actually impair the overall effectiveness of assistance programs. Worse still aid for trade has become a substitute for meaningful reform of the global trading system. The proposals we have made for a 'right to trade' and a 'global trade facility' would help ensure that international trade works for poor countries and the poor within those countries.

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