CNAEC Research Series 08-01

Development Cooperation for Economic Integration of East and South Asia

Kye Woo Lee

Korea Institute for International Economic P

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Development Cooperation for Economic Integration of East and South Asia
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Executive Summary

This study aims to analyze the rationale, trends, and scope of development cooperation in connection with economic integration, especially among countries in East and South Asia. It reviews the development of multilateral, regional, and bilateral economic integration efforts and discusses the rationales for development cooperation in the context of economic integration. It then reviews the history and patterns of aid for trade around the world during the period 1973-2005, drawing lessons for future directions of aid-for-trade.

Keywords: economic integration, development cooperation, aid-for-trade, East Asia, South Asia

국문요약

본 연구는 동아시아 및 남아시아 국가들간의 경제통합과 관련한 개발협력의 근거, 동향 및 범위를 분석하고자 한다. 또한 다국간, 역내간 및 양국간의 경제협력을 살펴보며 경제통합 측면에서의 개발협력에 대하여 논의한다. 더불어, 1973~2005년 동안의 무역을 위한 원조(aid-for-trade)에 대한 역사와 패턴을 살펴보고 향후 무역을 위한 원조의 방향을 제시한다.

Kye Woo Lee, who is a visiting professor of the Graduate School of International Studies, Seoul National University, and KDI School of Public Policy and Management, received his Ph.D. degree from Michigan State University. He is also a member of Prime Minister's Committee on International Development Cooperation. His areas of interest are international trade and finance, economic development, human development, poverty and income distribution, social safety nets, international organizations, and Latin American economy. His recent publications include "An Evaluation of Korea's 20-Year ODA" (2007).

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저서 및 논문

"NAFTA's Impacts on Korean Exports" (International Studies Review, 2005)
「한국의 공적개발원조 20년의 평가」(『한국개발연구』, 2007) 외

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I. Introduction

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II. Economic Integration and Regional Cooperation

As part of globalization, economic integration has rapidly progressed around the world. Economic integration has taken place on three levels: multilateral, regional, and bilateral. Recently, "new regionalism" is more often observed.

Since the end of World War II, international trade has greatly expanded and has grown in importance in both domestic and international economic affairs. While the volume of international commerce grew by only 0.5% annually between 1913 and 1948, it grew at 7% per year between 1948 and 1973. The rate of international trade has far outgrown that of global economic output over the course of the postwar era. Trade has grown steadily from 8% in 1950 to more than 26% in 1998. As a result, countries are increasingly interdependent through trade in goods and services, and flows of capital.

The growth of trade and investment owes much to a series of trade liberalization negotiations. Since the end of World War II, there have been eight major trade liberalization agreements completed under the framework of the General Agreement on Tariffs and Trade (GATT). The Uruguay Round, the eighth and last, was held during the period 1986–1994. The Round is considered a milestone in multilateral trade liberalization efforts. First, it succeeded in including areas formerly excluded from negotiations, including agriculture and clothing. Second, a framework agreement was created for international trade in services, namely the General Agreement on Trade in Services (GATS), which had previously never been subject to any set of agreed-upon rules. Third, a new institution named the World Trade Organization

(WTO) was established in 1995 to replace the GATT. In November 2001, the WTO members agreed to launch a new round of trade talks at the fourth ministerial meeting held in Doha, Qatar. It was termed "The Doha Development Agenda" (DDA) to emphasize that it deals with development issues and the interests of poorer countries (Yoo and Lee 2002).

Multilateral arrangements are not the only option for fashioning collective and coordinated responses to the challenges confronting developing countries in an increasingly interdependent, globalized economy. Indeed, following the failure of the international financial institutions to manage the financial shocks and crises toward the end of the 1990s, and given the slow progress of the Doha Round of multilateral trade negotiations, regional arrangements have assumed a more prominent place on the international development agenda.

Over the past two decades, policy makers in developing countries paid more attention to economic integration in pursuit of national development goals. These policies have been based on the belief that market liberalization and opening up to international trade and finance would lead to the best possible factor allocation, productivity increases, and technological upgrades in developing countries. This tendency to give priority to market forces in determining factor allocation is reflected in the rapidly increasing number of regional and bilateral free trade agreements (FTAs) or preferential trade agreements (PTAs) concluded since the early 1990s. The number of trade agreements notified to the GATT/WTO increased from 20 in 1990 to 86 in 2000 and to 159 in 2007.

The FTAs or RTAs concluded over the past 20 years have been mainly bilateral, and primarily between developing and developed countries. They have increasingly included provisions aimed at "deep integration," which involves harmonizing national policies to give greater freedom to market forces and reduce options for government intervention. This trend, combined with the increasing number of FTAs and RTAs involving countries from different geographical regions, characterizes what has come to be labeled as "new regionalism." This term is somewhat misleading, since most of the trade agreements are bilateral and involve countries that are not necessarily in the same geographical region. "New regionalism" denotes a departure from multilateralism and has grown out of some governments' sense of frustration at the slow progress in multilateral trade negotiations. It stems from their belief that a number of bilateral "regional" agreements could serve as a better vehicle for advancing their preferred agenda of economic liberalization and harmonization across a broad range of policies, laws and institutions aimed at promoting the internationalization of investment and production (UNCTAD 2007).

However, formal agreements on trade liberalization or other forms of regional cooperation are not a precondition for de facto integration; in general, there is a two-way dynamic interaction between the two. Once external relations reach a certain level of intensity due to regional growth dynamics, the emergence of international production networks, and related FDI flows, there will be pressure from producers to lower or remove the various barriers to intraregional trade, including tariffs, non-tariff barriers, bureaucratic red tape, and conflicting legal and administrative procedures, as well as demands for better transport and communications infrastructure.

In a world that does not correspond to the perfect competition model of economic theory, and where dynamic interactions between economics and politics shape the path of development, regionally coordinated or common public policies can promote regional integration and faster growth. Developing countries in a region can do this by bridging gaps left by market mechanisms and by helping partners to overcome constraints on industrial take-off, diversification, and sustained catch-up growth, as demonstrated by the experience of post-war Western Europe. Areas of such active regional cooperation can include apparently simple measures, such as trade and transit facilitation and the dissemination of commercial information. Another equally important ingredient for regional cooperation is cooperation in the planning and financing of transport and communication infrastructure to enable physical cross-border trade and reduce its costs. Other instances where regional integration can serve development are collective management of investment projects in the crucially important areas of energy and water supply, which represent serious bottlenecks in many developing countries. Expansion of trade also requires a stable financial and monetary environment. Since the international financial system lacks sufficient instruments to reduce the volatility of international financial markets and its impact on developing countries, regional cooperation in monetary and exchange-rate policies has become an important issue. This is a concern not only in Western Europe, but also in all developing regions. Indeed, in the absence of far-reaching reform of international financial architecture, strengthened regional monetary and financial cooperation can be critical for achieving greater coherence between the international financial system and the international trading system.

International, and for that matter regional, trade should not be considered an end in itself; rather, it is a means to achieve faster growth. Countries should therefore also investigate innovative areas of policy-making that could support diversification and industrialization of their economies. This could, for example, take the form of support for industrial projects and common undertakings in research and development, knowledge generation, and information dissemination that might be too costly and risky for an individual developing country, but viable if several countries pooled their resources.

Countries in East and South Asia are no exception. In fact, they have played a more active role in promoting economic integration than countries in other regions. There have been formal regional economic integration agreements like the Asia and Pacific Economic Committee (APEC) and the Association of Southeast Asian Nations (ASEAN), and many bilateral economic integration agreements. In addition, there has been market-based informal economic integration. Despite the erosion of regional tariff preferences as a result of the reduction in MFN tariffs, intraregional trade in East Asia has reached 50% of the total trade in the region, which is the highest level among all regions. In Africa, although the share of intraregional trade in its total trade has also increased, it is still less than 10% of its total trade. Intraregional trade in Latin America, excluding Mexico, has grown significantly since the late 1980s to reach almost 30% of its total trade. Intraregional trade among the economies in transition that are members of the Commonwealth of Independent States (CIS) has been declining, but is still significant, accounting for about one-quarter of total trade in 2005.

Of all developing-country regional arrangements, ASEAN displays the highest level of intraregional trade in its total trade: 25% on weighted average. Although ASEAN was created as a political rather than an economic grouping, trade among its participants has consistently increased since the mid-1970s. Trade liberalization was formalized in 1992 with the launching of the ASEAN Free Trade Area (AFTA). Developing countries in East and Southeast Asia accounted for almost 50% of total ASEAN trade in 2005, compared to only 30% in 1990. This trade expansion has largely been due to the development of a wider regional production network driven by other Asian economies, in particular China, the Republic of Korea, and Taiwan. Its success has encouraged negotiations for enlarging the free trade area to China, the Republic of Korea, and Japan.

III. Economic Integration and Development Cooperation

Irrespective of the level at which economic integration takes place, development cooperation among members of the economic integration agreements is essential for the efficiency and sustainability of the economic integration efforts. The needs for development assistance among partners become stronger in new regionalism. Development assistance can take many different forms, depending on the composition of the members of economic integration arrangements.

1. Multilateral Integration and Development Cooperation

Economic integration efforts have often been accompanied by development cooperation movements. Although this situation may have a historical or national background, it may also be a logical or theoretical consequence of economic integration. It is imperative that economic integration efforts should go hand-in-hand with measures to ensure equal competitive capacity among member countries. Economic integration implies removing restrictions on trade, investment, and other spheres of economic activities among member countries. It also implies that member countries compete fairly on the basis of common rules and market principles. Practices of fair competition require as a precondition a more-or-less equal capacity for competition among member countries. In order to be able to derive the benefits from external integration on the basis of comparative advantages, member countries must have a certain level of local production capacity, skills, and technological sophistication; an array of market support institutions; and good infrastructure. Many poor countries, however, lack the basic infrastructure to trade and face considerable supply-side constraints when participating in global markets. These difficulties can be compounded by their own trade policy settings that create disincentives to enter international markets, such as maintenance of high unbound tariffs. Moreover, some of them have to cope with transitional adjustment costs from liberalization, such as preference erosion and loss of scarce fiscal revenue from external trade (IMF and World Bank 2005). As such, it is natural to observe that economic integration movements are accompanied by development cooperation efforts for members lagging behind others in the development of international competitive capacity. Indeed, both the Doha declaration and its Framework Agreement contain multiple references to the need for technical assistance and capacity building for poor countries to undertake commitments and benefit from the round.

In fact, even with a freer world trading system built by the WTO, less-developed countries could not integrate into the new multilateral trading system and take advantage of new trade opportunities arising from the globalization of world markets. The WTO agreements provided enlarged market access to less-developed countries, but they could not increase their exports on a large scale because of the limited capacity to increase production. The reduction of tariffs resulted in a loss of tariff revenue without significantly increasing the efficiency in resource allocation because of the poor infrastructure.

The need to combine economic integration with development cooperation has increased as the new regionalism trend of economic integration intensifies. First, in a way, new regionalism bypasses multilateral institutions and arrangements as governments pursue economic objectives and use instruments for which no agreement has been reached at the multilateral level. FTAs generally demand far-reaching liberalization of foreign investments and government procurement, new rules on certain aspects of competition policy, stricter rules on intellectual property rights, and the incorporation of labor and environmental standards. Moreover, many FTAs oblige developing countries to undertake much broader and deeper liberalization of trade in goods than that agreed under WTO arrangements. Some also involve a form of liberalization of services that differs from what is envisaged in WTO agreements, thus exerting pressure on developing countries to make greater liberalization commitments in this area.

Second, since FTAs involve reciprocal commitments, the new regional agreements between developed and developing countries eliminate the special and differential treatment (SDT) that may be granted to developing countries in the context of multilateral agreements. Indeed, since the Doha Round negotiations began, 88 specific proposals on operationalizing SDTs have been made, of which 28 have been, in principle, accepted by WTO members. The reciprocity principle in North-South FTAs places developing countries at a disadvantage vis-à-vis their developed-country partners, as they typically enter into the liberalized trade relationship at a less advanced stage of domestic industrial development, implying lower supply and marketing capacities.

Third, the possibilities of developing countries to benefit from the investment provisions of these new regional agreements are limited. In order to comply with the principle of reciprocity, developing countries are also forced to cut tariffs from significantly higher levels, especially on industrial products.

Fourth, another motivation for joining this new type FTA is the perceived risk of losing competitiveness vis-à-vis other developing countries that might have entered into an FTA with the same primary trading partner. Indeed, unlike negotiations in a multilateral context, individual bilateral negotiations create an environment of competitive liberalization. However, the benefits that developing countries can obtain in North-South bilateral negotiations are circumscribed by their usually weaker bargaining power and the limited negotiating flexibility of their developed-country partner. This is due to a combination of strong pressure from domestic lobbies and limitations imposed by existing national legislation, as in the case of the United States, or complex governance and decision-making processes, as in the case of the EU. For example, these factors have made it especially difficult for the major developed countries to accept a reduction or elimination of agricultural subsidies as a negotiable issue in bilateral agreements. Consequently, developing-country partners in bilateral trade agreements are deprived of perhaps the most important potential source of increased market access in the major developed countries. Moreover, a developing country is often unable to derive the full benefits of the improved market access opportunities of an FTA because of limited supply capacities and competitiveness, and because local firms are often unable to comply with restrictive rules of origin on goods destined for export to the developed-country partner.

Finally, preferences negotiated by one developing country with a developed partner may quickly be eroded if the same developed country also concludes FTAs with other developing countries. However, the developing country has to bear the consequences of eliminating tariffs and other trade barriers in almost all categories of goods. It gives up the possibility to use potentially important and powerful instruments of industrial and agricultural policy, which are often indispensable for promoting the creation of new production capacities, industrial upgrades, and structural changes in their economies.

Thus, the gains for developing countries from improved market access are far from guaranteed, whereas the loss of policy space is certain. Therefore, it is important to realize that the sustainable achievement of the goals of new regionalism, especially using it as a vehicle for achieving global economic liberalism, is dependent on the incorporation of a stronger development dimension into those agreements or the establishment of stepped-up development cooperation in addition to new regionalism. This is the reason why new regionalism, to date, has a fairly modest record of enhancing growth and structural change in developing countries, and its underlying principles have come under increasing criticism.

2. Regional Integration and Development Cooperation

The UNCTAD Report of 2007 argues that instead of multilateral integration or new regionalism, a regional orientation involving countries at a similar level of development may be considered a more viable option for economic integration. This is because the initial foreign competition within the region may be less difficult to handle, the technological gap vis-à-vis competitors from more advanced countries outside the region may be easier to close, and the probability of finding a level playing field is greater. The UNCTAD further argues that in a world with increasing returns, external economies, and variable transaction costs, proximity still offers some real economic advantages. Although MFN tariffs have been substantially reduced over the past 20 years as a result of progress in multilateral trade liberalization, preferential access among regional partners may still be a tool for regional trade and industrial integration. Sometimes major investment in cross-border infrastructure or very capital-intensive industries can be an important motivation for regional integration to share the benefits and costs, and to avoid costly overcapacities. Moreover, as observed in the majority of existing regional integration agreements, political motivations and influences are an integral part of regional integration.

However, geographical proximity does not guarantee a level playing field, equal international competitiveness, or success of the regional FTAs or PTAs if a strong development cooperation mechanism is not put in place. As we have seen, the objectives of the FTAs or PTAs are not confined to the elimination of barriers to cross-border trade. Ultimately, they are tools for economic development and industrialization. They involve more spheres of economic activities including joint investments in infrastructure and production of international public goods, which would be facilitated by the development cooperation mechanisms in place in the region. The much weaker and less stable integration in Latin America than in East Asia can be attributed to a less dynamic overall economic performance, as well as to inadequate national policies. The relatively small share of intraregional trade in Africa, despite the existence of several RTAs, is largely due to their production structure and the composition of their exports, as well as the presence of non-tariff barriers and infrastructural constraints. As many countries still specialize in only a small number of primary commodities for export, while most of their imports consist of manufactures, the mismatch between the structures of supply and demand in their international trade limits the potential for intraregional trade. The export-oriented production of their labor-intensive manufactures has not significantly increased their intraregional trade either, because almost all of those exports go either to Western Europe or the United States. The experience in Latin America and Africa shows that effective formulation and implementation of a national development strategy and appropriate macroeconomic policies are of major importance. Overcoming those factors limiting the expansion of intraregional trade in those regions can be greatly helped by development cooperation mechanisms placed in the regional or multilateral agreements.

Regional integration among developing countries has the potential to support national development strategies, and, to some extent, fill the gaps in the global economic governance system. But in order to do so, regional cooperation has to extend beyond trade liberalization to include policy areas that strengthen the potential for growth and structural change in developing countries. These include macroeconomic and financial management, as well as trade support and industrial policies. To tap the potential for closer regional integration among developing countries in these areas, development cooperation should be mobilized for member developing countries whose capacities for policy development and management are weak and vulnerable.

For example, the growth process is often associated with technological development. Most developing countries rely heavily on accessing technology from abroad for application in local production systems. This requires appropriate national policies and institutions. National innovation systems could be devised for collaborative regional research, training schemes, and information gathering. These may involve complex institutional issues such as the design of intellectual property regimes, and they may be better supported by the harmonization of rules and laws on a regional basis and by pooling resources to ensure their more effective management in the context of local needs and conditions. Tight budgets and human resource constraints prevent many developing-country governments from offering greater support to “horizontal” industrial policies, for example, through more funding for innovation, research, and development activities. Often such activities, which generally lack a strong domestic lobby, have relatively long gestation periods and require substantial investments in physical and human capital. Costs of further developing already advanced technologies and adapting them to local conditions can come more easily when financed by several governments through a regional integration agreement or by regional development banks.

Regional integration must also ensure a fair distribution of the gains from integration among members, so that the regional integration is sustained. Inequalities in the distribution of gains sometimes stem from structural factors, but also, in many cases, from economic policies. In a customs union or a common market, the structure of the common external tariff and local content rules are not neutral in the sense that they may serve the interests of some members better than others. Moreover, the members of a regional agreement frequently pursue their own industrial policies: either in accord with their partners or unilaterally. Thus, there is the risk that the lack of a coordinated industrial policy could lead to “beggar-thy-neighbor” behavior, eventually weakening the integration process. In fact, not all the members of a trading bloc have the same financial and institutional capacities to promote production and exports. The EU dealt with that problem by harmonizing national support policies and by transferring some areas of national policymaking to the regional level to enable better distribution of the gains from integration. In integration agreements among developing blocs, this is largely a pending issue, although it is receiving increasing attention.

An often-neglected part of development cooperation is to address the inequality in the distribution of the benefits and costs of the regional trade agreement within a member country. Since an FTA or PTA has differential effects on the various groups of an economy, it is not easy to come up with a social consensus on a proposed FTA or PTA agreement, and consequently, it has to go through a protracted negotiation process within an economy. Advanced economies find it easier to cope with the adverse effects of such agreements on certain groups and sectors with a relatively well-established social security system and social safety nets. However, developing countries, especially LDCs, usually have social security systems and social safety nets that are weak or completely non-existent. For an efficient conclusion and implementation of an FTA or RTA, it will be required for member countries to pay attention to the development cooperation to address the imbalance between the winners and losers within a member economy, especially for the poverty groups.

To address the unequal structural and institutional capacities of member economies, the initial steps of a regional economic integration initiative may aim to provide long-term financing to participating countries through regional development banks and the creation of regional capital markets for technical assistance in policy changing, infrastructure buildups, and new product development. The establishment of the European Investment Bank as part of the effort to develop the

European Community in the late 1950s, and the Inter-American Development Bank in Latin America and the Caribbean as a precursor of the Latin American free trade movements in the early 1960s point to successful development cooperation cases (Bakker 1996; Corbo 1992).

More sophisticated forms of development cooperation involve the use of regional clearing banks to facilitate intraregional trade payments and short-term financing for countries facing balance-of-payments problems. Bond issuance in regional currencies and loans in local currencies may help to reduce a currency mismatch and induce the development of regional financial markets. Further steps toward closer regional cooperation include the creation of regional exchange rate mechanisms and monetary unions. Regional arrangement for exchange-rate management among countries with relatively high and increasing shares of intraregional trade and financial cooperation can be important elements in the process of creating a common market, as volatility of exchange rates may distort trade flows and undermine trade integration. Even if such arrangements require greater macroeconomic coordination among the participating countries, they can be useful for countries with very open economies targeting the stability of the internal and the external value of their currencies. Experiences in some regions show that the often-severe effects of volatile short-term capital flows, arbitrage, and frequent over- and under-valuations, particularly on growth and investment, can be considerably reduced via exchange rate management arrangements.

3. Trade Facilitation

Development assistance for trade facilitation, however, has gained importance in recent times due to the progressive reduction of tariffs and substantive non-tariff barriers in international trade through successive GATT rounds, thus bringing other frontier-crossing costs to new prominence. An increasing perception at the World Bank and other aid agencies is that poor quality frontier-crossing and payment procedures and associated inefficient practices are having pronounced adverse effects on the ability of traders, carriers, agents, ports, and airports in developing countries to play a full part in global trade expansion. In many cases, formal trade liberalization is not as successful as it might be because some fundamental aspects of trade logistics, such as facilitation of customs formalities, harmonization of procedures, and standards are neglected or used as non-tariff trade barriers. In other cases, poor infrastructure, or its complete absence, makes trade physically difficult, if not impossible, independent of the trade regime. Therefore, rather than focusing exclusively on the legal aspects of trade policies in regional integration, additional efforts to tackle these other aspects of intraregional economic relations may be as important as, if not more than, further trade liberalization (OECD 2002). Trade facilitation requires not only financial resources, but policy making, regulation, and other institutional capacities. Developing countries often face difficulties in strengthening their capacities for trade facilitation, and technical and financial assistance by advanced members of FTA or PTA arrangements or multilateral and bilateral aid agencies proves useful.

IV. Trade Facilitation and Development Cooperation

1. Trade Facilitation and Growth

Wilson *et al.* (2003) define and measure trade facilitation using four broad indicators. These are constructed using country-specific data for port efficiency, customs environment, regulatory environment, and electronic-business usage. They estimate the relationship between these indicators and trade flows using a gravity model. The model includes tariffs and other standard variables. The authors find that enhanced port efficiency has a large and positive effect on trade; regulatory barriers deter trade. The results also suggest that improvements in customs and greater electronic-business use significantly expand trade, but to a lesser degree than the effects of ports or regulations. The authors then estimate the benefits of specific trade facilitation efforts by quantifying differential improvement by members of APEC in these four areas. Based on a scenario in which APEC members that are below average improve capacity halfway to the average of all members, the authors find that intra-APEC trade could increase by $254 billion. This represents approximately a 21% increase in intra-APEC trade flows, about half coming from improved port efficiencies in the region. Using Dollar and Kraay's estimate of the effect of trade on per capita GDP (Dollar and Kraay 2001), these improvements in trade facilitation suggest an increase in APEC average per capita GDP of 4.3%.

The issue, then, is how to help the regional members improve their capacities for trade facilitation and mobilize resources cooperatively from members and outside of the region for promotion of trade and, ultimately, economic growth. A review of the history and trends of aid-for-trade would shed some light on the issue.

2. History of Aid-for-Trade

In the run up to the Sixth WTO Ministerial Conference in Hong Kong in December 2005 and in response to a specific request from the G8 in Gleneagles in July 2005, the World Bank and the IMF jointly proposed an aid-for-trade framework. This should comprise traditional instruments such as trade-related technical assistance and institutional and supply-side capacity building, including trade-related infrastructure development, but should expand to provide aid to help developing countries adjust to possible revenue losses suffered through cuts in tariff revenues and preferential margins, and, more generally, to smooth adjustment pressure arising from increased international competition. In response, the September 2005 meeting of the Development Committee endorsed the proposals for an enhanced Integrated Framework, stated its support for a strengthened framework for assessing adjustment needs so that IFIs and donor assistance mechanisms can be better utilized, and asked the World Bank and the IMF to examine further the adequacy of existing mechanisms and better integrate trade-related needs into their support for country programs. The World Bank and the IMF reported back to the Development Committee in September 2006. Their joint report confirmed that creation of additional funds would not be efficient and the current country assistance programs could accommodate the concerns of developing countries in the field of aid-for-trade (IMF/World Bank 2006).

In December 2005, at the 6th Ministerial Conference held in Hong Kong, the Ministerial Declaration endorsed the enhancement of the "Integrated Framework" and created a new WTO work program on aid-for-trade. The Hong Kong Ministerial Declaration announced that aid-for-trade should aim to help developing countries, particularly LDCs, to build supply-side capacity and trade-related infrastructure 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 of the DDA, particularly from market access; however, it can be a valuable complement to the DDA, and the declaration called for the creation of a task force to provide recommendations on how to operationalize aid-for-trade and how aid-for-trade might contribute most effectively to the development dimension of the DDA.

Subsequently, WTO members gave the Director General a mandate to (i) create a task force to provide recommendations by July 2006 on how to operationalize aid-for-trade and (ii) to consult with members, international organizations, and development banks on mechanisms to secure additional financial resources.

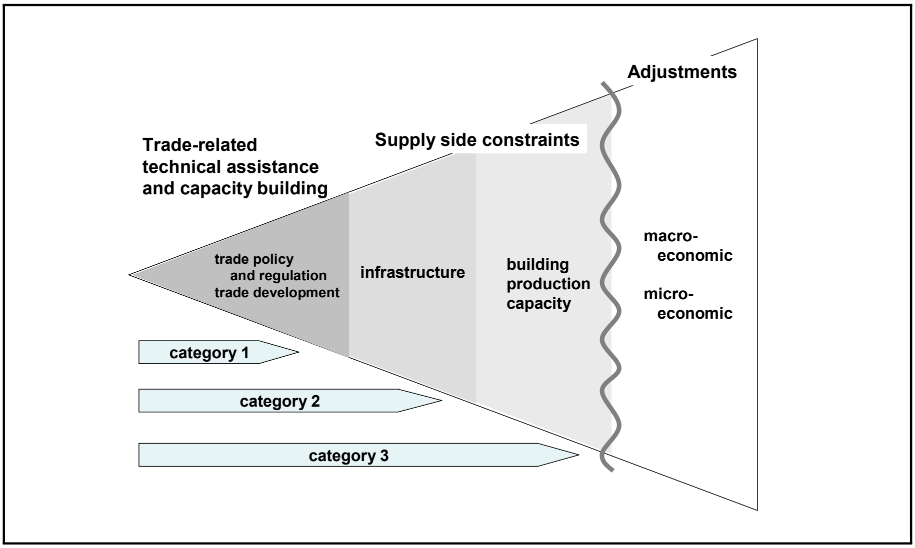
Accordingly, a task force was created to provide recommendations on how to operationalize aid-for-trade, and it delivered its recommendations in July 2006. Aid-for-trade has been defined as comprising the following:

a. Trade-Related Technical Assistance & Capacity Building (TRTA/CB)
b. Economic infrastructure
c. Building productive capacity
d. Trade-related structural adjustment (WTO/OECD 2007)

V. ODA for Trade: A Comparative Analysis

1. OECD Classification

Figure 1. Aid for Trade



2. A Comparative Analysis: Bilateral and Multilateral Aid for Trade

Types of Aid-for-Trade. The Trade-Related Technical Assistance and Capacity Building Data Base (TCBDB) was established by the WTO jointly with the OECD to provide information on trade-related technical assistance and capacity building projects. It covers national as well as regional projects. It is an ongoing activity and the 2006 Joint WTO/OECD Report on Trade-Related Technical Assistance and Capacity Building was circulated at the end of April 2007. At present, the period of coverage is 2001 to 2005 with partial coverage of 2006 and beyond. Data is reported from bilateral donors and multilateral/ regional agencies.

For the purposes of data collection, **TRTA/CB** is defined as activities that intend to enhance the ability of the recipient country in the following main categories of activities: trade policies and regulations, and trade development.

- **Trade policy and regulations** includes formulation and implementation of a trade development strategy and creation of an enabling environment for increasing the volume and value-added of exports, diversifying export products and markets, and increasing foreign investment to generate jobs and trade. It also covers participation in and benefit from the institutions, negotiations, and processes that shape national trade policy and the rules and practices of international commerce, including support to aid recipients' effective participation in multilateral trade negotiations; analysis and implementation of multilateral trade agreements; mainstreaming of trade policy and technical standards; tariff structures and customs regimes; and support for regional trade arrangements and human resources development in trade.
- **Trade development** covers stimulation of trade by domestic firms and encouragement of investment in trade-oriented industries. It also covers business development and activities aimed at improving the business climate, access to trade finance, and trade promotion in productive sectors (agriculture, forestry, fishing, industry, mining, tourism, services), including at the institutional and enterprise levels.

Activities to enhance the infrastructure necessary for trade, that is transport, storage, communications, and energy, are excluded from the annual TCBDB. The fact that roads, telephones, or electricity are part of a network makes it difficult to assess to what extent they focus on international trade. For example, it would be wrong to say that the construction of a road is trade-related because it goes to a port, while the construction of a rural road in a coffee growing region is not. Hence, in this report, all aid to infrastructure is deemed, *inter alia*, to assist international trade. Data on aid to infrastructure collected in the OECD's Credit Reporting System (CRS) are therefore considered to be sufficient to cover this aspect of trade-related assistance. The TCBDB provides direct access to the CRS online database that permits examination of aid to infrastructure at the level of individual activities or aggregated by donor, recipient, and/or sector.

While TRTA/CB, under the category *trade policy and regulations*, can be considered to be extended with the sole purpose of promoting trade, *trade development* (and, to an even greater extent, *infrastructure*)

Table 1. Aid-for-Trade Agenda and CRS Codes

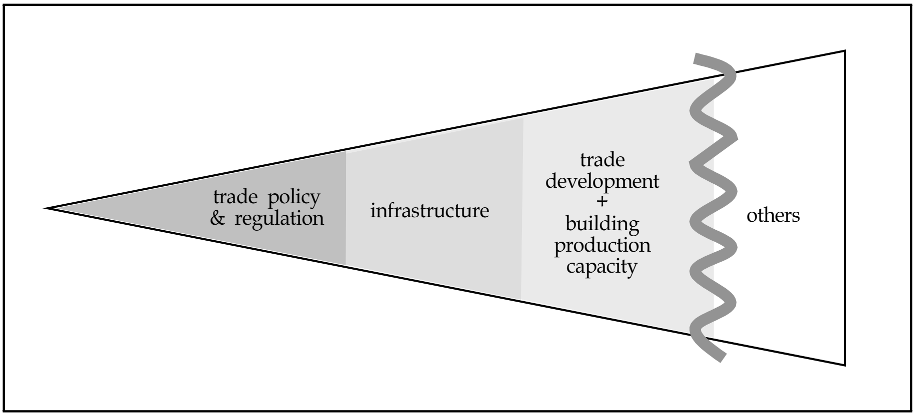
Aid-for-Trade Agenda	CRS/TCBDB Codes
1. Trade-related Technical Assistance and Capacity Building	
1.1 Trade Policy and Regulations	33111 - 33181
1.2 Trade Development	25011 - 25013 24000 - 24081(v) 31100 - 32268(vv) 33200 - 33210(vvv)
2. Infrastructure	21000 - 23082
3. Building Production Capacity	24000 - 24081(v) 31100 - 32268(vv) 33200 - 33210(vvv)

Sources: OECD Reporting Directives for the Credit Reporting System; 2005 Joint WTO/OECD Report on TRTA/CB.

activities generally have another major objective (e.g., agricultural or industrial development). For example, while coffee export development is clearly "trade-related," its primary objective is to foster the development of the agricultural sector. Given these variations in the degree of focus on trade capacity, it is preferable to avoid direct comparisons of the amounts between the three categories. Furthermore, in the category *trade development*, a number of donors isolate the trade component of each activity, whereas others report the whole activity, noting it as trade-related. Although some work to harmonize donors' approaches has been done, the total amounts of TRTA/CB per donor in this category should be interpreted with caution.

From the CRS online database, it is possible to calculate aid for trade policy and regulation, and that for infrastructure. However, the aid for *trade development* cannot be disaggregated from *building production capacity*, as they are in the same CRS codes. Therefore the pyramid that can be drawn from CRS is as following:

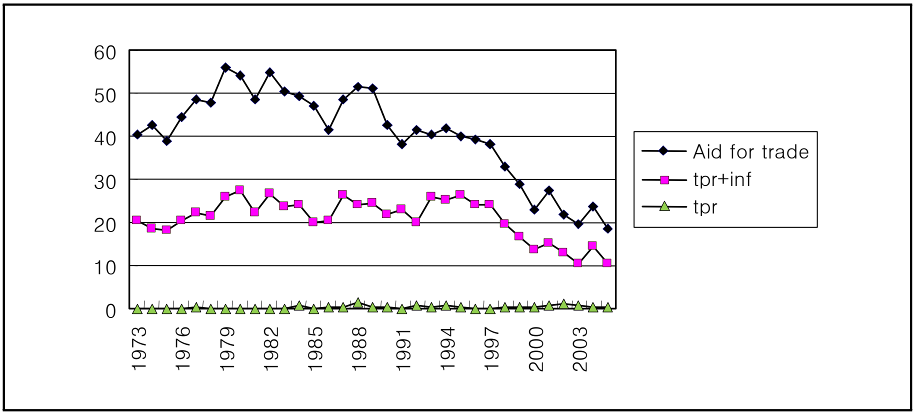
Figure 2. Aid-for-Trade Agenda Based on CRS Codes



As can be observed in Figure 3, the aid for *trade policy and regulations* was very small throughout the period of analysis, and therefore the change in its share of total aid over the period of observation is not discernible from Figure 4. As for aid for *infrastructure*, its share of total aid increased from 20% in mid 1970s to about 25% during early 1980s to mid 1990s. However, it decreased in the most recent ten years, and now it is slightly greater than 10%. The aid for *building production capacity* followed the same trend as that for *infrastructure*. Its share of total aid increased in the late 1970s, but decreased thereafter－the difference between the lines depicting all aid for trade and the sum of trade policy/regulations and infrastructure.

Figure 3. Aid-for-Trade: All Donors

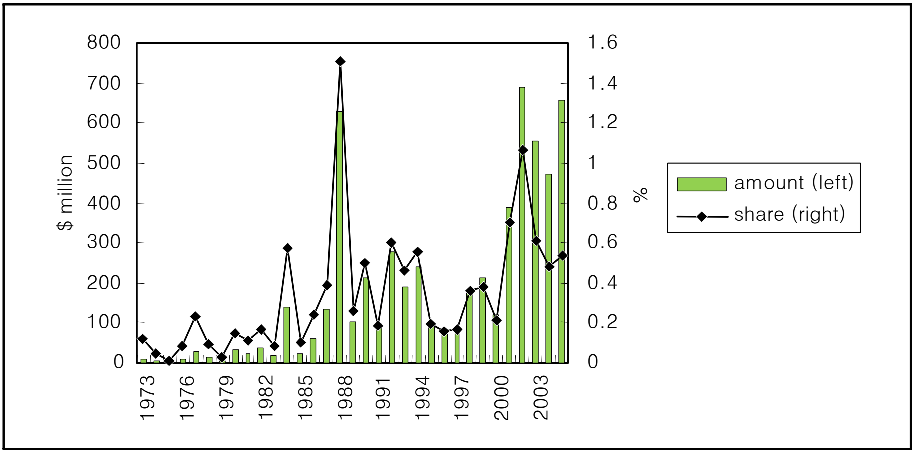
(Unit: % of Total ODA)



The amount of aid for trade policy and regulations and its share in total ODA are increasing but still very small. The amount never exceeded $1 billion, and the share barely exceeded 1% after 2002.

Consequently, the trend of total aid-for-trade reflects mainly that

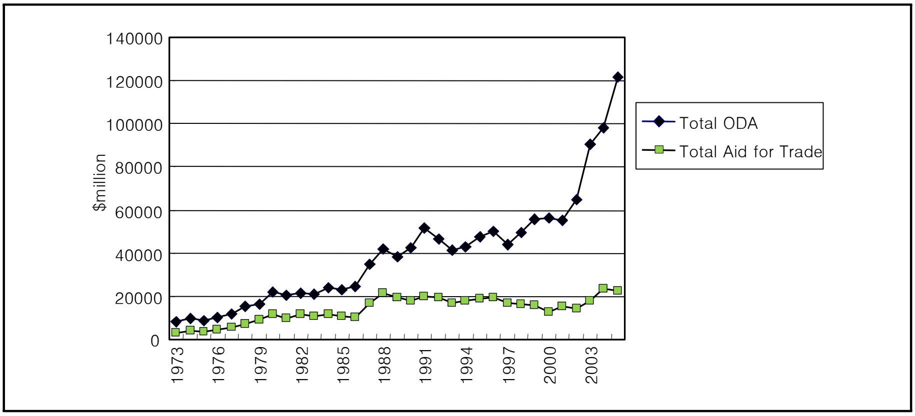
Figure 4. Aid-for-Trade Policy and Regulations: All Donors



of the aid for *infrastructure* and the aid for *trade development* and *production capacity building*, as in Figure 3. The share of total aid-for-trade of total ODA had increased from 40% in the mid-1970s to a range of 50–60% during the 1980s. Since the beginning of the 1990s, however, the share of total aid-for-trade had steadily decreased until recently reaching around 20%.

This trend was formed by the fact that although both total ODA and aid-for-trade increased steadily in absolute amount since the mid-1970s, total ODA rose at a greater rate than total aid for trade, and both declined during the 1990s. Total ODA increased sharply during the period from the late 1980s to the beginning of the 1990s. Then, it remained stable during the 1990s until it rose again more sharply from the beginning of the 21st century, coinciding with the timing of the forgiveness and rescheduling of the large amounts of highly indebted poor countries' debts and the international conference for ODA finance in Mexico (Figure 5).

Figure 5. Aid-for-Trade and Total ODA



Sources of Aid-for-Trade. If we compare aid for trade by multilateral donors and bilateral donors, their aid flows follow similar trends. Although the total amount of aid by both bilateral and multilateral donors increased steadily throughout the period of analysis, especially since 2001, they did not increase their amount of aid-for-trade proportionately. Each of both donors' aid-for-trade as a share of their respective total aid increased in the 1970s, but since then, the levels have decreased to date, especially in the 1990s when FTAs and PTAs proliferated (Figures 6 and 7).

During the most of the period analyzed, the share of aid-for-trade of multilateral donors was greater than that of bilateral donors, although the amount of bilateral aid-for-trade was much greater than that of multilateral aid-for-trade. In other words, multilateral donors provided a greater share of their aid-for-trade than bilateral donors. Before both shares started declining steadily in the 1990s, the share of multilateral aid for trade oscillated between 60% and 70% of total ODA, while the share of bilateral aid for trade moved between 40%

and 50%. Recently, the share of multilateral aid-for-trade in its total aid reached about 25%, and the share of bilateral aid-for-trade reached about 15%. In terms of the amount of aid-for-trade provided by both bilateral and multilateral donors, it remained static or even declined since the 1997 Asian Financial Crisis, and started rising only recently.

Figure 6. Bilateral Aid-for-Trade

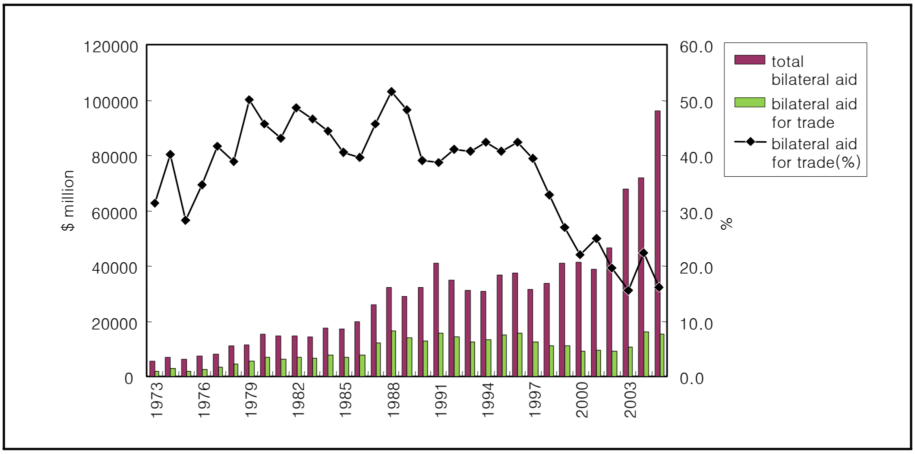
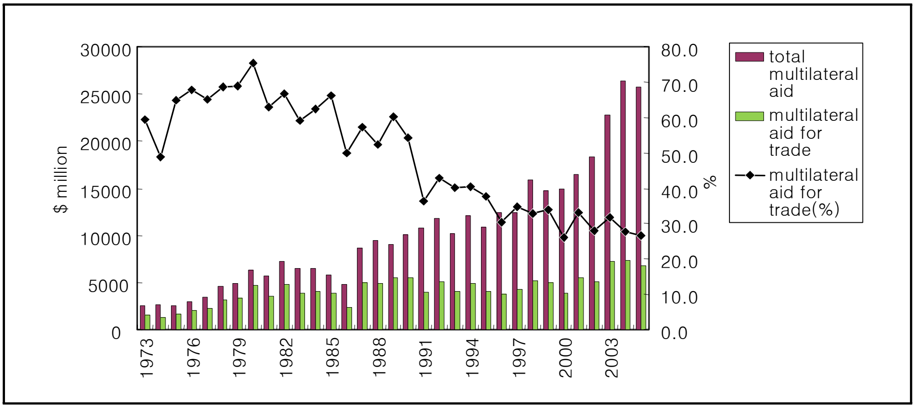


Figure 7. Multilateral Aid-for-Trade



The difference between bilateral and multilateral donors came more from the aid for *building production capacity* than from that for *trade policy and regulation* or for *infrastructure*. While multilateral aid for *trade development* and *building production capacity* started declining sharply at the beginning of the 1990s when the centrally planned economies collapsed, bilateral aid for *trade development* and *building production capacity* began plunging in the late 1990s when the financial crisis hit the emerging economies in Asia and Latin America (Figures 8 and 9).

Figure 8. Types of Aid-for-Trade: Bilateral Donors

(Unit: % of their total aid)

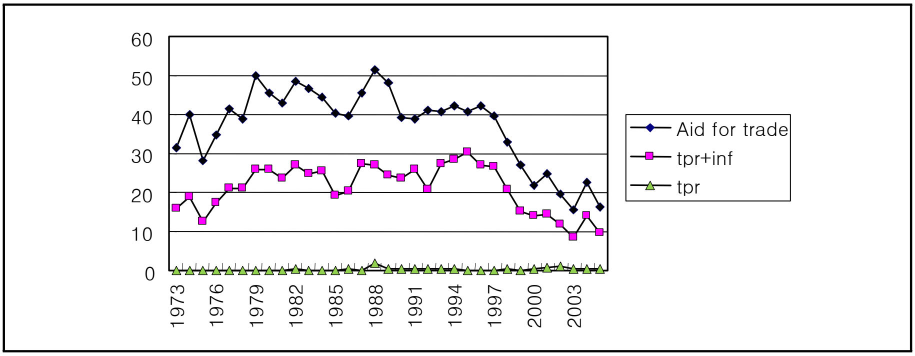
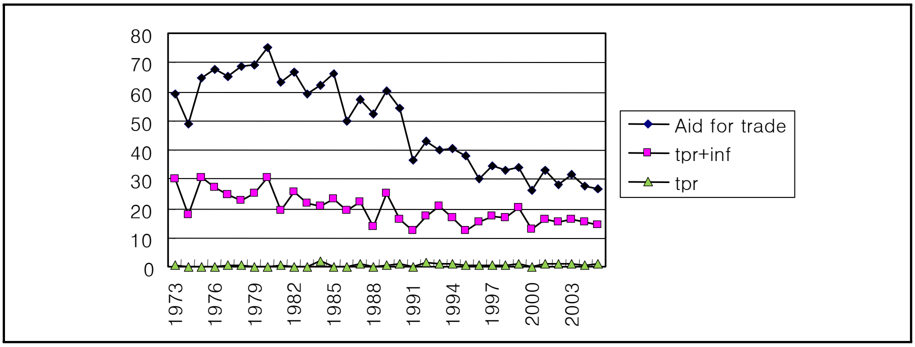


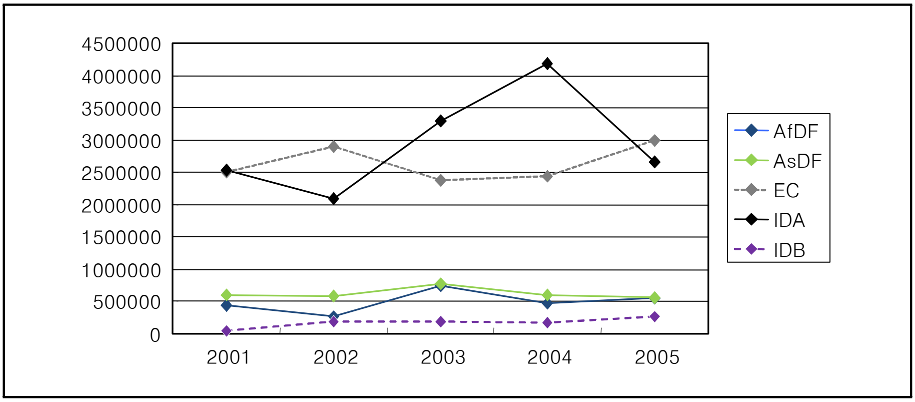
Figure 9. Aid-for-Trade: Multilateral Donors

(Unit: % of their total aid)



Multilateral Agencies' Aid-for-Trade. Top five agencies most active in providing aid-for-trade among the multilateral donors are IDA, EC, Asian Development Fund, African Development Fund, and IDB. During the period of observation, 2001–2005, the amount of aid provided by these agencies was stable, except that IDA's amount increased sharply from $2.1 billion in 2002 to $4.2 billion in 2004, but declined sharply to $2.7 billion in 2005; EC's amount increased from $2.4 billion in 2004 to $3.0 billion in 2005 (Figure 10). The top five multilateral aid agencies together provided about $7 billion in 2005.

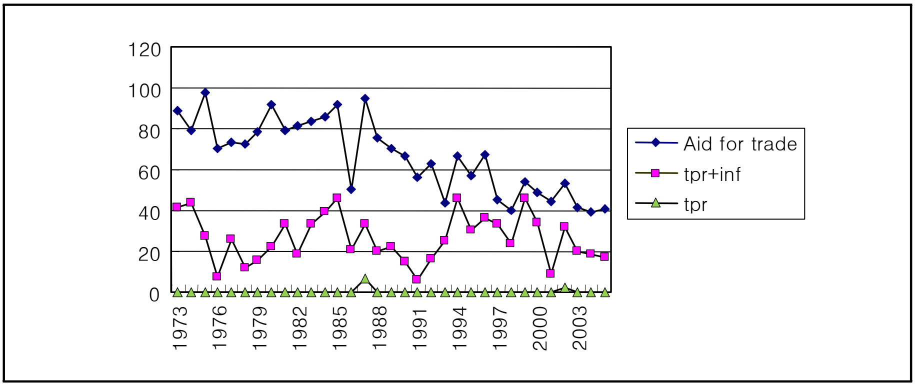
Figure 10. Top Five Agencies of Aid-for-Trade



In the case of ADB, the share of aid-for-trade was even higher than the average of multilateral donors over the period of analysis. In 2005, while the share of aid-for-trade in the multilateral donors' total aid fell short of 30%. ADB's share of aid-for-trade in its total aid reached slightly greater than 40% (Figures 9 and 11). Although the ADB's share of aid for *infrastructure* was higher than the multilateral average, the main difference between ADB and other multilateral donors came from ADB's larger share of aid for *building production capacity*. However, the aid for *trade policy and regulations* was zero in all the years except 1987 and 2003, thus there is little to analyze.

Figure 11. Aid-for-Trade: ADB

(Unit: % of total aid)



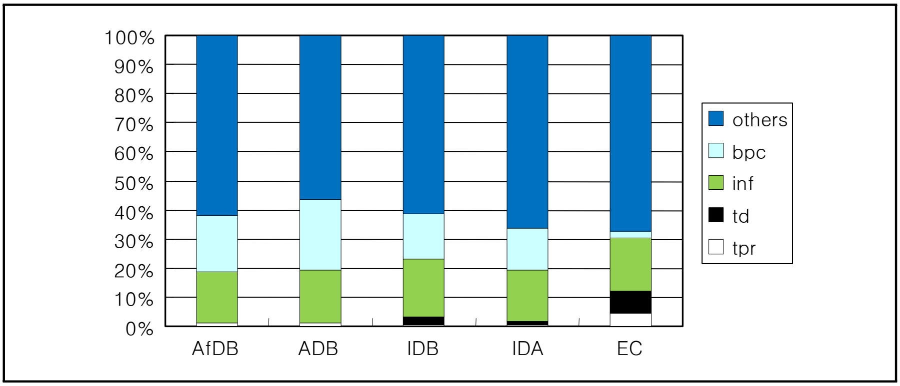
By combining TCBDB and CRS, we can have more reliable information.[1)] Figure 12 shows the share of each element of aid-for-trade in total aid by selected multilateral donors during the period 2001–2005. The share of aid-for-trade in the total aid of ADB was 44%, which was the highest among the multilateral donors whose average was slightly less than 30%. The share of *aid for infrastructure* was very similar across the donors. The share was 18% for all the donors except IDB, the share of which was 20%. The largest difference appeared in the *aid for building production capacity*. This share was as high as 25% in the case of ADB and as low as 2% in the case of EC.

1) When there was a discrepancy between TCBDB and CRS in the figures of aid for trade policy and regulations, the larger one was adopted.

The reason for this large difference may lie in the classification of the aid projects. In the original CRS code system, there is no code for *trade development*. TCBDB set up *trade development* as a new category of aid-for-trade. This new category consists mostly of aid projects that belonged to *building production capacity* in the original CRS code system. International organizations were not very consistent when they reclassified their aid projects. For example, in the case of ADB, a very small fraction of the aid projects in *building production capacity* was reclassified as *trade development*. In the other case of EC, a significant fraction of the aid projects in *building production capacity* was reclassified as *trade development*. However, even if we aggregate *trade development* and *building production capacity*, the difference prevails, as the shares of these two categories in total EC aid add up to 10%, which is still much lower than the 25% of ADB.

The share of aid for *trade policy and regulations* was very low in most of the multilateral donors' aid. This share was 4.5% in EC's aid, but was lower than 1% in IDB's and IDA's aid. In the case of AfDB and ADB, this share was about 1%.

Figure 12. Aid-for-Trade by Multilateral Donor



VI. Conclusion

While the need for aid-for-trade has been emphasized at various rounds of trade negotiations, the amount and share of aid-for-trade surged in the late 1980s and has been declining since the beginning of the 1990s, rising only moderately only in recent years. The declining trend of aid-for-trade took place during the time when many countries and regions launched FTAs and PTAs at multilateral, regional, and bilateral levels; therefore, development cooperation was more acutely needed. The need for aid-for-trade and its potential political and economic effects should be more rigorously analyzed and demonstrated in order for the integration partners to step up their development cooperation efforts again.

The natural questions posed are: Why have the amount and share of the aid-for-trade been declining? Is it because the capacity of member economies has been increasingly strengthened? If not, what were the factors responsible for the trend, and how can donors, recipients, or both together reverse the trend?

Which elements of aid-for-trade are more efficient in facilitating trade?

What are the factors determining the differential effects of the elements on trade growth? Is it the stages of development of aid recipients or is it the nature or sequence of aid-for-trade?

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Kye Woo Lee

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