

Aid for trade and climate finance

in the context of sustainable development

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Developing and least-developed countries have in general taken trade as a catalyst of income growth and job creation. As market access barriers fall, the importance of supply-side constraints to export performance is increasingly recognized. The Aid for Trade (AFT) initiative at the multilateral level is, in principle, aimed at tackling those constraints. At the same time, environmental concerns, notably those related

to climate change, have risen to global prominence. Climate finance is now accepted as critical for poor countries to combat climate change. The urgency to make growth compatible with environmental goals has also increased—with one instrument being trade. In this context, this policy brief argues how the two modes of finance can be harnessed in synergy with each other in pursuit of sustainable development.



Aid for Trade

It is now well-recognized that increased market access opportunities have not been significantly translated into market entry for low-income countries,¹ a critical reason being poor supply response owing to supply-side or productive capacity constraints. A variety of trade-related technical assistance and capacity-building programmes launched globally from 1997 onwards could not significantly ease the supply-side constraints (SSCs). Realizing the failure of such programmes on this score, and in light of the absence of a sufficient, unconditional, coordinated, predictable and sustainable funding² targeting SSCs, the AfT initiative was launched under the aegis of the World Trade Organization (WTO) in 2005. The guiding principles as stipulated by the AfT Task Force were: i) additional, predictable, sustainable and effective financing; ii) AfT to be guided by the Paris Declaration on Aid Effectiveness; iii) ensuring coherence, taking full account of, *inter alia*, sustainable development goals; iv) getting concrete and visible results on the ground; and v) effective monitoring and evaluation.

While donor-reported AfT commitments as well as disbursements have followed an increasing trend (Figure), with commitments accounting for nearly 35 percent of total sector allocable aid in 2010, and reported aid has gone predominantly to infrastructure and productive capacity building, the AfT initiative too is not without its share of criticisms, both at the conceptual and implementation levels. These pertain to the broadness of definition; the absence of a dedicated fund or consolidated mechanism; skewed allocation, driven predominantly by political and strategic considerations; risk of increased indebtedness of recipient countries; inadequate coordination,

and duplication; gap between commitment and disbursement; and a weak monitoring and evaluation mechanism that is largely “global” and top-down in nature. Evaluation of AfT on the ground through country studies³ substantiates quite a few of the common criticisms of the AfT initiative, and indicates its limited effectiveness, in contrast to the upbeat findings of Global Reviews produced by the WTO and the Organisation for Economic Co-operation and Development.

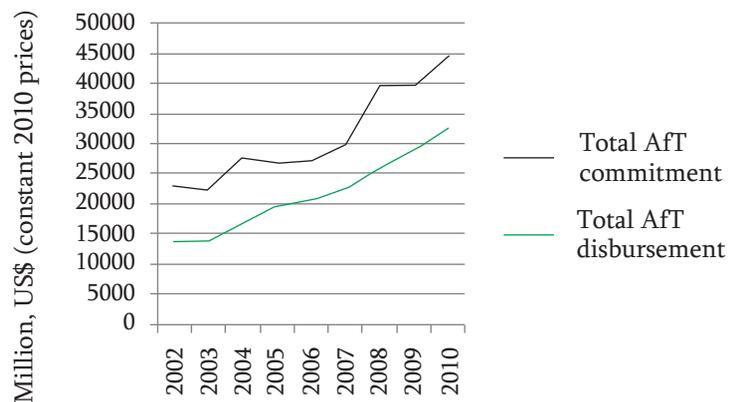
While the rationale for an initiative to direct aid to ease the SSCs facing poor countries is irrefutable, there is considerable room to increase the effectiveness of the AfT initiative. Furthermore, with growing concerns over the environment and climate change, and sustainable development issues capturing global attention, export markets for green and sustainable goods and services are expected to grow rapidly due to changing consumer preferences.⁴

The 2012 United Nations Conference on Sustainable Development (the Rio+20) adopted a document titled “The Future We Want”, in which it is recognized that green economy in the context of sustainable development and poverty eradication is one of the important tools available for achieving sustainable development

and that it could provide options for policymaking but should not be a rigid set of rules. There was agreement on a set of 16 principles to govern green economy policies, including avoidance of trade protection and aid conditionality. Countries reaffirmed that green economy policies should strengthen international cooperation, including the provision of financial resources, capacity building and technology transfer to developing countries. In the area of trade, the Rio+20 outcome document emphasizes achieving progress in addressing issues such as trade-distorting subsidies and trade in environmental goods and services (EGS). However, the document lacks specific commitments and targets, as well as an explicit recognition of supply-side constraints to taking advantage of green economy-related export opportunities by poor countries.

AfT has a potentially important role to play in enhancing poor countries’ capacity to cope with the challenges and exploit the opportunities on the trade front presented by climate change, and policies and actions to promote “green growth”. Trade opportunities in the context of green economy are present in a range of sectors: agriculture, fisheries, forests, manufacturing, renewable energy and tourism.⁵

Figure Aid for trade flows



Source: OECD, Creditor Reporting System database.

If targeted well, AfT can help alleviate SSCs to export-oriented green growth. A focus on SSCs to enhance production and export capacity in developing and least-developed countries could also help win the support of these countries for global initiatives for a green economy. First, standards-related non-tariff barriers facing exports of green products take on the nature of SSCs when certain standards are non-negotiable for the importing countries but poor exporting countries do not have the capacity to meet those standards. Here, AfT can help in enhancing export capacity.

Second, green and sustainable goods, including food and agriculture, services, including energy and tourism, and other such products have already been identified as products with comparative advantage or export potential by the governments of some developing and least-developed countries. In this case, all that is required is executing AfT towards its primary objective, that is, alleviating SSCs. In other cases, AfT can play a vital role in identifying potential products, strengthening of production and export capacity, and export promotion.

Third, AfT, under the trade policy heading, can help in the identification of export potential in EGS, and enable a more effective participation of developing and least-developed countries in WTO negotiations on EGS. In particular, there is a danger of marginalization of the least-developed countries (LDCs) from export trade in EGS, just as they have been marginalized in overall export trade. AfT can and should help prevent this. Environmentally preferable products, which are natural resource-based—for example organic agriculture products—represent a category among environmental goods in which developing and least-developed

countries, including those in South Asia, possess a clear comparative advantage. AfT for building productive capacity can serve to realize this advantage.

Fourth, in order to reduce or avoid commodity dependence in exports—a challenge especially for many LDCs—AfT can assist in horizontal and vertical export diversification and sophistication, also taking into account green economy considerations. For example, where applicable, renewable and clean energy such as hydropower and solar can be used to power industrialization.

Fifth, and also related to commodities, AfT can also help address infrastructure and technical constraints to adding value to and processing of agro-forestry commodities or bioproducts.

Sixth, it is to be noted that AfT for trade-related adjustment has been minimal so far, despite its importance. The need for such aid could increase with liberalization of EGS, and with growing adverse impacts of climate change on agriculture production.

Coherence and synergy

Finance is a key element in any global deal on climate change. However, so far the discourses on AfT and climate finance have taken place in their respective silos,⁶ although there is considerable potential for coordinating the two mechanisms “in a way that would permit greater coherence, transparency and predictability in resource flows”.⁷ Establishing coherence and synergy between the two can help avoid duplication and enhance efficiency and effectiveness. Prospects of synergy arise from the existence of areas of potential overlap between the two modes of financing. For example, AfT under the “economic infrastructure” category that goes into building hydropower projects,

rebuilding weather-battered infrastructure or climate-proofing infrastructure in coastal areas would meet climate adaptation objectives too. Likewise, AfT under the “building productive capacity” category that takes the form of research and development financing for developing high-yielding, drought-resistant varieties in agriculture⁸ also serve adaptation purposes besides raising productive capacity. However, the existence of overlaps also causes concern over the possibility of double counting, thereby inflating aid figures in each of the headings.

There are severe data limitations with respect to climate finance. There are reliable data on pledges and commitments only. Resources committed cover less than 10 percent of the needs: developed countries committed US\$30 billion over 2010–2012 while at least US\$100 billion is needed per annum. Even delivery of what has been committed is uncertain at best and grossly inadequate at worst. Further, commitment is skewed towards mitigation, although poor countries desperately need finance for adaptation. While developed countries must provide sufficient funds for the adaptation needs of the developing world, leveraging AfT to meet climate finance needs must also be explored for optimal use of resources.

Additionality is a key issue in climate finance, as in AfT. Although the developing world is insisting on additionality in climate finance, there is no consensus on the definition of additionality in climate finance pledges. The method of assessing additionality in AfT for individual recipient countries, as proposed by Adhikari (2011) and used in an AfT evaluation by Adhikari *et al.* (2011),⁹ could provide a starting point for devising a method for determination of additionality in climate finance at the country level. However, it must be recognized

that in the presence of overlaps between AfT and climate finance, the issue of additionality calls for creative thinking. In addition, duplication in climate finance at the objective and operational levels poses additional challenge to creating synergy between AfT and climate finance.¹⁰

There is considerable scope to draw on AfT and climate finance experiences for each mode of finance.¹¹ For example, while there is country ownership in climate finance through National Adaptation Programmes of Action in LDCs, there is no matching progress in trade policy through the Enhanced Integrated Framework.

Likewise, despite its weaknesses, the Global Environment Facility remains the central multilateral mechanism to coordinate climate finance, and other funds such as the Green Climate Fund could complement or replace it. But such a consolidated/vertical fund is missing in AfT. Similarly, while AfT is more grounded in poverty reduction objectives, climate finance is narrowly focused on environmental objectives.

Way forward

There is a clear need for a dedicated fund for AfT at both global and national levels. This will not only help in making the definitional issue less crucial (as the recipient country will have to agree that any particular aid project is indeed AfT) but, even more importantly, also contribute to sustainability,

ownership, alignment, transparency and, hence, overall effectiveness.¹²

AfT must be targeted as per the mandate of the Task Force: at helping alleviate the supply-side constraints in low-income countries and LDCs. The Geneva- and Paris-based monitoring and evaluation exercise must be complemented by conducting, and acting on the findings of, national-level monitoring and evaluation. Strengthening both the needs assessment and absorptive capacity of recipients is also essential for AfT to be effective.

With regard to climate finance, the foremost imperative is to substantially increase funding. In order to ensure additionality in climate finance, there is a need for an agreement on the definition of additionality in climate finance, considering the overlaps between AfT and climate finance. There is also a need for establishing coherence and synergy between sustainable development goals/ climate finance and trade policy/ AfT in donors' aid strategies as well as recipient-country strategies.

While the Rio+20 outcome document lacks specific commitments and targets, as well as an explicit recognition of supply-side constraints to taking advantage of green economy-related export opportunities by poor countries, the provision for financial resources, capacity building and technology transfer to developing countries, as envisaged in the outcome document, can and should cover

AfT and its potential synergy with climate finance. ■

Notes

- ¹ Adhikari, Ratnakar. 2011. "Synergy between aid for trade and climate finance", *Trade Insight* 7(2).
- ² *ibid.*
- ³ See, for example country-level evaluations for Cambodia, Nepal and Malawi, available at <http://ictsd.org>
- ⁴ UNEP, ITC and ICTSD. 2012. "Green economy and trade opportunities", available at <http://ictsd.org>
- ⁵ *ibid.*
- ⁶ Adhikari (2011). Note 1.
- ⁷ Ancharaz, Vinay Dey and Riad A. Sultan. 2010. *Aid for trade and climate change financing mechanisms: Best practices and lessons learned for LDCs and SVEs in Africa*. Geneva: International Centre for Trade and Sustainable Development (ICTSD), p. x.
- ⁸ Adhikari (2011). Note 1.
- ⁹ Adhikari, Ratnakar. 2011. *Assessing aid for trade effectiveness on the ground: A methodological framework*. Aid for Trade Series, Issue Paper No. 20. Geneva: ICTSD; Adhikari, Ratnakar, Paras Kharel and Chandan Sapkota. 2011. *Evaluating Aid for Trade on the ground: Lessons from Nepal*, Issue Paper No. 23, Aid for Trade Series. Geneva: ICTSD.
- ¹⁰ See Adhikari (2011). Note 1.
- ¹¹ Ancharaz and Sultan (2010). Note 7.
- ¹² Kharel, Paras. 2011. "A critical assessment of Third Global Review of Aid for Trade", in Prabhash Devkota (ed.), *Changing paradigms of aid effectiveness in Nepal*. Lalitpur: Alliance for Aid Monitor Nepal, pp.173–180.