Creating Country Trade Negotiating Strategies:

A Handbook

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List of Acronyms

A4T	Aid for Trade
ACP	Africa, Caribbean and Pacific Group
AGOA	African Growth and Opportunities Act
BSE	Bovine Spongiform Encephalopathy
CAP	Common Agricultural Policy
DAC	Development Assistance Committee
DFID	Department for International Development (United Kingdom)
EIF	Enhanced Integrated Framework
EPA	Economic Partnership Agreement
EU	European Union
FAO	Food and Agriculture Organization
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Country
IF	Integrated Framework
IMF	International Monetary Fund
JITAP	Joint Integrated Technical Assistance Program
LDC	Least Developed Country
MFN	Most Favoured Nation
MVA	Manufacturing Value Added
NFIDC	Net Food Importing Developing Country
ODI	Overseas Development Institute
OECD	Organization for Economic Cooperation and Development
PCD	Policy Coherence for Development
PRSP	Poverty Reduction Strategy Paper
SPS	Sanitary and Phytosanitary Standards
TIM	Trade Integration Mechanism
TRIPs	Trade Related Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WTO	World Trade Organization

Executive Summary

Introduction: This Handbook provides a primer for policy makers, trade negotiators and researchers to help design viable national trade negotiating strategies. It is intended to be of general use in developing countries and, in particular, to support a series of country level case studies. These studies will help in the formation of coherent trade and development policies and then provide a better basis for the planning of both Governments and aid donors. There is a pressing need for such a handbook because the international trade system is in a state of flux and negotiations are occurring at multiple levels, and these levels impose a high cost on the strained financial and human resources in developing countries.

The relationship between trade, growth and development: The far reaching and complex inter-relationship of trade and development policy sets a challenge for the task of policy making and negotiating prioritisation. Trade can lead to growth which can in turn lead to poverty reduction. But the relationship between trade and subsequently growth and poverty reduction does not occur automatically. The main intervening variable controlling the relationship between trade and growth is government policy (including, but not limited to, policy on trade). And success depends critically on the coherence of national policies and the external or international policies.

Trade and Poverty: It is in the nature of trade that any impact on poverty will be indirect and will often affect different groups of the poor in different ways. So there are two steps in the assumed linkage: the first is the link between trade and growth, which may be through the initial impact on the level of income or through structural change to adapt to a changed trading pattern; the second is the relationship between growth and poverty reduction.

Trade and Growth: Various cross-country studies have supported the idea that open economies facilitate growth and, whilst they have been critiqued on methodological grounds, this has not necessarily cast doubt on the fact that trade and growth are often linked, even though the direction of causality may be in doubt.

Growth and Poverty: The general consensus of the literature in the next step in the casual chain, between growth and poverty reduction is that, on average, growth has a positive impact on poverty reduction. Not only does it lift large parts of the population above the poverty line, but also growth provides government revenue which can be used to fund otherwise unsustainable poverty reduction campaigns: it provides fiscal space for dynamic redistribution to weaken national poverty.

Trade and Poverty: Literature linking all three elements of this chain – i.e. trade to poverty reduction via growth and structural change – is hotly contested. Many authors have argued that the effects of trade liberalisation on poverty depend on the type and pace of their management and implementation. Factors that affect the outcome of trade liberalisation include: the pre-existing level of income and its distribution; the comparative advantage of the country undertaking trade reform and the pattern of protection in place prior to privatisation; a household's location during liberalisation including their access to infrastructure and urban markets; and private endowments.

Competing Policy Arenas: Despite the fact that policy is the crucial intervening variable in determining how pro-developmental trade ultimately is, not all trade policy is directly under the control of a developing country government. These policies are framed in different arenas and the capacity of a developing country to influence the outcome varies between them. This variety can be illustrated by grouping situations into four broad arenas, two of them primarily domestic and two primarily international: wholly domestic, largely domestic, externally negotiated and externally non-negotiated. A high priority must be to ensure that the policies set domestically are the right ones as the government will have the greatest degree of control (within the bounds of existing international commitments). At the same time, if events in a wholly or partially external arena have a relatively large impact they cannot be ignored. Priorities must be established, therefore, in relation simultaneously to two sets of criteria: the relative scale of their potential direct and indirect impact on the link between trade and poverty; and the relative influence of the country concerned to determine the outcome.

What is policy coherence? Policy coherence is a relational concept and is present when a) objectives of policies are complementary rather than contradictory and b) when the impacts of policies are in tandem. There are two broad types: multiple objective incoherence and operational incoherence. Both types of policy incoherence can arise at the national level on at least three different points: among types of public policies, between different branches of government and among different interest groups. Thus, the objective of policy coherence is not to eliminate incoherence, but to ensure that policy is directed at a country's development objectives to the extent possible given the constraints of necessarily competing objectives and interests.

Why is policy coherence important? The coherence of policies is a concern both for governments and for researchers assessing country situations because it contributes to good trade policy. While it is not the only determinant of good policy and therefore good development outcomes – which are also dependent on things like competence, good analysis, honesty, sound implementation plan, etc. – it is critically important and a necessary if not sufficient element of good policy making.

Policy Coherence in Developed Countries: Most definitions of policy coherence in developed countries focus on, first, 'doing no harm,' by undermining one policy designed to foster one element of development by either one targeted at another aspect of development or a non-developmental policy, and second looking for 'win-win' scenarios where policies are both good for development and for reaching other objectives. Applying this approach to donor countries' development policies gives the following definition: "a process whereby a government, in pursuing its domestic policy objectives, makes an effort to design policies that, at a minimum, avoid negative spillovers which would adversely affect the development prospects of poor countries, and more positively, seek to maximise synergies."

Policy Coherence in Developing Countries: The term policy coherence is less commonly used to refer to rationalising policies to meet objectives in developing countries. But the broader definition of policy coherence – ensuring policies are complementary rather than contradictory and that impacts are in tandem – can be applied to the array of policies in developing as well as developed countries. If a country has clear, realistic and prioritised objectives for the role of trade in its development, it is more likely to successfully achieve its goals. Objectives that are clearly defined through coherent policies can be more easily transferred into actionable points in international negotiations, maximising developmental outcomes in such settings. Clearly defined objectives also help to demonstrate where policy 'windows' are open – that is to say, in which fora objectives are most likely to be met.

Analysing coherence in domestic policy: Incoherence amongst trade policies which fall completely within a government's competence may seem unlikely, but there are plenty of cases where trade policy appears not to be entirely coherent with a country's stated development policy. Governments often prioritise agriculture in their development plans, but then undermine that objective by over-taxing agricultural goods or allowing marketing boards to set prices. Analysts need also to be aware of the range of policy inconsistencies resulting from the international constraints under which developing countries develop their domestic trade policies – this is especially true in policies which are related to trade negotiations, and the trade elements of PRSPs, which are often written with strong input from donor and multilateral agencies.

Analysing coherence in international policy: Some influences on trade policy are partly or wholly outside the direct control of a government. Developed countries affect developing ones as negotiating partners, as a source of change and through their development and bilateral trade policies as well as through their aid policies. There is often inconsistency between these roles. When they are parties to trade negotiations, countries tend to take an overtly mercantilist approach (seeking 'gains' for their exporters and minimising 'losses' for their domestic suppliers) that sits uncomfortably with the stated goals of development policy. Non-negotiated policies also have impacts on developing countries: for example, rules of origin attached to trade preference agreements that require unrealistically high levels of processing within the country, and therefore limit ability to export.

Establishing a country negotiating strategy: The first step to negotiating in various trade fora is to evaluate the coherence of trade policies, both those determined exclusively domestically and those which are determined via external actors and institutions. In order to do so, an iterative process must be designed which takes a government's development policy objectives as a starting point. Trade objectives should be defined in relation to national development strategies. This will lead to the creation of detailed internal and external trade policies which will, in turn, inform negotiation strategy in international organisations. Throughout this process there is a large role for 'civil society', and more specifically for the private sector to be involved in defining priorities and objectives.

How aid for trade can help: Although good domestic arrangements are a necessary condition to promote trade, they will often not be sufficient. There is a role for external support both to provide an enabling external environment and to help deal with supply-side constraints (including support for governmental and private sector institutions). Aid for Trade, which has gained increasing prominence since the Hong Kong Ministerial of the Doha Development Round in 2005, is intended to help countries meet both broad and narrow costs of trade including adjustment costs from liberalisation, the construction of infrastructure and reducing other supply side constraints. While the Doha round of the WTO is currently stalled, progress has been made on advancing the Aid for Trade agenda.

Country case studies – putting it into practice: This Handbook represents a first step in a process intended to provide practical guidance to Commonwealth developing countries. The next step of the process is to undertake a series of country case studies in a representative sample of Commonwealth developing countries. The Handbook will guide the work of the consultants undertaking the studies. The results of the studies will, in turn, inform revisions to the Handbook so that it provides more 'real life' examples of the general issues discussed and increases the level of detail in the analysis. A broadly similar approach should be followed which focuses on: 1) analysing the current economic situation; 2) analysing the ways that trade is currently playing a developmental role in the economy, including its income effects; 3) a plan of action should be created which addresses the incoherence in the economy; 4) finally, a country negotiating strategy should be established, which is oriented towards the near future and prioritises amongst negotiating fora.

Creating Country Trade Negotiating Strategies:

A Handbook

1. Introduction

This Handbook provides a primer for policy makers, trade negotiators and researchers to help design viable national trade negotiating strategies. It is intended to be of general use in developing countries and, in particular, to support a series of country level case studies. These will identify the links between trade and aid in the countries being studied which, in turn, will serve two purposes. First the studies will help in the formation of coherent trade and development policies in the country concerned. Second, feedback from them will allow this Handbook to be extended so that it provides an even better basis for the planning of both Governments and aid donors.

The Handbook's primary message is that while the absolute importance of trade will vary between countries and situations, the inter-relationship between trade and development policy is very far reaching. Additionally, the links between trade and development policy are both direct and indirect; consequently, any thorough analysis of the role of trade in a country's development strategy must be similarly wide-ranging.

1.1 The need for the Handbook

As a result of the failure of the World Trade Organization (WTO) trade negotiations launched in 2002 in Doha and suspended in July 2006, governance of the international trade system is in a state of flux – and is occurring at multiple levels. These multiple trade negotiations already place a huge strain on limited financial and human resources. But the situation will get worse if negotiations proliferate regionally and bilaterally. To cope with this, countries must extend their current efforts to integrate trade and development policy.

The urgency of better integrating trade and development policy arises partly because the participation of developing countries in international trade negotiations has evolved substantially over the past 50 years. In the 1950s and 1960s developing countries had little incentive to participate in international trade organisations given both their domestic policy emphasis on an import-substitution oriented industrial strategy and the exclusion of products of interest to them from negotiations (such as textiles and agricultural products). But by the time of the Uruguay Round of the General Agreement on Trade and Tariffs (GATT) developing countries had become active participants in the negotiations. And as the WTO has evolved over the past ten years developing countries have gained more power.

But it is still an ongoing process. On the one hand, "developing countries concluded that there had been a further shift in the real balance of power: [they] could not only negotiate, they could block negotiations" (Page 2004: 4).[1] But, on the other hand, this 'negative power' that allowed them to block change they did not want is not necessarily matched by an equivalent 'positive power', allowing developing countries to create a consensus in favour of change that they do want.

[1] Page, Sheila (2004), "Developing countries: Victims or Participants, Their Changing Role in International Negotiations," Globalisation and Poverty Programme and ODI.

How should developing countries spread their limited human and financial capital among these multiple negotiating fora? How should governments allocate priority between trade and non trade policies? And between domestic and international trade policy? How can opportunities be maximised or problems minimised through appropriate integration of trade in wider development policies?

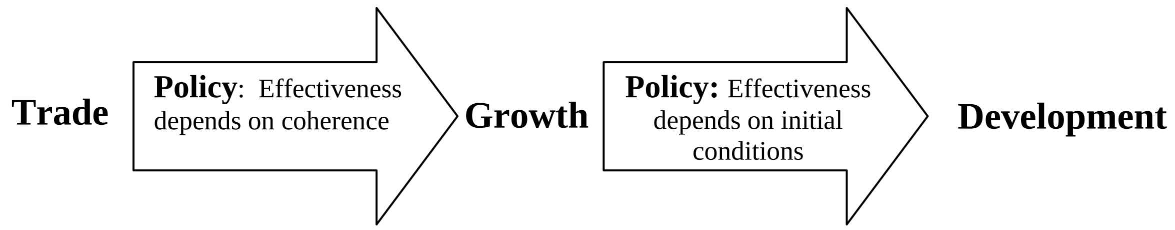
Answers to such questions have become imperative. This Handbook forms part of a broader project intended to:

- Help policy makers better understand the link between trade and development policy and whether there are identifiable features of a 'development friendly' trade policy that would distinguish it from other kinds;
- Help developing countries integrate their strategies on trade more closely with those on economic and social policy more generally, and to prioritise among negotiating fora on that basis;
- Help to create a consensus between rich and poor countries, and among developing countries, not only on the scope of 'development friendly' trade policies but also on the appropriate use of aid to support trade.

1.2 The relationship among trade, growth and development

The far reaching and complex inter-relationship of trade and development policy sets a challenge for the task of policy making and negotiating prioritisation. Trade can lead to growth which can in turn lead to development and poverty reduction. But, as is explored throughout the Handbook, the relationship from trade to structural change and increased income, and thus to growth and then from growth to poverty reduction does not occur automatically. The main intervening variable controlling the relationships between increased income or structural change and growth and between growth and poverty is government policy (including, but not limited to, policy on trade). And success depends critically on the appropriateness of national policies and the external or international policies (see Figure 1 below).

Figure 1: The relationship between trade, growth and development



The determinants of ensuring that growth and development are pro-poor are generally outside of the scope of this paper, though this literature is briefly reviewed in Chapter 2. Instead, the focus of the handbook is on how developing country governments can increase the appropriateness of their domestic policies, and the good effects of international policies. The purpose of doing so is to help them prioritise their trade negotiations and enable them to achieve more growth and poverty reduction (i.e. to be more developmental).

The links between trade and development must not be exaggerated: often, trade may be a relatively small element in development. But nor should analyses look solely at formal 'international trade policy' as if this were the only prism refracting the effects of trade on the welfare of groups within a society. In some cases it is not even the most important such prism: domestic policies, for example on competition and foreign exchange, may be more important. Still less is it invariably the case that trade policies negotiated internationally, such as in the WTO or with regional partners, are the sole (or most important) factor influencing the impact of trade on development.

1.3 The structure of the Handbook

The handbook is designed to provide the reader with an overview of the relationship between trade and development, and focuses on the importance of increasing understanding of all the consequences of all the tools of trade policy to maximise the effect of trade on development. Section two outlines the empirical relationships between trade and growth, and trade and poverty. It demonstrates the wide range of policies that channel the impact of trade on poverty reduction and the consequent importance of the policy context. Finally, it identifies the factors to be taken into account when setting priorities.

Section 3 introduces the concept of coherence. A recent trend in the policy literature is to exhort countries to have ‘coherent’ policies, whether they are developing countries or developed. But there are different sources of incoherence with different prospects and types of remedy. Country case studies need to recognise such differences and to frame their recommendations appropriately.

Sections 4 and 5 analyse the sources of incoherence within different policy arenas. Section 4 deals with those policies that are wholly or largely a domestic preserve. These are the ones over which developing country governments have a much larger degree of control. Because of this, a high priority can be put on integrating the various elements of policy that transmit the effects of trade into impacts on poverty reduction.

Section 5 covers those policies that affect developing countries but over which their governments have less control. These include international negotiations where a given country is only one actor contributing to the final result. But there are other fora in which developing countries have even less clout than this. Policies which may appear to be entirely domestic ones for developed countries (and are therefore agreed and implemented wholly autonomously) may have particularly strong effects for some developing countries. And their range of effects may be very complex.

Section 6 turns attention to what countries can do to improve their situation – and highlights the types of action that analysts should consider when constructing country strategies. Apart from the tasks of dealing with different types of incoherence, detailed in the preceding section, countries need to learn from ‘best practice’ in articulating their needs and focusing limited resources on achieving the desired results in key arenas. Donors too, have a role to play through a range of activities that are increasingly covered under the umbrella of ‘Aid for Trade’ (A4T).

Section 7 concludes by analysing the elements of a constructive country case study, and provides guidance for the completion of these case studies.

2. The relationship between trade and development

Policy making on trade faces a dual overload: tracking the complex effects of changes to trade policy and participating in multiple negotiations. This makes it difficult to ensure that what is proposed (and agreed) in different fora is mutually consistent and, even more importantly, is founded in a country's broader economic and social development strategy. This will become ever more difficult as negotiations move into highly technical areas (e.g. those concerning plant and animal health). Further challenges exist in making sure that such a strategy has been formulated in conjunction with all the relevant public and private sector institutions and groups.

The most fundamental question to answer when setting priorities concerns the relationship between trade and development. If the relationship is weak, developing countries may want to allocate a minimum amount their scarce resources to negotiating and designing trade policy; if on the other hand it is strong, trade policies could potentially serve as a basis of creating national development strategies.

The answer will vary between countries and according to the issue and socio-economic group under consideration. This section provides an introduction to the broad relationship within which specific countries and issues will be situated.

2.1 Trade and poverty

It is in the nature of trade that any impact on poverty will be indirect and will often affect different groups of the poor in different ways. So there are two steps in the assumed linkage:

- First is the link between trade and growth, which may be through the initial impact on the level of income or through structural change to adapt to a changed trading pattern;
- Second is the relationship between growth and poverty reduction.

The relationship between trade and growth is contentious. Various cross-country studies have supported the idea that open economies facilitate growth and, whilst they have been critiqued on methodological grounds, this has not necessarily cast doubt on the fact that trade and growth are often linked, even though the direction of causality may be in doubt. Rodriguez and Rodrik, for example, argue that country selection is systemically biased to find a robust link but they conclude that trade is not bad for growth.[2]

The effect of trade liberalisation on growth is another layer to the debate that is strongly linked to the issue of the appropriate trade policy stance for developing countries. One view is that a liberal trade policy accelerates growth. The econometric literature on trade liberalisation and growth has identified trade protection as a key factor in Africa's low growth performance.[3] Sachs and Warner make the strongest claim that restrictive trade policy and inappropriate exchange rate policies together account for 1.2% per annum growth shortfall.[4] Berg and Krueger examine how openness affects poverty reduction and conclude that although the evidence is mixed, it leans strongly towards the conclusion that there is no systematic relationship between openness and the incomes of the poorest beyond the effect of

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[2] Rodriguez, F. and Rodrik, D. (1999), "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-Country Evidence." Centre for Economic Policy Research, Discussion Paper Series, No.2143.

[3] Collier, P. & J.W.Gunning. (1999), "Explaining African Economic Performance." *Journal of Economic Literature* , vol. 37:64-111.

[4] Sachs, J.D and A.M. Warner (1997), "Sources of Slow Growth in African Economies." *Journal of African Economies,* vol. 7:335-376

openness on overall growth.[5] The counter position is that trade liberalisation has not necessarily increased growth and, even where it has; there have been negative effects on poverty reduction such as increasing inequality. Reference is made to the past interventionist trade policies of present day industrial countries which are held to have been responsible for their success.[6]

Trade may also impact growth through altering the sectoral composition of the economy. As a country moves to produce goods in which it has a comparative advantage, a one-off increase in income should be experienced. The consequences of this income adjustment may include growth, and this growth may induce development through the upgrade of technology.[7]

The literature on the next step in the casual chain, between growth and poverty reduction, is immense. The general consensus is that, on average, growth has a positive impact on poverty reduction. Not only does it lift large parts of the population above the poverty line, but also growth provides government revenue which can be used to fund otherwise unsustainable poverty reduction campaigns: it provides fiscal space for dynamic redistribution to weaken national poverty. A recent study examining pro-poor growth in the 1990s across 14 countries showed a correlation between the pace of economic growth and how quickly poverty declines. The study found that on average a one percent increase in gross domestic product (GDP) *per capita* led to a 1.7% decline in poverty during this period, which is consistent with a number of other studies.[8] However, for growth to be effective in reducing poverty it has to be *managed*. Few of the poorest countries can achieve the levels of growth that are sufficient by themselves to have a significant impact on poverty. In such contexts, growth and redistributive strategies become key channels for achieving poverty reduction objectives. [9]

Literature linking all three elements of this chain – i.e. trade to poverty reduction via growth and structural change – is hotly contested. Dollar and Kray argue that within countries there is no systematic tendency for trade to be associated with rising inequality that undermines poverty reduction efforts.[10] This finding has been widely critiqued by other scholars arguing that their methodology is unsound, and that their core finding (that World Bank and International Monetary Fund (IMF) programmes generating growth are pro-poor and should therefore be pursued) is unrelated to the tests run in the paper.[11] Other authors have argued that the effects of trade liberalisation on poverty depend on the type and pace of their management and implementation. Factors that affect the outcome of trade liberalisation include: the pre-existing level of income and its distribution;[12] the comparative advantage of the country undertaking trade reform and the pattern of protection in place prior to privatisation;[13] a household's location during liberalisation including their access to infrastructure and urban markets; and private endowments.

[5] Berg, A. and Krueger, A. (2003), "Trade, Growth and Poverty: A Selective Survey," IMF Working Paper no. 03/30, Washington DC.

[6] Chang, H. (2002), *Kicking away the ladder: development strategy in historical perspective,* London: Anthem Press.

[7] Lall, S, Navarelli, GB et al (1994), *Technology and Enterprise Development, Ghana under Structural Adjustment.* London: MacMillan.

[8] World Bank (2005), "Economic Growth in the 1990s: Learning from a Decade of Reform." Washington DC: World Bank

[9] Killick, T. (1998), "Have African economies turned the corner?" London: Overseas Development Institute.

[10] Dollar, D., & Kray, A. (2000). "Growth is Good for the Poor." Washington D.C: World Bank.

[11] See for example Lubker, M. et al (2002), "Growth and the Poor: A Comment on Dollar and Kray," *Journal of International Development*, vol. 14, 555-571; and

[12] Ravallion, M (2001), "Growth, inequality and poverty: looking beyond averages," *World DevelopmentI,* vol. 29, no. 11, 1803-1815.

[13] Jenkins, R. and Thoburn, J. (2003), "Can trade reform reduce global poverty?," Institute for Development Studies *Policy Briefing*, Issue 19, August.

There is additionally a rich case study literature that examines how policy frameworks have varied to maximise the positive impacts of trade on poverty. A case study on Vietnam, which integrated rapidly into the international economy during the late 1980s and 1990s and subsequently has achieved rapid growth, emphasises the impact of trade on the "enterprise channel" – that is to say on employment, wages and income.[14] In the case of rapidly growing, open economies in Asia, such as Vietnam, the growth impacts of increased trade have been strong, and the net impact of increased trade on employment has been positive. As Jenkins notes, "The fact that the government did not adopt a strategy of wholesale liberalization has probably contributed to keeping the negative effects of globalization on employment within bounds and ensured that the overall outcome for employment is positive."[15] More specifically, the Vietnamese pursued a policy framework which prioritised increased export capacity, while maintaining high levels of import protection for some industries: the effective rate of protection was some 50% in the 1990s and there were non-tariff barriers protecting key industries.[16]

2.2 The different policy arenas

As was briefly hinted in section 1.2, despite the fact that policy is the crucial intervening variable in determining how pro-developmental trade ultimately is, not all trade policy is directly under the control of a developing country government. These policies are framed in different arenas and the capacity of a developing country to influence the outcome varies between them. This variety can be illustrated by grouping situations into four broad arenas, two of them primarily domestic and two primarily international.

1. **Wholly domestic:** some policies fall wholly within a government's competence, such as those on domestic markets that determine how far any change in import or export prices are passed on to consumers and producers. Aid dependency may reduce a country's freedom of action, but the policy is still within government competence.

2. **Largely domestic:** others are largely a domestic preserve but within parameters set externally; this would be the case, for example, with domestic arrangements that are influenced by WTO rules such as on allowable domestic subsidies, or changes to tariff rates agreed with aid donors as part of policy-based lending.

3. **Externally negotiated:** there are policies that are negotiated externally between the developing country government and other countries or actors – with the European Union (EU), for example, on Economic Partnership Agreements (EPAs) or with other countries as part of the past or current WTO negotiations.

4. **Externally non-negotiated:** there are policy changes in which a developing country government is not a negotiating party and, hence, has no direct control such as preferences, the EU's changes to its agricultural policy and autonomous changes to private sector practice; if it is able to influence them at all, it is only through persuasion.

[14] McCulloch et al (2001) provide three channels via which trade policy has an impact on poverty: the price transmission channel, the enterprise channel and the government spend and tax channel. Subsequent work by Bannister and Thuggie (2001) has identified two further transmission channels: investment and innovation (which generates growth) and changes to the vulnerability of groups within the economy to shocks.

[15] Jenkins, R. (2004), "Vietnam in the Global Economy: Trade, Employment and Poverty," *Journal of International Development,* vol. 16, no. 1: p. 25.

[16] ibid

Clearly, a high priority must be to ensure that the policies set domestically are the right ones as the government will have the greatest degree of control (within the bounds of existing international commitments). At the same time, if events in a wholly or partially external arena have a relatively large impact, they cannot be ignored. Priorities must be established, therefore, in relation simultaneously to two sets of criteria:

- The relative scale of their potential direct and indirect impact on the link between trade and poverty;
- The relative influence of the country concerned to determine the outcome.

High impact domestic policies have the highest priority followed by high impact changes in the external arenas. In addition to attempting to influence the latter, governments must adjust to the resulting outcomes. This adjustment will often involve changes to domestic policy and may also require governments to initiate dialogue in yet other arenas (e.g. with donors on A4T or on compensatory trade policies).

Which are the high impact domestic and external policies? The answer is that they vary, of course, between countries and change over time. The strategy papers with which this Handbook is associated will identify the current high impact areas for the countries concerned. To fulfil its role as a primer, the Handbook provides an analytical framework and illustrative examples to guide the policy maker and researcher. The remainder of this section sets out an analytical framework for the circular process under which governments and society have to set priorities in relation to the domestic and international status quo, create appropriate domestic policies and negotiate externally, adjust to the external environment and re-set priorities.

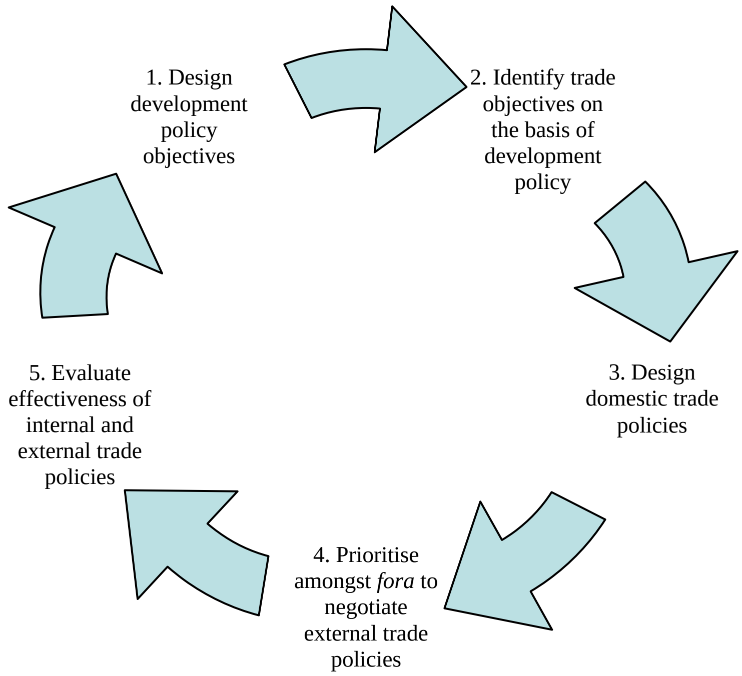
2.3 The iterative process of designing trade policy

Given the above, the first step to negotiating in various trade fora is to evaluate the coherence of trade policies, both those determined exclusively domestically and those which are determined via external actors and institutions. More is said below about the definition of policy coherence, but this section describes the iterative process of designing and evaluating trade policies in different fora.

The starting point of such an analysis should be a government's development policy objectives. Most Commonwealth countries have national development strategies or poverty reduction strategy papers (PRSPs) which should serve as a good first source for identifying these priorities, though as will be discussed in Section 4.2 on PRSPs, trade has not always been sufficiently included in such documents and policies are not well defined. This may in turn require that the national development strategy is re-evaluated.

Trade objectives should be defined in relation to national development strategies. This will lead to the creation of detailed internal and external trade policies which will, in turn, inform negotiation strategy in international organisations. Figure 2 provides a graphic representation of this iterative process.

Figure 2: Iterative Process of Designing Internal and External Trade Policies



Expanding on the above diagram, a step-by-step analysis of how such strategies could be developed is as follows. It is intended both as a broad guide to policy makers and negotiators and as a specific check-list of tasks for the country-level studies to be undertaken as part of the broader project with which this handbook is associated.

1. Completion of national development strategies. These plans have to be sufficiently detailed to be useful – it is not worth stating that the development strategy is simply to engage in international trade. The point is on what terms, in what product classes, etc. Growth and structural change should be part of the development strategy, and trade will be an integral part to achieving these objectives. Most Commonwealth countries have existing national development plans, or national economic plans. Such documents should be 'fished' for information that could correspond to the framework outlined above – and then expanded or improved with the participation of the private sector and other civil society groups whenever possible.

2. Analysis of existing trade policies: internal and external. WTO Trade Policy Reviews to which governments contribute provide an excellent starting point for such analysis. For the country-level researcher they contain a wealth of information – an overview of the types of policies generally analysed in such documents is provided in the Appendix I.

3. Comparison of development priorities with existing trade policies on a point by point basis – once both have been translated into detailed and disaggregated points.

4. Analysis of ways to improve their coherence where discrepancies exist – consultation and government prioritisation. Political economy approaches should be applied to see what is both most productive and what is most feasible.

5. Formulate strategy for changing trade policies:

   a. Domestic Policies: trade policies should be achievable and monitorable. Achievability should include analysis of political capacity to approve and implement such policies (including democratic requirements for approval of new laws).

b. Internationally Relevant Policies: trade policy with international implications must be translated into a negotiable point, and the correct forum for negotiation must be identified (multiple fora are possible). These must be in a form that: can be expressed unambiguously in a legal agreement, are achievable, and are monitorable.

Throughout this process there is a large role for 'civil society,' and more specifically for the private sector to be involved in defining priorities and objectives. While there is some risk that government policy will be 'captured' by the interests of individual industries, trade policy in developed countries relies heavily on the detailed knowledge of exporters and importers of certain goods to determine the impacts of proposed trade policies. Governments can minimise the effects of capture by asking detailed, technical questions of producer groups (e.g. what would the effect of policy x be on metrics y and z) rather than seeking broad input from producer groups about the general direction of trade policy. Where capacity for such analysis is currently not present, Commonwealth countries may consider seeking dedicated Aid for Trade funds to facilitate the development of such capabilities.

Thus far, this handbook has explained that trade negotiation strategies should be informed by the ultimate aim of trade – to generate growth and development. In order to do so, trade policies must be created which are coherent and which promote development priorities. Additionally, developing country governments should seek to influence policies which are not under their direct control when it is critical to the achievement of their trade policy. Setting national priorities and reacting to international policies in order to achieve high development returns from trade is an iterative process, and requires coherence. The remainder of this handbook provides an understanding of the ways in which lack of coherence limits these processes, and how developing countries can seek to change such incoherence.

3. Improving the coherence of trade and other pro-poor growth policies

Section 2 showed that the impact of trade on development and then on poverty will be influenced by a country's policy framework and that, in turn, appropriate trade policies can contribute to the achievement of development goals. But to produce desirable outcomes policies must be coherent. *In*coherence is seen by some as a source of some developing country problems and there are increasing calls within the development and trade communities to increase 'policy coherence.' The call applies to the multiple policies of developing countries, to those of the developed countries and to those of international institutions.

The coherence of policies (or lack of it) is a concern both for governments and for researchers assessing country situations (including those who will undertake the Commonwealth Secretariat country case studies). While it is not the only determinant of good policy and therefore good development outcomes – which are also dependent on things like competence, good analysis, honesty, sound implementation plan, etc – it is critically important and a necessary if not sufficient element of good policy making. The following sections provide some illustrative examples. But first, attention needs to be given to the whole concept of 'policy coherence', why it is desirable, and the different forms of incoherence and how far coherence can ever be achieved.

3.1 What is policy coherence

Policy coherence is a relational concept and is present when a) objectives of policies are complementary rather than contradictory and b) when the impacts of policies are in tandem. Yet *complete* policy coherence in any field is impossible. There are both necessary and potentially avoidable reasons for this. Among the necessary reasons is the fact that governments do not have one single objective. As the United Nations Food and Agricultural Organization (FAO) puts it:

> At the heart of the policy coherence debate is the nature of the policy process, a process of arbitration between conflicting objectives…Governments may not only have contradictory policies, but also contradictory objectives. The only way to promote coherence is to reconcile the objectives as well as the policies. Objectives change over time and may become incoherent as values and conditions change. Hence, by definition, policy coherence is an evolving and elusive target [17]

In addition to this 'multiple objective' incoherence, incoherence arises within or between organisations because of overlapping functions or poor communications – what can be called 'operational incoherence'.

Both types of policy incoherence can arise at the national level on at least three different points: among types of public policies, between different branches of government and among different interest groups (Organization for Economic Cooperation and Development (OECD) 2003: 4).[18] Thus, the objective of policy coherence is not to eliminate incoherence, but to ensure that policy is directed at a country's development objectives to the extent possible given the constraints of necessarily competing objectives and interests.

[17] Fresco, Louise O (2004). "Policy coherence for agriculture and development," *Agriculture 21 Magazine,* Food and Agriculture Organization, Rome. http://www.fao.org/ag/magazine/0406sp.htm

[18] OECD (2003), "Policy coherence: Vital for global development," Policy Brief within the OECD Observer, July 2003. Available online at http://www.oecd.org/dataoecd/11/35/20202515.pdf

The term policy coherence is most often used in the context of northern donor countries – in fact "policy coherence for development" or PCD was coined by the OECD's Development Assistance Committee in 1991, and the organisation has worked to foster policy coherence amongst Donor Assistance Committee (DAC) members since that time. A subdivision within the OECD conducts studies on coherence among different types of member state policies and development objectives (e.g. environmental and agricultural policies). The concept received renewed attention in 2000 when the Millennium Declaration was signed, and was further strengthened by the Monterrey Consensus in 2002, which required that developed countries commit more effective aid along with policy coherence.

3.2 Policy Coherence in Developed Countries

Most definitions focus on, first, 'doing no harm,' by undermining one policy designed to foster one element of development by either one targeted at another aspect of development or a non-developmental policy, and second looking for 'win-win' scenarios where policies are both good for development and for reaching other objectives.[19] Applying this approach to donor countries' development policies gives the following definition: "a process whereby a government, in pursuing its domestic policy objectives, makes an effort to design policies that, at a minimum, avoid negative spillovers which would adversely affect the development prospects of poor countries, and more positively, seek to maximise synergies."[20,21]

The discussion on PCD originally referred primarily to aligning OECD countries development policies with their own policies on aid, trade and debt, where the most obvious inconsistencies arose. Since September 11, 2001 however, the term has often been used as a short hand for ensuring that security policies do not undermine development.

Policy coherence for development is advanced as a desirable objective to avoid ineffectiveness and inefficiency in policy, as well as the loss of credibility. The United Kingdom's Department for International Development (DFID) notes that "policy incoherence weakens the efficiency and impact of aid. This occurs through lost opportunities for complementarity and when policies contradict each other. For example, subsidised EU beef exports undercut the same meat producers in Burkina Faso, Niger and Mali being supported by EU development programmes."[22] Thus coherence should be increased to a) reduce already observed inconsistencies, b) to maximise effective global governance and c) to prioritise commitments to the Millennium Development Goals and sustainable development.[23]

From a more practical standpoint, policy incoherence is also thought to be expensive: the OECD estimates that aid tying increases the cost of development cooperation by 15–30% and numerous estimates of the losses from agricultural subsidies have been made. The UK Department for International Development estimated, for example, that subsidies to farmers in high income countries were US$250bn in 2000, over four times the level of aid.

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[19] House of Commons (2004), "The Commission for Africa and Policy Coherence for Development: First do no harm," First report of the 2004-5 session, December 2004: HC 123. Available online at http://www.publications.parliament.uk/pa/cm200405/cmselect/cmintdev/123/123.pdf

[20] Matthews, Alan and Giblin, Thomas (2006), "Policy coherence, agriculture and development," Institute for International Integration studies

[21] DFID's definition is similar: "Policy coherence for development is achieved when policies across a range of issues (for example trade, migration, security) support, or at least do not undermine, the attainment of development objectives." http://www.dfid.gov.uk/mdg/aid-effectiveness/policy-coherence.asp

[22] http://www.dfid.gov.uk/mdg/aid-effectiveness/policy-coherence.asp

[23] Ashoff, Guido (2005), "Enhancing Policy Coherence for Development: Justification, Recognition and Approaches to Achievement," German Development Institute, September 2005, page 14. Available online at: http://www.die-gdi.de/die_homepage.nsf/6f3fa777ba64bd9ec12569cb00547f1b/7ba2ebede5eef2fcc1256f81003054da/$FILE/Studie%2011%20Internet%20Fass.pdf

It is also worth noting that EU countries have a legal obligation to strive for policy coherence in the text of the treaty establishing the Union. The Union is obliged to pursue consistency in its policies, particularly in the field of external relations (which includes security policy, external relations, trade / economic policy and development). Additionally, the EU treaty obliges countries to check whether other policies have an impact on development cooperation.[24]

These exhortations and goals clearly cover the avoidance of operational incoherence; but what about multiple objective incoherence? In a discussion of cross-sectoral coherence Ashoff highlights the complications of prioritising development policy over other types of policy in Germany:

> What right does the development policy have to demand greater development orientation of other policies? True to the motto that 'coherence is not a one-way street,' it might conversely by expected of the development policy that it take account of other political objectives and so, for example, help to promote German exports and employment. The development policy is, after all, subject to cabinet discipline and, like all policies, to the requirement…that it serve German interest.[25]

There is also a risk that the pursuit of coherence will reduce developing country ownership of policies. As a report written for the UK House of Commons stressed:

> Coherence in support of misguided policies, or in support of policies around which there is no consensus, is counter-productive. Policy coherence must not become a way of depriving developing countries of their policy space, their right to formulate laws and regulations suited to their own contexts and needs, based on their analysis of the evidence. This risk can best be avoided by ensuring that developing countries have an equal role in shaping the agenda, and ensuring that policy design is driven by evidence, rather than by ideology.[26]

3.3 Policy Coherence in Developing Countries

The term policy coherence is less commonly used to refer to rationalising policies to meet objectives in developing countries. This is because it is part of the issues generally subsumed into discussions of good governance, national development priorities and occasionally, 'joined-up government.'

Again, the discourse covers both operational and multiple objective incoherence. The broader definition of policy coherence – ensuring policies are complementary rather than contradictory and that impacts are in tandem – can be applied to the array of policies in developing as well as developed countries. If a country has clear, realistic and prioritised objectives for the role of trade in its development, it is more likely to successfully achieve its goals. Objectives that are clearly defined through coherent policies can be more easily transferred into actionable points in international negotiations, maximising developmental outcomes in such settings. Clearly defined objectives also help to demonstrate where policy 'windows' are open – that is to say, in which fora objectives are most likely to be met.

[24] Title XX, Article 177, "Development Cooperation" of the Treaty Establishing the European Community.

[25] Ashoff, Guido (2005), "Enhancing Policy Coherence for Development: Justification, Recognition and Approaches to Achievement," German Development Institute, September 2005, page 18. Available online at: http://www.die-gdi.de/die_homepage.nsf/6f3fa777ba64bd9ec12569cb00547f1b/7ba2ebede5eef2fcc1256f81003054da/$FILE/Studie%201%20Internet%20Fass.pdf

[26] House of Commons (2004), "The Commission for Africa and Policy Coherence for Development: First do no harm," First report of the 2004-5 session, December 2004: HC 123, page 28. Available online at http://www.publications.parliament.uk/pa/cm200405/cmselect/cmintdev/123/123.pdf

Governance also becomes more coherent through the process of changing incentives in the political economy: “rents and privileges accruing to a few, at the expense of the many, may well be challenged.”[27]

3.4 Multiple levels of analysis

When analysing coherence (or the lack of it) researchers have to be aware that the subject has two dimensions: multiple objective vs. operational incoherence; and horizontal vs. vertical policy coherence. Clearly, the appropriate diagnoses and prescriptions will vary according to whether or not a particular problem is identified as falling into the one or the other dimension.

What is horizontal and vertical policy incoherence?

- **Horizontal** policy coherence refers to the national level where governments should strive to achieve “inter-sectoral coherence between different policies and between stakeholders who may advocate conflicting objectives.”[28] This is equally applicable to developed and developing countries.

- **Vertical** policy coherence refers to coherent frameworks among international, regional, national and local levels. International actors must achieve coherence in their own policies (horizontal), but also their policies must be coherent with national and local government policies. Policies should be organised in such a way that the ownership lies at the lowest level of authority possible:

  > “A key principle in this respect is subsidiarity, whereby decisions are made at the most appropriate and effective level. This is of particular importance in international negotiations, where countries should be able to negotiate their position based on a detailed understanding of how national and local policy action affect and are affected by international agreements”.[29]

The next two sections take up this theme of horizontal and vertical planes and deal with each in turn.

[27] OECD (2003), “Policy coherence: Vital for global development,” Policy Brief within the OECD Observer, July 2003, page 4. Available online at http://www.oecd.org/dataoecd/11/35/20202515.pdf

[28] Fresco, Louise O (2004). “Policy coherence for agriculture and development,” *Agriculture 21 Magazine,* Food and Agriculture Organization, Rome. http://www.fao.org/ag/magazine/0406sp.htm

[29] Ibid

4. Analysing coherence in domestic policy – horizontal coherence

Based on this understanding that (in)coherence is not a simple phenomenon, Sections 4 and 5 provide illustrative guides of typical cases likely to be encountered by the trade analyst. Section 4 focuses on the two primarily domestic arenas identified in Section 2; Section 5 on the two external arenas.

4.1 Independent domestic policy

Incoherence amongst trade policies which fall completely within a government's competence may seem unlikely, but there are plenty of cases where trade policy appears not to be entirely coherent with a country's stated development policy. This section provides some examples of incoherent policy, attempts to explain the likely causes of such incoherence and suggests ways to address domestic policy incoherence.

The range of problems

Some of the most flagrant examples of domestic policy inconsistency arise in the context of agriculture. Agriculture is commonly prioritised in national development documents given the high numbers of poor people that live in rural, agricultural areas. Yet often the policies that are in place, including trade policies, undermine growth and trade in the agricultural sector. Agriculture may be over-taxed or prices may still be set monopolistically by parastatal marketing boards.[30] As a consequence, exchange rates may be over-valued complicating the export opportunities of new producers.

Similar inconsistencies have been found in industrial policy. Lall attributes failures to implement effective industrial policy in Africa, where he describes policy as 'abysmal,' to an array of factors including:

> poor information and capabilities on the part of policy makers, neglect of lessons from other regions, insufficient data, inability to withstand analytical pressure from outside agencies and experts, weak negotiation in and preparation for WTO membership and so on… [and]… lack of coherence between product and factor market policies, such as education and training, technology support, capital markets and export promotion.[31]

Thus, amongst a number of other factors, a lack of coherence between policy objectives (industrialisation) and public spending on support for product and factor markets complicates industrial development.

An example in Nigeria provides more insight. A case study on Nigerian manufacturing highlighted that in 2000 Nigeria was one of the most unindustrialised economies in the world with manufacturing value-added accounting for only 5% of GDP (lower than levels at independence in 1960).[32] This was the case:

> in spite of government's huge investment in the industrial sector, active industrial policies as well as a restrictive trade policy with effective rate of protection higher than the developing country

[30] Driscoll, R et al (2006). "Growth and Trade in Africa's Second Generation Poverty Reduction Strategies," London: Overseas Development Institute.

[31] Lall, S (2000), "Selective Industrial and Trade Policies in Developing Countries: Theoretical and Empirical Issues," Working Paper no. 48, Queen Elizabeth House, University of Oxford.

[32] Ikpeze, N.I, Soludo, C.C. and Elekwa, N.N (2004), "Nigeria: The Political Economy of the Policy Process, Policy Choice and Implementation," in *The Politics of Trade and Industrial Policy in Africa: Forced Consensus?*, eds. Soludo, C., Ogbu, O. and Chang, H-J, London: Africa World Press.

average. This is also in spite of four different national development plans (1962–1985), and industrialization as the number one priority of successive governments in Nigeria.[33]

The paradox between a stated policy which prioritised the development of manufacturing and low and declining manufacturing value added (MVA) in the economy is explainable mainly by the role of oil. The reason for the persistence of inconsistent policy statements lies in the political economy of policy processes. The authors argue that stated policy preferences were strongly influenced by 'the power of dominant development ideas' which in practice enjoyed little support either from government or other organised interest groups (e.g. business and ethnic groups) given the nature of the rentier economic system. Industrial development was highly contingent on government favours, and there were close links between politicians and businesspeople. The Dutch Disease effects of the oil boom (see below) have undoubtedly been a major direct cause of the low level of industry (which is important for technological change), but the political process described by the authors will have contributed to the government's failure to take effective action to neutralise Dutch Disease pressures. Similar political economy explanations of incoherent policy are widely available in other domestic political contexts.

Domestic policy inconsistencies such as those described above stem from an array of factors. These inconsistencies could arise from one of several sources. First, governments could simply be unaware of inconsistencies because holistic analysis of existing policies are lacking due to insufficient capacity or attention to the problem. Second, policy objectives may be insufficiently defined and / or prioritised, resulting in incoherent policies. Third, policy objectives may be well articulated, but contradictory and without easy means of reconciliation.

Coherence within PRSPs

Any of the above may be the result of, or be exacerbated by, dynamics within the political economy. Governments are not usually purposefully irrational, as a wide body of literature on public choice demonstrates; rather their inconsistencies are likely to stem from pressures to conform to competing priorities and to appease constituencies and interest groups with contradictory objectives. Literature reviewing the implementation of PRSPs highlights that while enhancing trade and growth was often a *goal* of PRSPs, implementing reforms in favour of trade are exceptionally difficult given repercussions on incomes. This is in contrast to spending on other types of government priorities such as health and education, where funds were more easily reallocated, and where enhanced aid funds facilitated the process of reform.[34] More generally, trade reforms suffer from classic collective action problems: producer groups adversely affected by liberalisation of tariff and subsidisation schemes are usually well organised as changes have a strong impact on them, whereas consumers, who stand to benefit, are diffuse and poorly organised on the whole.

Strong participation of interest groups, and other political economy features, also undermine the attempt to make the PRSP process inclusive and accountable. Booth notes that the PRSPs have failed to bring about change for some of the following reasons:[35]

[33] Ibid, page 1. Note that the authors do not explicitly consider the role of Dutch Disease in making the entire tradable sector of the economy uncompetitive due to resource wealth.

[34] Canagarajah, S., & v. Diesen, A. (2006), "Uganda's experience with the Poverty Reduction Strategy Approach: an overview of Lessons Learnt," Report to Department for International Development. London: DFID UK.

[35] Booth, D (2005), "Missing Links in the Politics of Development: Learning from the PRSP Experiment," Working Paper 256, London: Overseas Development Institute.

- Many policy decisions are made informally by small groups of politicians linked together by clientelism and patronage.

- Governments are not well-unified and well-coordinated actors. To the extent that there is effective accountability, it operates through the patronage system, and follows criteria other than those formally agreed.

- Formal decision-making processes, including the national budget and the PRS are from a political point of view window dressing, or largely 'theatre'.

- Whereas in some middle income countries there is an informed public opinion and a degree of effective parliamentary scrutiny, here the preconditions (e.g. a large local newspaper readership and an effective press) do not exist…[36]

Given the above, what can be done to improve the situation? The literature on PRSPs suggests at least three priorities:

- First, trade diagnostic initiatives (like the integrated framework (IF)) can be improved to ensure that such diagnostics are consistent with the sequencing of national processes (budget cycles);

- Second, ministries of finance should be better utilised to coordinate planning and budgeting for pro-poor growth, to initiate institutional reform in productive sectors and to manage the contradictions between aid and trade (e.g. Dutch Disease, about which more is said below);

- Third, prior experience with sector-wide approaches in social sectors can be applied to strengthen government capacity in areas related to growth and trade; donors can play a role in ensuring that specialists in trade and growth are included in the PRS process and help to develop a body of expertise on pro-poor growth and trade which draws on country experiences.

The extreme example of Dutch Disease

A classic example of operational incoherence arises in countries which experience an inflow of foreign exchange, whether it is a result of booming exports (traditionally more common) or massively increased aid (a recent concern) which is expected to be temporary. It is long been recognised that a commodity boom can give rise to what is called 'Dutch Disease' under which the surge of foreign exchange may shift relative prices in ways that are unfavourable to exporting and import-substituting sectors, and in favour of non-tradeables. Sometimes known colloquially as 'the resource curse', what happens is that an apparent bonanza has the net effect of reducing other exports because of the consequent rise in the exchange rate. Clearly, there still exists a technical problem in ensuring that the potential effects associated with the foreign exchange inflow are minimised.

The issues are most clearly understood in relation to a substantial increase in foreign aid (since the government of the recipient country is the principal actor involved; the principle differences in relation to a commodity boom relate to the multiplicity of actors).[37] When the

[36] Booth, D (2005), "Missing Links in the Politics of Development: Learning from the PRSP Experiment," Working Paper 256, London: Overseas Development Institute, page 5.

[37] See Foster and Killick 2006 for a systematic review of the options.

aid is transferred to the recipient country it accrues in the form of foreign exchange to Central Bank reserves; at the same time, the recipient government is credited with a counterpart value in domestic currency. The use of foreign exchange to the Central Bank is called 'absorption' whilst the utilisation of a domestic counterpart is 'spending'.

There can be four combinations of absorption and spending.

1. Governments may neither absorb nor spend – the aid is saved with the foreign exchange added to reserves and the counterpart used by government to reduce its domestic indebtedness.

2. The counterpart is spent but without absorbing the foreign exchange. What happens is the foreign exchange is added to reserves but increased government spending on local goods and services adds to the monetary base and domestic demand causing inflation unless there is spare capacity in the economy.

3. The foreign exchange is absorbed but the counterpart is not spent. In this case the foreign exchange funds an increase in imports taking demand out of the economy, probably pushing up the real effective exchange rate and contributing to the problems associated with Dutch Disease.

4. Government can fully absorb the foreign exchange and spend the counterpart: the result is an increase in domestic demand but this is matched by more imports and so the effect is not inflationary. However, absorbing all the aid may lead to an appreciation of the real effective exchange rate creating Dutch Disease conditions.

In order to avoid adverse inflationary or Dutch Disease effects, it is very important that governments choose the combination appropriate to their objectives and to their assessment of the long-term structure of the economy, post-inflow – but frequently they do not. A review of the experience in seven African countries shows outcome 4 to be completely absent; in fact, governments were far better at spending the aid increases through their budgets than they were at absorbing them via increased imports leading to large excesses of spending over absorption.[38]

Which of the options is best depends critically on the quality of spending decisions (and whether governments can avoid a lowering of the productivity of spending), the division of spending between tradeables and non-tradeables, the initial state of public finances, the overall macro-economic situation and expectations on whether or not the surge is temporary or permanent. Consequently, the 'right decision' is very much country and situation-specific. Making the wrong choices may well have adverse consequences both for trade and for development. Ensuring that the right choices are made, therefore, is a critical part of integrating trade and development policy.

4. 2 Dependent domestic policy

Analysts need to be aware of the range of policy inconsistencies resulting from the international constraints under which developing countries develop their domestic trade policies. Different types call for different diagnoses and prescriptions. This section provides examples of two main types.

[38] Foster, M. & Killick, T. (2006). 'What would doubling aid do for macro economic management in Africa: a synthesis paper', *ODI Working Paper 264*, April.

Trade negotiations

Trade negotiations run along a continuum in terms the level of domestic autonomy. Some are appropriately covered in this section, others in Section 5.1. This section covers cases where governments alter their trade (and trade-related) policies in ways that may not be wholly desired as a result of negotiations – sometimes with aid donors (policy-based lending) and sometimes through other international negotiations. The current negotiations between the Africa, Caribbean and Pacific Group (ACP) and the EU illustrate the second of these in a particularly stark fashion. Under the Lomé conventions and Cotonou Agreement, the EU has granted preferential treatment to imports from the ACP for the last three decades. By definition, such preferences are discriminatory for the other actual and potential suppliers of the products in question that face a competitive disadvantage when selling to the EU against the ACP. Until the mid 1990s, such discrimination was accepted, at least tacitly, by the countries concerned, but increasingly this is no longer the case.

The preferred strategy of the EU, accepted as a basis for negotiations by the ACP in the Cotonou Agreement signed in 2000, is to replace the current trade regime with one that is justifiable within the WTO on the basis of the clauses covering Free Trade Agreements (FTAs) and Customs Unions. These are Article XXIV of the GATT and Article V of the General Agreement on Trade in Services (GATS). This necessarily requires a change from the status quo: this is that ACP countries remove their tariffs on ‘substantially all’ imports from the EU.

There is considerable ongoing research at the present time on the likely economic development consequences for specific ACP countries of such liberalisation. The results are not necessarily uniformly adverse – but what is important in this context is that the decision about whether to liberalise towards the EU will not be an autonomous one made by the ACP in the absence of external pressure. On the contrary, the EPA negotiations are being undertaken solely because of challenges from the external environment to a continuation of the status quo. Depending upon the perspective of the observer, the principle challenge is coming either from those WTO members likely to object to a continuation of the old Cotonou regime or from the EU because of its decision to amend past practice. If EPAs are signed then it will be because ACP governments have come to the conclusion that in the new international circumstances their benefits exceeds their costs.

The tasks of the analyst and policy maker in these circumstances are, first, to calculate both costs and benefits and, second, to relate them to a country’s overall development strategy. The need to amend domestic policy in the light of external factors is common place. What is important is to design the change in such a way as to maximise synergies with development policy which may, in turn, require some change at least of the modalities of development policy if not to the goals.

PRSPs

Despite the patina of being prepared and ‘owned’ by the countries to which they relate, it is not unfair to characterise the PRSP process as donor-driven. Given that the initial impetus for PRSPs was the need for a new form of conditionality for debt relief and concessional lending related to the heavily indebted poor country (HIPC) initiative, their ancestry can be traced back to policy-based lending. The tension between the emphasis on country-ownership, a more equal partnership between governments and donors, and their use as an instrument for conditional aid has surfaced both in the content of PRSPs and in the implementation of actions identified in them.

Inconsistencies in the context of trade policy are rife. There are inadequate links between trade policies and poverty reduction, and specificities of trade policies are often missing. While trade features in a number of PRSPs, both 'first' and 'second' generation, it is usually subsumed within a broader discussion of the macroeconomic environment. PRSP trade policies are criticised as largely silent on both the income and non-income aspects of poverty reduction. International trade-related conditions such as fiscal reform or tariff reductions are not grounded in *ex-ante* analysis of the probable impact on poverty. For example: only one out of 17 PRSPs completed before 2003 seemed to recognise that trade policy could differ in its effects on different sections of the economy while only two considered trade and gender linkages.[39]

There are some exceptions to this pattern such as the PRSPs for Ethiopia, Nicaragua, Vietnam and Zambia.[40] These place some emphasis on trade policy being used for poverty reduction, for example to assist the rural poor, benefit female entrepreneurs, and benefit vulnerable smallholder farmers. Another review of early PRSPs noted that except for Mozambique and Honduras none of the documents had adequately linked trade liberalisation reforms to both growth and poverty reduction.

Analysis of second-generation PRSPs (those produced after 2003) suggests that, whilst almost all include at least one specific sub-section on trade policy and/or export promotion, there is a continuing failure to integrate trade adequately.[41] The trade sections generally appear in the discussion on economic management, product competitiveness or industrial policy together with frequent references to trade throughout the documents, in particular within sector strategies. But the trade content still lacks coherence with, for example, both export promotion and import substitution measures being mentioned in the same document without sufficient detail to support their joint adoption. The macro linkages of trade reform are also analysed weakly with little consideration of trade related opportunities and vulnerabilities. Particular weaknesses exist around policy content on trade in services in PRSPs.

In general, the PRSPs do not establish any analytical link between trade and poverty reduction, although some make passing reference to the importance of increased exports for poverty reduction. Discussions about options are only weakly informed by consideration of implications for poverty levels or vulnerable groups. Exceptions include some mention of possible economic risks for the poor in Burkina's regional integration process, for farmers in Uganda with respect to volatility in commodity process and for urban poor in Tanzania following trade liberalisation. But even in cases where a substantial number of trade priorities are listed, operational measures to put them into practice are not included (except in the case of issues related to WTO accession).

The policies that are covered tend to focus heavily on export promotion. In common with the first generation, second generation PRSPs include much more extensive analysis of supply-side constraints relative to those on the demand-side and there is a very little discussion of broader trade-offs between different policy options. The documents tend to discuss at length supply-side constraints to domestic industry (in particular in sectoral strategies) which undermine the export potential of the economy.

[39] Driscoll et al 2006

[40] Hewitt, A and Gillson, I (2003), "A Review of the Trade and Poverty Content in PRSPs and Loan Related Documents," Overseas Development Institute. Available at: http://www.odi.org.uk/iedg/Projects/christian_aid_paper.pdf

[41] Driscoll et al 2006

There is a general recognition that market access is not sufficient for the development of the export sector, and that market access should be accompanied by other measures strengthening the domestic productive system, including infrastructure development, marketing activities and productivity improvements. The recognition of the importance of such measures was already present in the first generation PRSPs but only one of the new documents makes reference to diagnostics support through the IF and Enhanced Integrated Framework (EIF) to private sector participation in international trade.

5. Analysing coherence in international policies – vertical coherence

Some influences on trade policy are partly or wholly outside the direct control of a government. There are two corollaries that pose particular challenges for the task of integrating trade and development policies. One is that governments have to decide how much attention to give to these fora: how many scarce resource to devote to the task of influencing the outcome of the negotiations. Given that the number and range of these external events is vast, prioritising between them is inevitable. The second corollary is that the inter-linkages between trade policy and development are likely to be particularly opaque, which creates added problems when attempting to seek coherence between the different arms of government and between a government and its society. How does EU reform of the dairy sector affect Rwanda? Indeed, *does it* affect Rwanda and, if so, how important is it compared to change to US farm policy or to the purchasing policies of Northern-based supermarkets?

Given that the first corollary makes prioritisation inevitable and the second requires it to be tightly constrained, some criteria are needed to provide a preliminary sifting between the events that *might* be important to help identify the highest probabilities. One set of criteria must focus on the scale of the potential impact of the events; another must look to the scope for remedies of some kind. If there are no remedies then negotiation or lobbying are pointless save to delay the inevitable. But if there exist alternative ways of achieving a given objective, or there exist palliatives that will offset the adverse effects of a given change then there may be a strong justification for involvement.

This section provides illustrative examples of the types of international policies that have potentially substantial implications for development in some countries and for which some remedies are available. The first sub-section deals with external negotiations in which developing countries are principals. This is the arena that comes to mind perhaps most often when reference is made to the effects of trade policy on development. In practice the boundary with partially domestic policies (Section 4.2) may be blurred. The second sub-section deals with those international events in which developing countries are not principals though their interests may be affected. The third sub-section considers what other external actors, notably the developed world, can do to facilitate a favourable development outcome from externally negotiated policies and to offset adverse effects from their autonomous policy decisions.

5.1 Negotiated external policies

Developed countries affect developing ones as negotiating partners, as a source of change and through their development and bilateral trade policies as well as through their aid policies. There is often inconsistency between these roles. When they are parties to trade negotiations, countries tend to take an overtly mercantilist approach (seeking 'gains' for their exporters and minimising 'losses' for their domestic suppliers) that sits uncomfortably with the stated goals of development policy.

Countries have many objectives and it may be naïve to seek full coherence between development and all such instruments. But improved coherence around good policies could be considered a desirable target – if it can be achieved. Country assessments need to take a view on how far multiple objective incoherence can be mitigated and operational incoherence removed. This section considers the range of situations that may be encountered via a limited number of illustrative examples.

Directly negotiated agreements

What distinguishes the type of agreement covered in this sub-section from those in Section 4.2 is that there are a sufficiently large number of players that a single developing country can achieve its objectives but only through alliance building and, in some cases, it may feel it has the latitude to absent itself in whole or in part. The latter is clearly not a feature of the negotiations covered in Section 4.2; the former means that significant resources may have to be deployed for an uncertain outcome. In other words, the task of the analyst in assessing the options facing a country is quite different.

An *apparent* additional difference is that the type of negotiation covered here should involve fewer adverse shocks to which countries have to adjust; but this need not be the case. A key feature of multilateral negotiations is that formally all parties can walk away without loss (other than the opportunities foregone) if dissatisfied with the outcome. They are therefore unconstrained (unless informal pressures are brought to bear) in the sense that agreement will only be reached with well-informed developing countries if the outcome is beneficial. The same applies to some regional and bilateral negotiations that share the key characteristics.

Even so, similar considerations apply to those described in Section 4.2 although the line-up may be much more opaque. Whilst a successful outcome of the Doha Round has been described as a win-win situation, it is in the nature of 'negotiations' that one party does not necessarily obtain everything that it wants without making any 'concessions' in return. This is likely to apply *a fortiori* to developing countries characterised by different degrees of weakness. Hence, even if on balance a country believes that is has achieved a 'good deal' from an international negotiation such as a WTO Round, it is likely to have to make some changes to domestic trade policy that it would not otherwise have chosen.

Just as with EPAs, the benefits (of the changes that it has sought and obtained) have to be calculated and then compared to the 'costs' (in terms of the policy changes that would not have been introduced in the absence of the negotiations). And it must be assumed that there will need to be ancillary changes to other policies in order to adjust to the new circumstances created by the successful negotiations.

5.2 Non-negotiated external policies

In some cases the most profound impact of one country on another arises from their domestic policies which, of course, are not negotiated at all. For example, rules of origin attached to trade preference agreements that require unrealistically high levels of processing (perhaps higher than are achieved domestically in the 'preference granting' country). Amid the clamour of domestic lobbies developed countries can find it hard to take into account developing country interests (even though these may be affected profoundly) when making autonomous changes. These effects need to be mapped. The nature of the task will vary according to the instruments involved since they produce different effects.

In some cases one or more of the conflicting objectives may be perceived as less favourable than the 'development objective' with which they are in conflict, but this need not always be the case. Sometimes all of the objectives are unexceptionable. Unless over- or poorly-specified, for example, an importing state's policies to protect the health of its population against hazards in imported goods is a legitimate one, yet changes to such sanitary and phytosanitary standards (SPS) may cause problems for developing countries.

This sub-section illustrates the range of concerns by reference to one policy which is about influencing and lobbying (though not negotiating) and one major external policy framed without any development objective: the EU's Common Agricultural Policy (CAP). It interacts with the EU's trade policy (especially on preferences for products such as sugar) to produce a complex pattern of effects.

Trade preferences

The effects of changing trade preferences also deserves its place in this section because a country's ability to influence the outcome is similarly constrained, although for a different reason. It is an important area for analysts to consider since all Commonwealth developing countries are parties to trade preferences changes to which may have an impact on poverty which may, in some cases, be very substantial.

Preferences are a broad category of policies fitting into 'non-negotiated external policies' and can exist in any situation in which a country imposes direct or indirect restrictions on imports from some sources. If it applies protection it can choose to relieve some suppliers from some or all of the restrictions. At present the most frequently encountered preferences occur when a country imposes positive most favoured nation (MFN) tariffs but removes them, wholly or partially, on imports from preference recipients (such as under the EU's Cotonou Agreement or the USA's African Growth and Opportunity Act (AGOA)). The most important in quantitative terms are the special quotas for sugar offered to some developing countries by the EU. But there are other situations in which preferential treatment could be possible, e.g. sub-multilateral agreements could facilitate services exports from 'preference receiving' to 'preference giving' states (such as mutual recognition of qualifications or work permit/visa agreements). As not all services are yet included in the GATS, developed countries have more freedom to choose recipients of preferences in services.

These examples make clear three features of preferences:

- They are not limited to accords with the word 'preference' in them; Others include the Cotonou agreement, Everything but Arms, and the African Growth Opportunities Act.

- Their potential value to the recipient is linked directly to the relative degree of restriction on imports from non-preferred sources;

- The possibility of granting preferences will remain as long as countries do not provide universal free trade to all trade partners on all goods and services, and as long as their use is not further restricted by international agreement – in other words, for the foreseeable future.

Because of this, the commercial value of any given preference can be altered by changes that providers impose directly on 'beneficiaries', by changes that the 'provider' agrees with other trade partners, and by changes forced on the 'provider' by third parties (such as the WTO). In addition, it can be altered by changes that are wholly autonomous by the 'provider' (dealt with in the next section). The extent to which a beneficiary can influence the outcome or must simply adjust will vary between these situations. Analysts must take such differences into account.

Because of this, the effects of changes to preferences can be very complex. (And they can also occur in the context of changes to autonomous national policy in the preference giver, see below). Analysts need to check carefully exactly what will change as a result of a stated policy decision. Often they may find that it is not what might be expected from public pronouncements. For example, the reduction of MFN tariffs, normally called liberalisation, will reduce the preference margins for some suppliers (known as 'preference erosion'). Whether a country gains or loses will depend critically on whether or not its access to the market of the preference giving state becomes more or less open compared to those of other suppliers.

Another important lesson is that the era of preferences is not necessarily dead: as existing preferences are eroded, it is technically feasible to create new preferences until the preference-giving country has completely free trade with all of its partners. The main exception to this is preferences which already offer zero tariffs and barriers to some countries (notably the least developed countries, or LDCs). Clearly, it is not possible to increase preferences for these. For other developing countries, country level studies can help by identifying cases where a new preferences could facilitate the economic shifts required by the erosion of old preferences.

The Common Agricultural Policy

The CAP was created in 1961 to support European farmers through the extension of subsidies, price supports and other production incentives such as direct payments, and stemmed from previous national level attempts to support European agriculture and ensure food security during the 19th and 20th centuries. It was originally based on three principles: a unified European market for agricultural goods without trade barriers; preferences for the internal market rather than external supply reinforced by trade policy; and common financing for agriculture through the Community's budget (centred initially on improving agricultural efficiency and modernisation).

Since 1992, it has undergone a series of reforms which have largely transformed the support farmers receive into direct payments which are not based on the production output, although output-related payments remain for some of the most sensitive.[42] Despite these reforms and preferential export access schemes for many developing countries, the CAP still represents a hurdle for developing country exports of some agricultural products. It still represented €54 billion in budgeted expenditure in 2004, €28 billion of which was for direct payment to farmers.[43] And this figure does not include the cost of the CAP to European consumers paid through increased prices caused by import restrictions – the main impediment to developing country exports.

Its multiple effects

In fact, the CAP (like other forms of protectionism) affects developing countries in a variety of ways. The OECD groups developed country agricultural policy effects on development into four categories:

- Subsidies, which can create food surpluses;
- Trade barriers including tariffs;

[42] Major reforms were undertaken in 1992, 1995, 2000 and 2003. The 1995 reform process was generated by the formation of the new World Trade Organization and a desire to comply with its regulations. The 2000 reforms were in advance of the enlargement of the EU from 15 to 25 member states.

[43] European Commission (2004), "Indicative figures on the distribution of aid, by size-class of aid, received in the context of direct aid paid to the producers according to Reg. (EC) No 1259/1999" available online at http://ec.europa.eu/agriculture/fin/index_en.htm.

- Constraints on agricultural related intellectual property, such as geographic indicators for specific geographic origins of products.[44]

The net impact of any change will depend on which of these categories is altered and how. A shift in subsidies from price to income support, for example, if not accompanied by any reduction in tariff barriers may be labelled as 'liberalisation' but might not have any of the economic effects normally foreseen when this term is used. The share of the economic rent created by the CAP accruing to preference receiving countries may decline but there will not necessarily be offsetting gains for efficient global producers or for non-agriculture within the EU.

Because of this, developing country governments and analysts have to examine very carefully precisely what is being changed and how it will impact upon the volumes and prices of what they trade. In particular, it is wrong to assume that losses for any one country or socio-economic group is offset by greater gains for others.

The critical importance of market access

The most striking incoherence between European agricultural and development policy concerns measures applied at the border. The EU imposes high tariffs on agricultural imports – with bound tariff equivalents of around 100% for beef and dairy, and over 60% for sugar and cereals.[45] These are necessary to reinforce the price supports available for EU agricultural products. Yet through its development policy the EU urges the utility of international trade to generate growth and thereby eradicate poverty. Not only do the prescriptions differ but the EU's high tariffs on goods that are developing country exports make the achievement of increased trade for *some* developing countries harder to achieve, and for some much harder.[46]

But all is not simple – hence the italicisation of 'some' developing countries. There are two caveats which temper the impact of these tariffs on demand for developing country exports which, in turn, is only one side of the 'trade and development' coin. The first is that many of the products produced by developing countries do not compete with European agricultural products (e.g. cocoa, coffee and tropical fruits) and therefore tariff levels are not set by the CAP. The notable exceptions include sugar, bananas and cotton, which are primarily produced by developing tropical countries but is also highly protected by the EU.

Second, preferences for many developing countries mean that they can export to the EU at discounted tariff rates. The Cotonou regime, for example, allows ACP countries to export many products tariff free or at low tariffs, and LDCs can export all agricultural products duty- and quota-free under the 'Everything But Arms' initiative.[47] As Bureau and Matthews note, these provisions mean that the EU agricultural policies have a differential impact on the agricultural export capacity of different developing countries.[48]

In a recent strategy report, two UK Ministries argued that developing countries can be grouped into three categories according to the impact on them of CAP reform. One, relatively

[44] Dahlsten, S. (2004), "Institutional Approaches to Policy Coherence for Development: Key Policy Coherence Issues in Agriculture and Migration," OECD Policy Workshop, 18-19 May, Room Document 4. Available online at: http://www.oecd.org/dataoecd/24/26/31744363.pdf

[45] UK Treasury & DEFRA (2005). 'A vision for the common agricultural policy', December, table 1.1

[46] Bureau, J. and Matthews, A. (2005), "EU Agricultural Policy: What Developing Countries Need to Know," Institute for International Integration Studies Working Paper no. 91, Dublin: Trinity College: 15.

[47] Though there are special regulations on bananas, rice and sugar.

[48] Matthews, A. and Bureau, J.C. (2005,) "EU Agricultural Policy: What Developing Countries Need to Know," The Institute for International Integration Studies, Discussion Paper Series: iiisdp91. Available at: http://ideas.repec.org/p/iis/dispap/iiisdp91.html

small, group is well placed to take advantage of true liberalisation of European agriculture. They are already relatively efficient and competitive producers and have the capacity to respond to the market opportunities that liberalisation would create.

The second, and potentially the largest, group includes countries that will not gain without substantial supply-side reforms needed to improve their capacity to take advantage of the potential gains. Without such support, they may actually lose as agricultural import prices rise.

The third group is relatively small but countries concerned may suffer substantially, at least in the short run, because of preference erosion. The report cites a study by the Commonwealth Secretariat which estimates the annual value of OECD agricultural preferences for three of the most protected products (sugar, bananas and beef) at US$536 million.[49]

This makes the task of governments and policy analysts in devising solutions for the external shocks that result from any such change difficult. The task of responding to the shock and restoring coherence between agricultural and development policy will differ between countries, and all will have to take account of the fact that the impact of any given change will vary between socio-economic groups. The country case studies need to be nuanced to take full account of these differences.

[49] Commonwealth Sec 2004 and Treasury and DEFRA

6. Establishing a country negotiating strategy

The ultimate objective of developing countries (and of country case studies such as those to be prepared under the Commonwealth Secretariat project) is to create a reasonable coherent set of policies that correctly identify interests, advance them positively where possible (through domestic and international action) and adjust to external shocks when necessary. As noted in Section 1, though, this places a huge strain on the technical and financial resources of poor countries. How can they best organise themselves for this task? What supports can the international community provide? These are the subject of Section 6.

6.1 How to organise

A high priority must be to reduce domestic operational inefficiency to the minimum through good organisation, and to harmonise multiple objectives as far as possible in order to promote development. Of equal importance is to be able to identify key external interests with sufficient precision that they can be advanced effectively even with limited resources.

How has this been done in a country like Mauritius which is generally considered to be one of the most capable trade negotiators in Africa,[50,51] and dedicates significant time and resources to lobbying developed country governments on trade policy which will affect their national strategy and preferred outcomes? This sub-section briefly reviews the manner in which the government has pursued its trade policy even on issues which are not under their control.

In general, Mauritius' ability to influence trade policy in third countries is partially attributable to two special institutional characteristics. First, the Mauritian process of trade policy formation is notably inclusive and therefore has a higher chance of being coherent. Bilal and Szepesi highlight that the country's trade negotiation process includes a number of non-state actors including representatives of the private sector, unions and trade related associations (such as the Mauritius Export Processing Zone Association or MEPZA) who are often also included in trade delegations in the WTO and other regional groupings.[52] Page suggests that given the size of the economy, even small and medium sized enterprises have been able to participate in the trade policy formation process,[53] which is unusual for a developing economy. These actors participate in the process of trade policy formation in an iterative process with the Ministry for Trade throughout the process of international trade negotiations, including those taking place at the WTO but also those conducted at the regional level.

Second, the country has had an active export promotion agency for many years (under various guises). It has been highly effective in promoting the country's exports,[54] in contrast to other cases in which the selection of 'winners and losers' has been perceived as highly negative.

[50] See for example the Mauritian case study in Bonaglia, F. and Fukasaku, K (2002), *Trading Competitively - Trade Capacity Building in Sub-Saharan Africa*, Paris: OECD.

[51] It is worth noting that Mauritius is exceptionally preference dependent, so is likely to need to devote an exceptional share of resources to trade negotiation and lobbying. Nonetheless, it is a useful case study.

[52] Bilal, S. and Szepesi, S (2005), "How Regional Economic Communities can Facilitate Participation in the WTO: The Experience of Mauritius and Zambia, (Case Study 27)," in *Managing the Challenges of WTO Participation - 45 Case Studies*, eds. Gallagher, P et al. Geneva and Cambridge: WTO and Cambridge University Press.

[53] Page, S. (2003), "Towards a Global Programme on Market Access: Opportunities and Options," Report prepared for IFAD. London: Overseas Development Institute. Page 22.
Available online at: http://www.odi.org.uk/iedg/meetings/market_access_report_IFAD.pdf

[54] Ibid

Although Mauritius is an active participant in regional and other groupings within the WTO, these groupings have provided few substantial benefits for Mauritius in terms of the creation of trade policy.[55] The country has therefore focused lobbying efforts on changing the policies of developed countries which are of key interest – such as actively contesting the changes to the EU's sugar regime. Prior to the reforms, in 2003, sugar accounted for 85% of agricultural exports and 6% of GDP, employing 25,000 people and in 2005 accounted for 17.4% of all exports.[56] The EU's changes to the regime were originally intended to result in a price cut of some 39% over four years, therefore inducing massive lobbying on the part of the Mauritian government and sugar sector.[57] [58] The then minister of agro-industry, Arvin Boolell, led several missions on behalf of ACP sugar producers to Brussels to lobby against changes, or to ensure that changes were more amenable to the Mauritian position including support measures for a transition period.[59] The result was a cut of 36% over four years. For a country with Mauritius' dependence on sugar, this may have been a good return to the lobbying; for another, with a smaller potential gain, it would not have been the appropriate strategy.

6.2 How Aid for Trade can help

Although good domestic arrangements are a necessary condition to promote trade, they will often not be sufficient. There is a role for external support both to provide an enabling external environment and to help deal with supply-side constraints (including support for governmental and private sector institutions). This sub-section reviews the status quo on aid for trade and the next considers some examples of innovative solutions to stimulate the country case studies.

The overt linking of trade and aid was given new impetus at the WTO Singapore Ministerial in 1996, which proposed a more 'integrated approach' to assisting LDCs to enhance their trade opportunities and led to the creation of the IF. This stimulus was further reinforced by the 2005 report of the Commission for Africa which proposed that much more aid should go to developing the physical and institutional requirements for countries to be able to trade.

In the last year A4T has taken a much more centre-stage role with its inclusion in the Hong Kong Ministerial Declaration of December 2005 and the completion of a set of recommendations by the "Aid for Trade Taskforce" which was convened after the Ministerial. In that document, the WTO defined its scope and purposes as to "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".[60] The Task Force recommended that A4T be "additional, predictable, sustainable and effective,"[61] and defined A4T into several categories which "is both broad enough to reflect the diverse trade needs identified by countries, and clear enough to establish a border between Aid for Trade and other development assistance of

[55] Bilal and Szepesi (2005).
[56] Economist Intelligence Unit.
[57] See for example a discussion of the alliance between the UK sugar lobby and some developing country exporters in Denny, C (2004), "Sugar lobby fights to keep virtual monopoly," *Guardian* 23 February; and the prominence of discussions of the role of sugar in the Mauritian success story in an interview of Deputy Prime Minister and Finance Minister Rama Sithanen: White, D (2006), "Mauritius seeks €1.5bn support as EU reforms hit exports," *Financial Times* 3 August.
[58] Garside, B et al (2005), "Who Gains from Sugar Quotas?" ODI-LSE DESTIN DV406 Research Project, Available online at: http://www.odi.org.uk/iedg/projects/EU_banana_sugar_markets/ODI_LSE_SugarProject_2005.pdf
[59] See for example a news report by the government of Mauritius on http://www.gov.mu/portal/site/Mainhomepage/?content_id=8de4d575d1a88010VgnVCM100000ca6a12acRCRD
[60] Aid for Trade Task Force (2006), "Recommendations of the Task Force on Aid for Trade," WT/AFT/1, 27 July:
[61] Ibid: Page 1.

which it is a part."[62] The categories set out by the Task Force, which were the result of a substantial amount of research and discussion amongst interested parties, were:

- **Trade policy and regulations**: This is part of what has been called "narrowly defined" Aid for Trade and includes capacity building for trade policy officials, assistance in analysing proposals, support for inclusive policy dialogues with the private sector and other civil society groups and institutional and technical support to help countries adapt to and implement trade agreements, rules and standards.

- **Trade development**: This category, while broader than the category above, is still "narrow" aid for trade in so far as it is directly related to trade capacity building and addressing supply-side constraints. It includes investment promotion, support for business and institutions regulating export, trade finance, trade promotion, and market analysis.

- **Trade-related infrastructure:** A broad element of Aid for Trade, which includes funding for the construction of physical infrastructure to increase trade.

- **Building productive capacity:** Additionally broad, encompassing support for the increase of productive capacity amongst private sector groups in developing countries.

- **Trade-related adjustment:** A range of interventions including helping to implement new government revenue systems in countries that have reduced tariffs, via assistance to those having to adjust to new relative prices and demand following trade policy change, to helping to create new market institutions where the old ones are no longer viable. The need for such support does not arise only from trade policy reform: changes in relative prices may arise from any world market shock. Appendix II details the concept of 'preference erosion' and how developing countries can be compensated for this in some detail.

- **Other trade-related needs:** The Task Force included a provision for assistance which was characterised by developing countries as trade related needs, but which fall outside of the categories above.

Prominent instruments

All major donors have either maintained or increased over time their spending on trade-related assistance, though only two donors can accurately be described as 'specialising' in A4T relative to other donors: the EU (through expenditure on trade policy and regulation and trade development) and Japan (due to its strong commitment to infrastructure-related aid). Given this relative low level of specialisation, this sub-section provides a brief introduction to some of the most relevant of the existing dedicated A4T programmes which generally address 'narrow' A4T.

The **Integrated Framework** is best described as a diagnostic tool which was intended to help to identify a country's trade-related needs. It was established in 1997 and updated in 2001 (with the aim of embedding in countries' overall development strategies a broad-based trade agenda and of promoting coherence in trade-related capacity building). It is jointly managed by the IMF, World Bank, WTO, several UN agencies (UNCTAD and UNDP) as well as

[62] IBID: Page 2.

bilateral donors. At present, only LDCs are eligible for participation. The IF does not provide any money for implementing, contrary to some initial expectations from recipient countries.

Due to increased interest and demand from LDCs to join the IF, the Development Committee of the World Bank and IMF endorsed a proposal at the Bretton Woods annual meetings in 2005 to enhance the IF. The proposal set out a programme for expanding its resources and scope, as well as enhancing its effectiveness. The EIF will seek to:

1. "Provide increased, predictable and additional funding on a multi-year basis;
2. Strengthen the IF in-country, including through mainstreaming trade into national development plans and poverty reduction strategies; more effective follow-up to diagnostic trade integration studies and implementation of action matrices; and achieving greater and more effective coordination amongst donors and IF stakeholders, including beneficiaries;
3. Improve IF decision-making and management structure to ensure an effective and timely delivery of the increased financial resources and programmes. The task force will make its final recommendations by the end of April 2006. And the enhanced IF is to enter into force before the end of 2006."[63]

Because the IF did not provide sufficient resources for countries to implement the trade diagnostics which were funded, they were largely unsuccessful. The EIF will seek to address this weakness, and is already being used more extensively: 31 countries are currently using the EIF.

Additionally, the IMF has introduced the **Trade Integration Mechanism** (TIM) designed to assist member countries to meet balance of payments difficulties that might result from trade liberalisation by other countries, and explained how it calculates eligibility. But only three countries have taken advantage of the TIM so far – Bangladesh (US$78 million) and the Dominican Republic (US$32 million) and Madagascar (US$80.8 million). This money was made available as a loan, not as a grant, which has limited its attractiveness, and contradicts a fundamental principle of A4T as it is currently being discussed (to be provided on grant basis).

Organised by the ITC, UNCTAD and WTO, another mechanism is the **Joint Integrated Technical Assistance Program** (JITAP). JITAP was founded in 1998 and renewed in 2003, and it is a trust fund for trade capacity building in Africa (exclusively) where donors can deposit money to be managed centrally. Donors include Canada, Denmark, Finland, France, Germany, Japan, the Netherlands, Norway, Sweden, and the UK. Three more specific objectives include building national capacity for participation in the multilateral trading system, adapting national trade policy to new demands of the WTO, and helping African countries to maximise potential gains from participation in the multilateral trading system. JITAP II also has the objective to help with trade negotiations and meet supply capacity. To date, six developing countries and ten LDCs have participated in JITAP's five organising 'modules' which include: institutional support, compliance, policies and negotiations; strengthening reference centres and national enquiry point; enhancing knowledge and network; product and services sector strategies; and networking and programme synergy.

[63] EIF website available at: http://www.integratedframework.org/enhanced_if.htm. Also see: Integrated Framework Steering Committee (2006), "An Enhanced Integrated Framework: Report of the Chairman of the Task Force on an Enhanced Integrated Framework, including recommendations," WT/IFSC/W/15: 29 June.

There is a **WTO** technical assistance programme aimed primarily at African countries which is devoted almost entirely to helping developing countries (and countries in transition from centrally-planned economies) operate successfully in the multilateral trading system. The objective is to help build the necessary institutions and to train officials. The subjects covered deal both with trade policies and with effective negotiation.

Dedicated or vertical

With the recent emphasis on defining and enhancing A4T, there is an ongoing debate about the extent to which it should be distributed through 'dedicated' or 'vertical' funding mechanisms similar to those reviewed above or should be integrated into broader development aid and funding in order to fulfil recent pledges to increase the coordination of aid. If A4T is intended to incorporate a number of different initiatives, it may be necessary to utilise a variety of organising mechanisms rather than one centralised fund. Some types of technical assistance, for example, such as meeting the costs of implementing WTO agreements are likely to be relatively small, easily defined and time bound. For theses cases a vertical fund (akin to the proposed EIF) could be highly efficient in disbursing aid with minimum conditions. Broader types of A4T, though, such as those related to supply-side capacity may need to be much more closely integrated into a country's existing development framework to ensure that they are in line with the needs of the country, and potentially, the region. Therefore the most useful delivery mechanism is likely to be different – i.e. trade related assistance embedded in comprehensive aid programmes.

Hence, there is some tension between the principles underpinning many types of A4T to date (need- and purpose-based) and best practice initiatives in the field of aid. The Paris Declaration on aid effectiveness highlights three principles: ownership, alignment and harmonisation. Vertical funds meet few of these criteria whereas multilateral and bilateral programmes are more easily harmonised and have built mechanisms to improve national ownership and alignment. Extensive evaluation of vertical funds in the field of health, for example, show that while they tend to be highly effective in achieving intended results, they also have negative effects, such as skewed spending priorities, which serve to create an imbalance of services and contribute relatively little to building local skills to ensure that programmes are maintained in the future.

In summary, the arguments for using vertical funds include the following. Vertical funds may build up a level of expertise and specialisation and thus create a comparative advantage in an area, they may benefit from economies of scale, they may be better at coordinating global level solutions for global problems and they can ensure that money is effectively distributed to a cause. The arguments against include the possible lack of ownership by the receiving country, their proneness to sudden shocks in donor tastes, and the challenge of aligning vertical funds with country programme.

To date, attempts to deal with these problems have tended to focus exclusively on harmonisation. While A4T, out of necessity given its broad remit, may be distributed and organised by different agencies, it has been suggested that the WTO, and the Committee on Trade and Development in particular, should play a role in overseeing and monitoring all A4T initiatives. It has also been suggested that the Trade Policy Review mechanism could be used to monitor progress and impact of A4T at the country level.

7. Country case studies – putting it into practice

As explained, this Handbook represents a first step in a process intended to provide practical guidance to Commonwealth developing countries. It deals with the task of integrating their trade policy into a broader development strategy and prioritising the myriad demands placed upon them. It identifies (in general terms) the ways in which trade can be affected by policy (which extends far beyond the bounds of simple ‘trade policy’) and the wide range of factors that governments need to take into account to ensure that what they are doing in different arenas is consistent and coherent – at least to the extent that differences are not required to accommodate diverse interests.

The next step of the process is to undertake a series of country case studies in a representative sample of Commonwealth developing countries. The Handbook will guide the work of the consultants undertaking the studies. The results of the studies will, in turn, inform revisions to the Handbook so that it provides more ‘real life’ examples of the general issues discussed and increases the level of detail in the analysis.

In order to ensure that this objective is fulfilled, the country case studies need to follow a broadly similar approach. This will ensure both that they take full account of the guidance provided in the Handbook and also that their results can be aggregated in a way that facilitates the revision of the Handbook.

The guidance below will be supplemented at a workshop to be organised by the Overseas Development Institute (ODI) and supported by the Commonwealth Secretariat. This will bring together the consultants who will undertake the country studies, the authors of this Handbook and other experts to prepare a detailed plan of work. The following sub-heads identify the main areas to be covered by each country study and the sequence of the analysis.

Current economic situation

Clearly, no country starts from a zero base line. The extent to which trade and trade-related policies reflect development strategy will vary between countries and needs to be spelled out. The link (actual and potential) between growth and exports should be very clear, but will vary according to the situation from which countries start as these two examples illustrate.

- As explained above in relation to Dutch Disease, successes in one product may make life difficult for other actual or potential exports. So a major challenge for trade policy in such cases will be to manage the export boom in such a way as not to jeopardise other trade and domestic objectives.

- In countries where exports are heavily dependant on trade preferences, the nature of the analysis may be quite different. Here the focus is on the characteristics of trade with the preference giver, the reasons for its dominance over other trade (with other trade partners and in other products) and ways in which preference erosion can be managed.

Imports are a vitally important part of the trade analysis. A frequently overlooked point is that the primary reason for exporting is to fund imports: it is the ability to import that is important – exports are merely a means to achieve this goal. What does the country import? What are the global trends in relation to those products? Should it be importing different things in order to achieve stated development goals? Or should it be importing more (of these products and of others)? These are the questions that the analysis of the current pattern of trade needs to answer.

The linkage between trade and development

The first section will have sketched the role of trade and development when explaining which traded products are important and why. This section needs to elaborate and deepen that analysis by showing the relative importance of trade in the various facets of the economy for which it is relevant.

Trade may be a source of government revenue. What would the effects be of liberalisation on government revenue involving as it does a cut in tax rates as tariffs are lowered if, at the same time, the volume imports grew rapidly (whether funded by an export boom or by a massive increase in aid)? What are the alternatives to tariffs as a source of government revenue? It is frequently assumed (wrongly) that there are only two major sources of revenue for poor countries: tariffs (which are simple to collect at a border) and highly sophisticated value added or income taxes (which whilst economically superior are much harder to organise). But there are many intermediates. An obvious one is a simple sales tax which the government tries to collect on both imported and domestically produced goods but is set at a level that raises revenue equivalent to what is lost through liberalisation even if collected just on imports. How high would such a simple sales tax have to be in order to achieve this effect? This may be a question that the country studies can answer through access to data on the level of revenue currently raised by governments from their tariffs.

Such revenue analysis will need to be set at a level appropriate to the data available and the policy options under review. If what is proposed is full liberalisation (on all products and towards all trade partners) then the effect on government revenue will be simple to identify provided that data exists on total tariff revenue. But if, as for example in economic partnership agreements, a country is proposing to liberalise on only some products from some sources, then a more detailed analysis will be desirable that uses information on the tariff revenue collected by product and trade partner.

The relationship between trade, domestic production and consumption, and the employment and consumption needs of the poor is also an important focus. Which socio-economic groups benefit from an increase in the availability of which imports, and for which groups are these same goods a potential challenge? This is clearly a fundamentally important piece of information given that governments will need to balance consumption and production interests, and will probably wish to do so in a way that favours certain groups.

Which groups? Is government policy well articulated in these areas? Is there a trade strategy and, if so, is it coherent with other stated objectives in relation to balancing the interests of different socio-economic groups. And is it coherent with government revenue forecasts? Is it being implemented effectively? Are any problems primarily ones of concept (policies are in conflict with each other) or of implementation (policies are supportive but some are implemented more effectively than others)?

Having identified such issues, the analysis then needs to move onto political economy considerations to explain why things are as described. What is the scope for identifying different instruments (or implementation mechanism) that recognises these features of the political economy but improves performance?

The analysis needs to be forward looking. Predicting the future is always difficult! And for this reason, any predictions need to be well founded in a detailed and astute analysis of the status quo. Given such a fundamental analysis, it should be possible to identify how major trends in the global economy could alter fundamentally the status quo. What will be the effect of growth in Asia on the issues identified? How will escalating SPS standards impact on current trade flows? What needs to be done to deal with these sorts of challenges – in very practical terms?

A plan of action

Having identified the main sources of incoherence between different domestic policies and between domestic and external policies, in terms of their magnitude and pervasiveness as well as their underlying causes, the analysis can move on to sketch a plan of action. Clearly, this will need to be set at a fairly broad level but it must be sufficiently precise for it to be possible to be subjected to cost-benefit style analysis – even though both costs and benefits may have to be established in very broad terms. The aim should be to produce a cascading picture showing how each of the central changes identified will, in turn, have ripple effects each of which will have its own costs and benefits.

What will be the costs of the proposed changes in terms of the opportunity costs of the resources required, which will then not be available for other purposes, and of the policy options foregone because they are inconsistent? By describing ‘costs’ in this way it becomes clear what level of quantification is needed. It will not be possible, for example, for the country case studies to estimate in other than very broad brush terms the costs of setting up laboratories and training technicians necessary to meet escalating SPS standards. But the broad order of magnitude is needed in order to assess whether the opportunity cost of using resources in this way will be substantial or trivial relative to relevant government expenditures. And the need for technical personnel has to be understood to know whether a change to immigration policy is the only realistic way in which the problem can be solved.

Such data establish the ‘costs’ needed to achieve the ‘benefit’ of, in this example, continued agricultural exports of the current kind to the current market. This ‘cost’ can then be compared – again in broad terms – to the ‘cost’ of not seeing a continuation of the current pattern of agricultural exports. As established earlier in the report, this might mean either a continuation of export of the same products but to different markets or a sharp fall (or even cessation) of exports. And if it means a shift in exports to different markets, there will be costs to ensure the viability of this shift (e.g. to support marketing) or costs associated with the shift (e.g. a loss of revenue because the new markets are lower priced).

Establishing a country negotiating strategy

The ultimate objective of the case studies and the Handbook is to inform countries’ domestic decision making and their strategies for negotiation with all relevant parties. This section should work backwards from the objectives that have set out in the preceding section rather than starting from the status quo of existing government commitments and structures. What needs to be done to achieve the stated objectives? How does this differ from what has been done at present? And, therefore, what needs to change in order to square the circle?

This analysis should be oriented towards the near future and is intended to identify what governments need to do now in the light of the foregoing analysis. What objectives, and in which trade negotiations, should be decided to secure the changes described in the previous section? What is required in other fora besides formal ‘trade’ negotiations – such as relations with actual and potential aid donors and other sources of finance to support the ‘costs’ needed to achieve the ‘benefits’?

Given this short term agenda, how should government get itself organised? What objectives need to be set, what institutional arrangements are desirable, what are the relevant timeframes for different negotiations and how often should reviews be built in to ensure continuing coherence in the light of evolving events in each of the fora?

What is the regional dimension to this strategy? Are current regional arrangements supportive of the strategy or not? How might they be changed? What are the domestic and external obstacles that need to be overcome – and what is a realistic approach and timetable for achieving this?

Given all of the above, how important is the multilateral dimension? What issues are best dealt with at this level and what are the effective strategies to deal with them? Where do 'regional' agreements with non-regional partners (such as the EPAs) fall into this picture? Can Aid for Trade be used to foster change? What is the role of the IF? How do PRSPs need to be changed to achieve the stated objectives and to bring non-regional partners into a practical supporting role?

In this way the case studies should provide a reasoned plan of action for both the government and foreign donors and trade partners. The former has to articulate a coherent strategy that would utilise aid or improved market access to support development goals. The latter must be pushed to rally in support.

Appendix I: Illustrative List of Trade Policy Categories for Analysis

Measures Directly Affecting Imports:

Custom Laws (includes pre-shipment laws)

Customs Valuation

Rules of Origin

Tariffs (applied, bound, concessions and preferences)

Other import taxes

Import prohibitions and restrictions and import licensing

Antidumping and countervailing measures

Safeguard measures

Standards and other technical requirements

Sanitary and phyto-sanitary regulations

Measures Directly Affecting Exports:

Procedures, documents and registration

Export taxes, charges and duties

Export prohibitions and restrictions and export licensing

Tariff and other tax concessions, including free export zones

Export promotion, financing, insurance and guarantees

Measures applied in foreign markets

Other Measures Affecting Production and Trade:

Legal framework for business, including registration

Competition and pricing policy

Incentives and other government support

State trading, government-owned enterprises and privatisation

Government procurement

Intellectual property rights

Appendix II: Aid to compensate for preference erosion

As explained in Section 5.1 any liberalisation of an importing country's market will erode any preferences that it gives on the products concerned (or their substitutes) – although not all trade policy change is necessarily 'liberalisation'. Depending on the circumstances there can be three very different (and potentially combinable) responses, two of which involve aid.

1. Aid donors can compensate the formerly preferred exporters both to increase their willingness to accept the change (if they have the power to block it) and to ease the adjustment process (which some observers would consider falls under the broad definition of Aid for Trade).

2. In cases where erosion reduces but does not eliminate the formerly preferred exporter's competitiveness, aid can be focussed on reducing supply costs in order to restore competitiveness (which falls easily under the broad definition of Aid for Trade).

3. The liberalising state can offer preferences on new developing country goods or services exports that are not yet fully liberalised. Also other not-yet-liberalised states might offer preferences on the existing exports and, in some cases, it may be feasible for the exporter to shift its market to the new preference giver. Both go beyond Aid for Trade.

Point 1 applies in cases where it is not feasible to maintain exports after the erosion. In such cases a key need is to maintain import levels following the collapse of the formerly preferred exports. This implies a need for direct balance-of-payments support over an adjustment period. In addition, there is a need to develop other economic activities to replace the old. Between them these need to fulfil all the roles of the previously preferred activity. For example, Mauritius aims to boost its services exports to compensate for the expected decline in sugar and clothing as a result of preference erosion. The new exports may replace the foreign exchange of the old, but they are unlikely to employ the same semi-skilled and unskilled labour. Employment creation, if necessary in activities that will never be internationally competitive, may be needed as well.

What about point 2 – aid to reduce costs in line with preference cuts? Clearly, there is no overarching case to focus 'aid for supply capacity' on goods that are (or may) suffer preference erosion, but there are pragmatic reasons for such goods to be given attention when establishing aid priorities. This is because:

- The existence of preference-receiving exports is evidence of some level of supply capacity; it is likely that the quality of the goods meets the demands of the importing market and that prices can be competitive given the restrictions that exist;

- Trade policy rents are often not extinguished over night, but simply reduced, so that the preference-giving market may still offer more remunerative prices for the goods in question than it does for alternative exports or are offered by alternative markets for the same goods.

Donors need to distinguish between 'structurally uncompetitive' suppliers for which diversification is the only option (such as some Caribbean sugar exporters) and producers in which high costs could be reduced by measures to provide better infrastructure, market support, etc. In the latter, the initial stimulus of preferences has helped suppliers become established in the market. The next task, even when preferences are not being eroded, is to aid them to cut costs so that they are competitive even without a tax break in the importing state. There is a wide range of measures that could be relevant to reducing the costs of supply.

Such assistance to help developing countries deal with changes in their export markets should go beyond those created by preference erosion. There are many changes (often occurring in parallel) that happen outside a developing country and alter substantially its ability to export competitively. The changes relating to SPS illustrate the issues.

In principle SPS standards (if applied to all suppliers) should not necessarily be a particular problem for developing countries. In practice, though, four sets of problems arise from the ever-changing SPS requirements of major markets, some of which could be alleviated either through modulations to the existing trade agreements or through aid in support of trade.

The four problem areas are regulation that:

- Is inappropriate to developing country circumstances;
- Skews the distribution of gains from trade;
- Is disproportionately onerous for small exporters;
- Changes too rapidly.

There are two reasons why SPS requirements could be inappropriate: protectionism or oversight. There is little aid can do on the former, but a great deal can be done on the latter. Appropriate methods of SPS will emerge only if scientific expertise on conditions specific to developing countries is brought to bear – usually at an early stage in the formulation of rules. Such expertise is in very short supply, especially in Africa. A substantial effort of financial and technical assistance is needed.

The second and third problems are closely linked, and related to the poverty impact of trade. Problems have arisen already, for example, in relation to EU traceability requirements and regulations on pesticide residues. Whilst the big Kenyan exporters, for example, appear able to meet EU requirements, they have contributed to a sharp fall in the number of smallholders who can participate in the trade. In this case, aid could either help provide smaller producers with the technical and infrastructural support that they need to supply the 'paper trail' or help them to reorganise into export groups big enough to export seriously.

The most recent changes in EU regulations put renewed emphasis on the role of the public sector in developing countries to provide a legal and enforcement mechanism to assure that the required standards are met. Until now, 'good firms' in states with failing public SPS infrastructure have been able to export provided that they could demonstrate compliance. In future this may no longer be possible. Huge public sector investment (in the legal system, laboratories, extension, animal and plant health departments, etc.) may be needed or else a country may be excluded altogether from export to the EU.

Botswana provides an example of the substantial role that government is currently playing in the countries with good public sector infrastructure. The government of Botswana has felt obliged to introduce the tagging of cattle (because fears over bovine spongiform encephalopathy (BSE) in South Africa) in order to ensure its continued ability to meet EU veterinary requirements and its future beef exports. The cost has been put at US$30 million.

Without it, small-farmer participation in exports would have been limited. Such action, even if affordable, may be beyond government capacity in other countries.

There has been particularly rapid change in EU SPS regulations, which has created its own problems. A legitimate move towards uniform practice within the EU, it has caused concern for exporters due to the sheer speed with which events have taken place. Also of concern is the cost of meeting the inspections that are now required. On pest control, for example, it appears likely that the charge will often be a significant proportion of the value of consignments, especially in relation to small shipments. At the very least this will discourage diversification to new national markets (and the emergence of new sub-Saharan African suppliers that do not sell the quantities that Kenya has achieved).

The range of aid-supported measures to deal with such SPS issues is huge. It runs from, for example, paying for health inspectors of the importing state to be based in the ports of the exporter, to give pre-shipment clearance, to the wholesale revival of veterinary and plant health extension departments. Such supply-side measures may be required in many areas. The argument for linking them to trade preferences is that the latter could give the resultant supply a helpful boost in finding a market.

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