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Financing International Public Goods
A Framework to Address Aid for Trade

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Related ILEAP papers

ILEAP (2005). "Aid for Trade: Why and How?" ILEAP Negotiating Advisory Brief No. 10. Prepared by Dominique Njinkeu and Hugo Cameron, ILEAP.

ILEAP and German Marshall Fund (2006). "Aid for Trade After the Hong Kong Ministerial – An Introductory Text". ILEAP Background Brief No. 8. Prepared by Claire Healey, Dominique Njinkeu and Hugo Cameron.

ILEAP (2006) "The Financial Architecture of Aid for Trade". ILEAP Background Brief No. 9. Prepared by Overseas Development Institute (ODI).

ILEAP (2006). "Aid for Trade: How We Got Here, Where We Might Go". ILEAP Background Brief No. 10. Prepared by Michael J. Finger.

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ILEAP (2006). "Aid for Trade: A New Issue in the WTO". ILEAP Negotiating Advisory Brief No. 16. Prepared by Sheila Page, ODI.

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1 Introduction

Aid for Trade has rapidly emerged as an important topic for those interested in both aid and trade (see http://www.odi.org.uk/IEDG/aid4trade.html for references to the literature). It became firmly established as a concept when the World Trade Organization's (WTO) Sixth Ministerial Conference in Hong Kong in December 2005 led to the set up a Task Force on Aid for Trade.

The Task Force reported to the WTO membership in July 2006. Part C of its recommendations reads:

> 'Additional, predictable, sustainable and effective financing is fundamental for fulfilling the Aid for Trade mandate. The effectiveness of the following recommendations for operationalising Aid for Trade requires substantial additional targeted resources for trade-related programs and projects as pledged at the WTO's Hong Kong Ministerial Conference,[1] and against the background of the broader international commitment at the UN's Monterrey Conference and the G8 Summits in Gleneagles and St Petersburg to significantly scale up development assistance by 2010. The Task Force urges the Director-General to seek confirmation from donors and agencies that funds are readily available for the implementation of the Aid for Trade initiative and as part of his mandate to consult on "appropriate mechanisms to secure additional financial resources for Aid for Trade". In order to measure additionality and the adequacy of funding available to meet the Aid for Trade needs of developing countries, including those associated with a successful completion of the DDA, an account of what is being done today needs to be established as part of that process. The Task Force urges donors and agencies to provide the necessary information in order to make it possible for the Director-General to fulfil his mandate.'

Despite the laudable results of the Task Force, little is known about the precise operationalization of aid for trade. This chapter addresses the issue of 'additional targeted resources for trade-related programs and projects' from an international public goods perspective. In particular, while it is important to consult on 'appropriate mechanisms to secure additional financial resources for Aid for Trade', a key issue will also be to understand the purpose of these additional funds and how they will be allocated and spent (often a pre-condition for generating new, additional pledges).

While the literatures on aid for trade and (financing) international public goods (IPGs) have largely developed separately, linking both areas has implications for the way we think about aid for trade, both in terms of justifying the allocation of resources on trade-related programs and in terms of the financial architecture for aid for trade. In this context, it is important to differentiate between the types of trade-related projects and programs. Such projects will have different degrees of international '*publicness*' which, therefore, need different types of approaches.

[1] In Hong Kong, Japan announced spending on trade, production and distribution infrastructure of US$10 billion over three years, the US announced Aid for Trade grants of US$2.7 billion a year by 2010, and the EU and its member states announced trade-related spending of €2 billion per year (up by €600 million) by 2010.

The literature on IPGs has developed concepts, definitions and examples of activities that contribute to IPGs (Kaul, 1999; Mody and Ferroni, 2002, Kaul, 2003), and justified the use of aid to provide such IPGs on the basis that developing countries would not be in a position to supply these goods from their own resources. The aid financing literature developed the principles of aid systems (OECD Paris Declaration, Rogerson, 2005). The emphasis here is entirely on country-based aid strategies and how they are owned by the host, harmonized across donors and aligned with developing country programs, with little regard for challenges that span borders.

The current aid system is a hybrid of national aid programs, some of which contribute to IPGs and global funds. Recently, te Velde, Morrissey and Hewitt (2006) suggested that aid for financing needs to take into account the Paris aid principles[2] before aid for public goods initiatives become more entrenched in aid agencies. In contrast, this chapter will suggest that aid programming *will* have to take into account international challenges such as the development of global trade rules, which cannot necessarily be solved by fragmented and uncoordinated national aid programs.

The discussions surrounding aid for trade can be seen as useful ways to raise the importance of trade in country based development programs. Thus those interested in aid for trade and public goods need to take into account aid principles in order to get this type of aid to resonate with aid agencies. In contrast, aid agencies concentrating much of their efforts at bilateral programs need to take into account challenges posed by international public goods.

Both aid and public goods literatures have not considered individual sectors and activities, while the WTO Aid for Trade Task Force recommendations are more explicit, and deal with the 'sector' of trade. This chapter applies an IPG financing framework to the specific example of aid for trade to inform a possible aid for trade architecture. What makes this task challenging is the fact that the currently accepted definition of aid for trade is deliberately wide-ranging and does not correspond easily to what the IPG literature has so far covered in terms of health, environment, security, governance, and knowledge.

The report of the International Task Force on Global Public Goods *Meeting Global Challenges: International Cooperation in the National Interest* in September 2006 refers to the need for an Aid for Trade fund. The report argues that:

> 'the Quad members,[3] given their pre-eminence as providers of official development assistance, could also take the first clear steps [to restart the stalled WTO negotiations and strengthen the international trading system] to constitute an 'Aid for Trade' fund to compensate the poorest countries for their loss of trade preferences and support them to improve their infrastructure and develop their export capacity.'

Despite the suggestion of a new fund, the report does not address financing implications or the specific activities a fund would be focusing on.

[2] The Paris Declaration, endorsed on 2 March 2005, is an international agreement to which over one hundred Ministers, Heads of Agencies and other Senior Officials adhered and committed their countries and organizations to continue to increase efforts in harmonization, alignment and managing aid for results with a set of monitorable actions and indicators. See OECD web page, http://www.oecd.org/

[3] Canada, the EU, Japan, and the United States

The aid for trade literature has included several references to the need for the establishment of a (global) aid for trade fund, albeit for different reasons. For instance, the Millennium Project Task Force on Trade suggested the establishment of a (temporary) 'Aid for Trade Fund'. In January 2005, Page (2005) called for the establishment of a preference erosion fund. The Zedillo report (2005) recommended an aid for trade fund in August 2005. Subsequently, Joseph Stiglitz presented the idea for an aid for trade fund in February 2006 (Stiglitz and Charlton, 2006). One of the aims of this paper is to unpack these ideas and provide a basis for why certain activities would benefit from an international approach by applying an international public goods framework to the range of activities covered by aid for trade.

The structure of this chapter is as follows. Section 2 discusses key concepts in the literature on international public goods and how aid for trade relates to the aid financing of international public goods in definitional terms. Section 3 provides some practical examples of global programs that have addressed public goods-type concerns, and considers the advantages and disadvantages vis-à-vis national programs. Section 4 provides a public goods framework for conceptualizing aid for trade, suggesting that the financial architecture of aid for trade is likely to consist of a hybrid of international and national approaches. Section 5 offers some concluding reflections.

2 Financing International Public Goods

Review of key issues in literature on IPGs

Definition. A pure public good must exhibit two characteristics. First, the good must be non-excludable: i.e., once it has been provided, no one can be excluded from enjoying its benefits. As long as it is difficult or costly to exclude, private providers will not find the market attractive – they cannot exclude non-payers from deriving benefit and therefore cannot recover the costs of production. Consequently, there is a role for the public sector in providing the good. Second, the good must be non-rival in consumption: consumption by one person does not prevent somebody else consuming the same amount, therefore extending consumption to more users creates benefits for zero marginal costs. As the private sector would under-supply a non-rival good, there is a role for the public sector to increase its provision.

In practice, most goods are impure public goods, as they exhibit neither of the two characteristic completely. For example, a road is, in principle, non-rival, but access to a road is rival or excludable if the road is congested or if it is a toll road. Developing a rules-based system is another example. The benefit of global rules is both non-rival and non-excludable. However, the method of providing the public good may be both rival and excludable (e.g. if private consultancies would be contracted to draft trade rules). The discussion about public goods and providing them is, therefore, often one about degree of excludability and rivalry.

Reflecting these practical difficulties, different researchers use different definitions. The UNDP approach is quite broad, using the concept of global public goods to encompass a broad range of development activities (Kaul et al., 1999, 2003). Other researchers use narrower definitions of what constitutes a global public good (Kanbur et al., 1999; Ferroni and Mody, 2002).

Spillover range. Traditional discussions on public goods were national in scope, e.g. provision of national security by the government within its borders. However, the spillover or spatial range can extend from the local to the global level, such that we can distinguish between national and international public goods. The term 'international public good' is used when the benefits of a good extend beyond national boundaries. Conversely, a national public good (NPG) is one where the benefits are enjoyed mainly within national borders. NPGs may be needed to contribute to providing the associated IPG. For example, to provide the IPG for eliminating a contagious disease, each country must have a health system in place, or an NPG, to administer the cure or prevention.

Within international public goods, one can distinguish between truly global and regional public goods. A significant part of the literature covers regional public goods (Arce and Sandler, 2002; Ferroni, 2002). The regional reach of the spillovers depends on a host of factors, and contiguity of countries and area is not a precondition (e.g. in the case of preferential trade rules). However, often a public good is regional precisely because its neighbors are affected by the provision of the public good. For some issues, a regional spillover range is more likely than global.

The World Bank (2001) distinguishes further between core and complementary activities associated with the provision of IPGs. Core activities aim to produce international public goods. Complementary activities, in turn, prepare countries to consume the international public goods that core activities make available – while at the same time creating valuable national public goods (World Bank, 2001). Core refers to the provision of the global benefit or, in other words, the production of the IPG. Similarly, a core activity helps to provide NPGs, which is complementary to providing IPGs. Complementary refers to helping in providing the good or assisting in the ability to derive a benefit from the presence of the public good.

Options to provide IPGs

The general rule is that public goods will not be supplied in the optimal quantity when supply is left to the market alone. This does not mean that the public sector must supply the good itself, but it could intervene to correct market prices and hence provision, including through setting rules and regulation to reach a socially more optimal supply. In general, if non-excludability is the core feature of the good, direct public provision may be the most effective solution. If, however, non-rivalry is the core feature, public intervention would help to increase the level of private provision. In both cases, it could require public provision using public financial resources.

Morrissey and te Velde (2005) distinguish three levels of intervention. First, there is *direct provision* when the government finances and provides the good, usually financed by taxes. Security public goods are typically provided directly, with perhaps some private sector involvement. Activities with significant positive externalities, where provision is excludable, and rival because of congestion, typically have public and private provision. Examples include infrastructure, e.g. toll roads (rival and excludable) and telecommunication or broadcasting services (non-rival but excludable using scrambling). Part of the externalities derive from the fact that new infrastructure reduces congestion on older ones, but generally if one firm helps to build a road others would benefit as well.

Second, public goods can be provided by *regulation or agency*, at the national or international level. In practice, this is related to governance, as an agency or regulatory body undertakes the intervention. Many of the market failures associated with economic development can be addressed through agencies that, in doing so, provide a public good. Agencies coordinating training or providing information on adopting technologies are examples. As in the case of direct provision, the agency is usually publicly financed. However, charges, at a subsidized rate, can be levied for the service provided so that costs are shared. For example, the International Trade Centre charges for its services.

Third, public goods can be supplied by altering the price or cost of production, either through taxes or subsidies. The intervention could be made by an agency or a direct public provider. Subsidies can encourage activities with positive externalities with regard to health or education, or for adopting cleaner technologies, while taxes could discourage activities with negative externalities associated with polluters.

These three levels of intervention may apply to both IPGs and NPGs. Since international agencies such as the WTO play a coordination and monitoring role at the global level, one could consider such agencies as direct *providers* of governance IPGs. However, the institutions themselves are not public goods. International bodies are required to coordinate the provision of the core IPG, and have a role in assisting national providers of complementary NPGs. It does not necessarily require an international body to provide the IPG. For example, national or international trade research centers are, in principle, equally competent to deliver knowledge, but the latter may be better able to benefit from research economies of scale. It is important to coordinate national programs related to the provision of some IPGs, for example in the case of knowledge public goods related to trade policy research, so single countries do not need to reinvent the wheel of trade policy research.

The literature on financing the provision of IPGs is complex (Sandler, 2002), and depends on such issues as the aggregation of technology for the provision of public goods. Some international public goods can best be provided at the point of the weakest link, such as polio eradication in those few countries doing the least about it, but which are crucial in the fight against a communicable disease. Some countries will derive more benefits from provision than others. An effective multilateral trading system and national trade development contribute to global economic stability, but this is likely to benefit some countries more than others (including differential benefits for those that are or are not committed to the rules). The poorest countries tend to be the most unstable, both politically and economically, with relatively low levels of capacity, and are least able to pay. For these reasons, financing IPGs is often justified in terms of aid allocations by rich countries to poor countries (te Velde et al., 2002). It would also justify grants rather than loans. In addition, it would not be easy to provide loans to regional bodies - and most financing instruments and loans are at national not international level (World Bank, 2006).

The private sector can support the financing of public goods. The principal source of private sector contributions is charitable organizations such as the large Bill and Melinda Gates Foundation on health, the Ford Foundation on research, or World Wildlife Fund on environmental issues. Another factor that can increase the role of the private sector is the focus on corporate social responsibility (CSR) in corporations, which initially included voluntary contributions and community investment. There are movements to put CSR into practice including by promoting socially and environmentally responsible behavior by corporations.

Mapping Aid for Trade activities onto the provision of international public goods

The Aid for Trade Task Force suggested that the scope of aid for trade includes support for the following activities:

- trade policy and regulations,
- trade development,
- trade-related infrastructure,
- building productive capacity,
- trade-related adjustment, and
- other trade-related needs.

Public goods use a different classification, and are normally divided into the following (World Bank, 2001):

- governance,
- knowledge,
- health,
- security and
- environment.

There are several links between the two types of categories. Aid for trade activities can contribute to the provision of public goods, but not all categories do. Projects in one aid for trade category may contribute to the provision of different types of public goods (i.e. once provided are close to being non-rival and non-excludable), or none at all. While several activities have externalities that cross borders, this does not necessarily mean they contribute to public goods.

A simple mapping of individual activities is as follows (summarized in Table 1, below). Activities contained in *trade policy and regulations* contribute to governance IPGs in the area of establishing global trade rules. The benefits from trade rules may confer "benefits" to countries even if they are not directly part of a trade rules agreement it, although the utility derived from those trade rules will not be the same across all countries. Activities in this category can also contribute to knowledge IPGs – support for trade policy impact assessments, for instance. NPGs, on the other hand, would benefit from international expertise and coordination. Activities contained in *trade development* contribute to knowledge NPGs, insofar as they relate to knowledge activities to support trade development. *Trade-related infrastructure* activities do not provide pure public goods, since they are often rival (toll roads) and excludable (through scrambling). The building of *productive capacity* can feature externalities and the provisions of knowledge public goods (IPGs and NPGs), for instance through raising the level of knowledge of technological development and adoption. *Trade-related adjustment* activities are not further specified, though certain adjustment measures could contribute to the provision of public goods, depending on how it is spent. *Other trade-related needs* are also not specified.

Table 1 Mapping Aid for Trade and IPG classifications

Task Force classification of Aid for Trade	GPG classification
Trade policy and regulations	**Governance IPGs** in the area of establishing global trade rules. **Knowledge IPGs** (e.g. trade policy analyses would benefit from international expertise and coordination).
Trade development	**Knowledge NPG** when related to knowledge activities to support trade development.
Trade-related infrastructure	These activities do not provide pure public goods, and are often rival and excludable.
Building productive capacity	Features externalities and the provision of **knowledge public goods** (**IPGs and NPGs**), e.g. by raising the level of knowledge on technological development.
Trade-related adjustment	Not specified
Other trade-related needs.	Not specified

Aid for trade activities fall into at least three different categories with varying public goods aspects: 1) knowledge international and national public goods, 2) governance international and national public goods; and 3) international or national provision of infrastructure. This will have implications for operationalizing aid for trade, particularly if an issues-based, public goods approach of aid financing will be prevalent.

There is another, more general point. One could regard all of these activities as required to secure progress on the development of global trade rules and that all activities contribute to the provision of international governance public goods. There is a further argument to regard the discussions on aid for trade as international knowledge public goods. The discussions themselves raise the profile and knowledge of trade issues. This is helpful in at least two ways: (i) for aid agencies to understand the importance of trade and hence aid for trade; and (ii) for developing countries to act strategically about trade in the economy and trade in country assistance programs, such as national and regional indicative programs between the EU and ACP countries (see chapter by Sunassee in this volume). As such, a global forum to discuss trade issues can inform national development programs, which may otherwise not sufficiently take global challenges into account.

Table 2 provides a public goods lens of aid for trade activities, by core and complementary activities. This is useful for designing a strategy and the appropriate role of government and the international community in supporting trade in developing countries. One could consider the core activity as the aim of policy or the objective to which an organization contributes. Core activities are those that are directly required to provide the public good, whereas complementary activities are those that contribute to the production and facilitate the consumption of the public good. For instance, the core is knowledge on trade policy. Specifically, under knowledge it is shown as policy research and under governance it is shown as policy coordination on trade policy. The core activity is able to provide the public good only if the complementary activities are undertaken, ensuring that full benefits are derived from the public good. Complementary activities that are needed to produce research include training, statistics and a conducive research environment, while complementary

consumption activities include education and dissemination or transfer of information and experience, so the research results can be used.

Table 2 Providing public goods for trade and development – examples by activity

Public goods sector and spatial range	**Core activity**	**Complementary activity**	
	Provision of public goods	*Production of public goods*	*Consumption and utilization of public goods*
KNOWLEDGE Research, transfer, dissemination, skills	Policy research	Research and knowledge transfer; training	Facilitating and disseminating
International	Trade policy research	Policy development Statistics, evidence Training provision	Policy transfer, advice and experience.
National	Analysis to support trade in services	Policy development National statistics Training	Disseminating local advice and providing support to be receptive to new knowledge.
GOVERNANCE Regulation and coordination	Policy coherence and global trade rules	Institutions (e.g. WTO)	Implementation of trade rules
International	Coordinating research, policy and rules setting	Research and policy networks,	Support for adapting and adopting research and policy
National	Adapting and coordinating policy and research	Policy and research agencies, National Export Promotion Agencies, Regulatory agencies	Support for adapting and adopting research and policy

Source: Adapted from Morrissey and te Velde (2005)

Aid financing of Aid for Trade and public goods: how much?

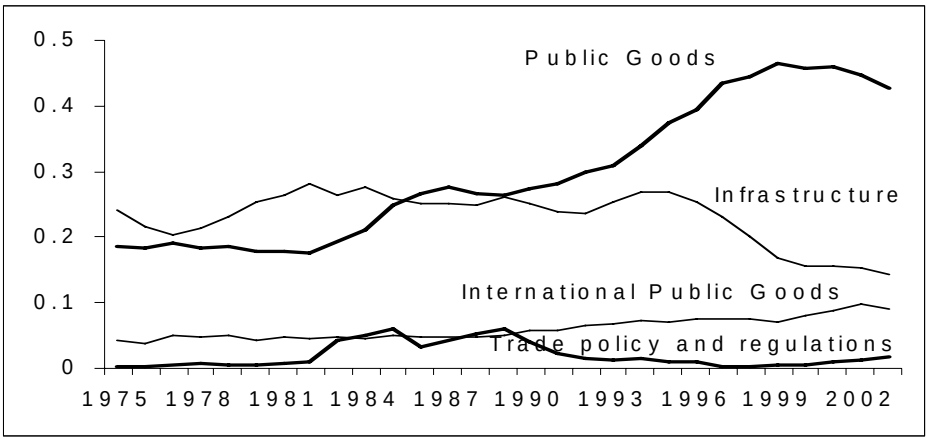
There have been several estimates of how much aid is already going to aid for trade (see Calì et al., 2006) and how much aid is used to provide IPGs. The share of aid allocated to IPGs has risen since the early 1980s (see Raffer, 1998, GDF, 2001, te Velde et al., 2002 for the first estimates). Te Velde et al. (2002) estimate the share of aid allocated to IPGs and NPGs – in total and by individual donors – since the 1980s, and show that by the late 1990s donors allocated at least 10 percent of aid to IPGs and 30 percent to NPGs. They also show that using CRS (OECD Creditor Reporting System) data may underestimate the share of aid allocated to IPGs by some 50 percent, so one can assume that 15–20 percent of aid by bilateral donors in the late 1990s was allocated to providing IPGs.

Chart 1 presents new evidence on the share of aid going to different spending categories. Using public good definitions as in te Velde et al. (2002), it shows that there was a doubling

in the share of aid allocated to financing public goods over the past two decades, and this has been broadly true for both IPGs and NPGs. There was a marked increase in aid commitments in 2003 in all categories (IPGs, NPGs, other aid), but while the share of IPGs in aid increased, the share of NPGs in aid actually declined. This is in part due to the boost in aid due to debt relief and spending on infrastructure (Chart 2). According to these data, aid for trade policy and regulations was much higher (in percentage terms) in the 1980s than presently. This is an interesting finding, given that the OECD/WTO trade related technical assistance (TRTA) database has recorded data only over the past few years (though we need to acknowledge that measurement and definitions may have changed).

In the past two decades, increased aid spending on public goods has been undertaken at the expense of other types of aid spending.[4] Some of these other types of spending may be desirable in their own right (e.g. schemes targeted directly at poverty reduction) or may generate externalities and benefits that contribute to growth and development, e.g. capital infrastructure projects excluded from the definition of public goods. Chart 2 shows that aid going to 'economic infrastructure' stabilized in the 2000s after decreases in the 1990s, but increased in the last few years.

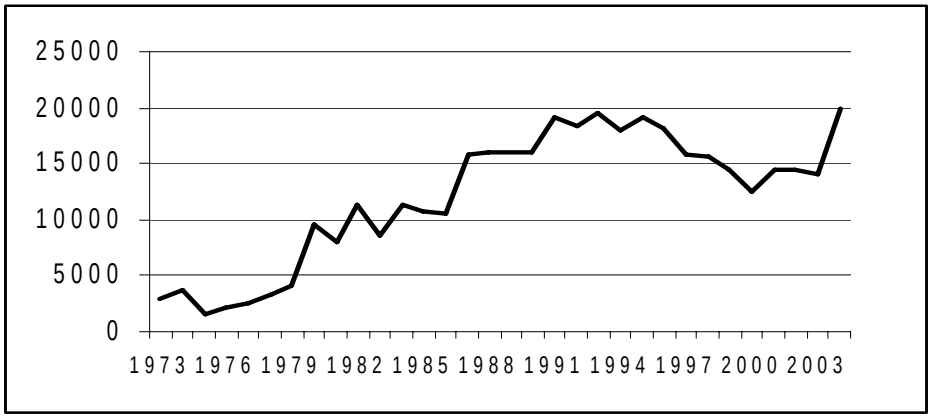
Chart 1 The share of aid to public goods (all, international), infrastructure and trade policy (last 3yr average)



Source: OECD CRS (commitments)

[4] Primarily because total aid spending did not increase much – of course this has changed dramatically more recently.

Chart 2 Aid to infrastructure (mn USD)



Source: OECD CRS (disbursements)

3 Examples of past financing mechanisms relevant to Aid for Trade

The purpose of this section is to review a number of funds, multilateral and bilateral, general and specific (or 'vertical') trade- and non-trade-related, that have been created mostly on the recent decasde, see the long version of Calì et al. (2006).[5] This is done in order to analyze their advantages and disadvantages, and determine whether the fund or the experience derived from it can be applied to designing the architecture for aid for trade. The information in this section is based on a common set of criteria, including basic facts about the funds as well as their general effectiveness and relevance to aid for trade. The long version is included in This section will summarize the relevance of each fund to aid for trade.

We focus on bilateral, regional and multilateral funds. However, national aid programs can also be useful in delivering international public goods. For instance, we discuss the role of national indicative programs in trade-related assistance that the EC has put in place in discussion with African, Caribbean and Pacific (ACP) countries. Poverty reduction strategies are another way, though we know that trade is not sufficiently included in Poverty Reduction Strategy Papers (PRSPs) – see Box 1 on recent comments on this by multilateral agencies, and Hewitt and Gillson (2003) on the trade content of first-generation PRSPs and Prowse (2006) on weaknesses of trade ministries in developing countries behind this.

[5] The long version containing additional information has been compiled mainly by Lauren Phillips and Sven Grimm; the discussion on the relevance of funds to aid for trade discussions owes much to Sheila Page. This section adds an assessment of which type of public good each fund might contribute to.

Box 1 Trade and PRSPs: Selected submissions to the Aid for Trade Task Force

One set of questions raised in Aid for Trade Task Force submissions concerns the trade content of PRSPs: Has trade been adequately addressed in countries' development plans and poverty reduction strategies? If not, what are the main reasons and how could this be corrected? What are the lessons learned?

World Bank
Focus on trade is correlated to focus on growth in PRSPs; however, trade strategies are not operational because of lack of capacity and intra-ministry coordination. The enhanced IF should be undertaken at the same time as the PRSP to maximize results.

ITC
No, for three reasons: links between trade, development and poverty reduction have not been proven to national policy makers (economic vs. social goals); lack of link between development programs and trade expertise; insufficient awareness of trade opportunities for small and medium enterprises.

IMF
Focus on trade is correlated to focus on growth in PRSPs; however, trade strategies are not operational. Diagnostic Trade Integration Studies (DTIS) can have a positive impact on the quality of the trade information included.

UNIDO
Have not incorporated trade sufficiently, in part because donor agencies have a hard time justifying aid for private sector development.

UNCTAD
Needs to be better integrated into development strategies. Lack of capacity to articulate in-country trade policy formulation. The Integrated Framework should be linked to national development strategy.

UNDP
Shortcoming with the analytical approach – there are projections but no follow through with trade strategies. These are more short term than long term strategies.

Source: WTO. For a summary of aid for trade positions see summary compiled by Lauren Phillips: http://www.odi.org.uk/IEDG/Projects/Aid4trade_files/aid_for_trade_multilat_orgs_views.pdf

Multilateral

The Integrated Framework (IF) is relevant to aid for trade because an enhanced IF can be considered to be part of aid for trade. Its diagnostic trade integration studies can only identify needs, not meet them, so it contributes to a knowledge public good. There has been criticism that it is highly administration-intensive for little or no return, and reduces the interest of potential recipients in participating in it, thus weakening its status (in aid policy terms) as a country-led program based on countries' own identification of needs. Its limited funding makes it unlikely that it will go beyond funding for studies to actually implementing what the studies recommend for LDCs (see Box 2).

The Joint integrated Technical Assistance Programme (JITAP) is also highly relevant to aid for trade, but like the IF is small in scale. Its size effectively restricts it to small projects, particularly capacity building, and hence contributes to a governance IPG.

WTO technical assistance is a form of aid for trade, though the initiative has a small budget and is primarily designed to do training-type activities. The present structure, based on unbound contributions from member countries, could not be massively scaled up and there is no capacity to determine needs for trade-related supply-side assistance (based on demand for training courses). It has a direct link with articles in WTO agreements calling for greater assistance in implementing trade agreements. It has been criticized by recipients because its

relationship to the WTO means that it is not able to offer advice on how to minimize compliance with WTO rules. The fund contributes to a governance IPG.

The United Nations Conference on Trade and Development (UNCTAD) is the organization with the longest history of relating trade to development and major current capacity building functions. It may also offer evidence on how to ensure that developing countries participate actively and believe that they are involved in making decisions. UNCTAD is mainly an implementing agency, so it provides technical cooperation on the basis of projects planned by donors. The main areas of activities are in trade policy and regulations.

The International Trade Centre (ITC) offers trade-related aid. The main areas of intervention are concentrated in trade development and business participation in the global trading system. The ITC has developed a role related to global products and networking of trade support institutions that is complementary to the *trade development* trade-related technical assistance of the bilateral donors who support larger projects in developing and transition economies. Some of these activities fall under knowledge national and international public goods.

The Trade Integration Mechanism (TIM) of the IMF is close to the aid for trade concept in its purpose, and type of analysis of needs for adjustment. It was established explicitly to deal with preference erosion, as implementation of the commitments made by the IMF and the World Bank before and at the WTO Cancún Ministerial 10-14 September 2003. It is the clearest recognition by an international agency outside the WTO that there is a legitimate aid problem as a consequence of WTO obligations. The facility offers loans not grants. It is impossible to say what the ultimate aims of the funds would be.

The World Bank's Highly Indebted Poor Country (HIPC) initiative is an example of how funds can be allocated to some broad areas (e.g. education, health), but not to specific initiatives. Governments have to decide on priorities within these sectors, which is considered less distorting than narrower funds.

Box 2 The Integrated Framework

The Integrated Framework is one possible example of how the aid for trade architecture might look. However, in order to fit the criteria for an aid for trade fund, the IF would have to be empowered to provide funding of its own, separate from other lending and aid processes. This has started to a limited extent with the creation of an IF Trust Fund. This is for trade, so it is an example of a trade-specific fund. It is relevant to the Broad types of aid for trade, but it can only identify needs through its diagnostic trade integration studies, not meet them. It has not been able to solve the problem of ensuring that the commitment in principle to meet identified needs is translated into actual aid flows, and has instead focused on mainstreaming trade in PRSPs on the basis of DTISs, which unfortunately have often come later than PRSPs. This, in turn, has given rise to criticism that the IF is highly administration-intensive for little or no return, and reduced the interest of potential recipients in participating in it, thus weakening its status (in aid policy terms) as a country-led program based on country's own identification of needs.

Recent attempts to enhance the IF in the context of aid for trade have resulted in three broad changes: (i) the establishment of an Integrated Framework Steering Committee; (ii) a group to help coordinate donors (the IF Working Group); and (iii) the establishment of an IF Trust Fund which would give the mechanism its own funding and encouragement of improved coordination amongst donors in trade policy.

LDCs do not want the Integrated Framework extended to non-LDCs because it provides a very limited amount of money. It is not a suitable model for Narrow aid for trade because its main purpose is to identify countries' needs (through the Diagnostic studies), and Narrow needs are already identified. It is unlikely to be a model for Broad because the funding is only sufficient for the studies, not for implementing what the studies recommend. Do non-LDCs need a diagnostic process? There may be elements of its administration which can be copied by the agencies which will need to design programs to spend the aid for trade money.

It could be related to aid for trade: If the DTIS process has already identified projects under IF, then Broad Aid for Trade may be able to start from these. Several WTO papers suggested the IF infrastructure as a vehicle to access aid for trade funds.

Source: Cali *et al.* (2006).

The Standards and Trade Development Facility (STDF) is an example of program (run by the WTO), created to tackle one of the main non-tariff barriers to developing countries' access to developed regions' markets: meeting and implementing international sanitary and phytosanitary standards (SPS).

The Global Environmental Fund (GEF) is an example of a fund established to meet international objectives outside the normal scope of national aid programs. It contributes to the provision of environmental public goods.

The Montreal Protocol Fund is an example of a vertical fund which was established (after widespread consensus about the causes and effects of the issues addressed) to implement an international agreement which imposes obligations on developing countries, outside normal national aid programs. It contributes to the provision of environmental public goods.

Global Fund to Fight Aids, Tuberculosis and Malaria is an example of a fund established because some donors felt that a specific need was not being met as part of normal aid programs. There is criticism that even where a country had a health plan that was well costed, but not funded, donors came in and over-funded spending on AIDS, while everything else was under-funded. The Global Fund is quite different from other vertical funds reviewed in this section as it disburses money through a competitive proposal process. It contributes to the provision of health public goods.

Global Alliance for Vaccines and Immunisation (GAVI) is an example of a vertical fund established to meet a need identified outside the aid community, but not one that is the result of an international convention. It contributes to the provision of health public goods.

The Consultative Group on International Agricultural Research (CGIAR) is a research network with very flexible funding for members, as they determine the level of earmarking. It is potentially a pick-and-choose approach to a (research) menu set by the institutions. It is not quite clear how the funding covers all institutes, but it seems there are preferred partners to some. It contributes to the provision of knowledge public goods.

Regional

A particularly interesting example is the trilateral scheme by the Inter-American Development Bank, the UN Economic Commission for Latin America and the Caribbean and the Organization of American States to provide Latin American and Caribbean countries with assistance for negotiations and for regional integration. This was initially only for FTAA negotiations, but was subsequently extended to others. If meeting regional needs is one of the 'gaps' identified, there could be a role for regional organizations. The range of programs has allowed the IDB to provide support to all the types of trade needs identified here, and it is one of the few multilateral donors with a regional focus.

In the European Cohesion and Structural Funds, the funding rules are relatively straight forward, country ownership and planning is required. This might be due to the relatively recent date of establishment.

Bilateral schemes

The EU-ACP Project Management Unit could be a precedent for country-by-country identification of costs of adjustment to an agreement. It is like the IF, with its DTISs, in identifying needs, but the methods and criteria include some similar to those used by TIM to calculate transition costs of liberalization. There is no commitment by any donor to supply additional money to meet identified costs, but as the studies are to be completed before the end of the negotiations, countries have the option of not signing an Economic Partnership Agreement if the costs are too high and are not met. Although it is bilateral and funded by a donor which is also the relevant trader, the organization has been implemented in a way that ensures that country assessments are not seen by the EC. It contributes to the provision of knowledge public goods.

The EU special fund for rum was intended to help a sector damaged by trade reform in the EU. It was unusual in its direct assistance to the private sector. It attracted a high degree of regional ownership (private sector) and because of this showed some success. It was transitional and ended after its scheduled end date.

The EU special framework for assistance for bananas is an example of an assistance program designed to meet the costs of countries that are damaged by trade reforms which could assist other developing countries. It demonstrates the potential difficulties of choosing the most appropriate means of adjustment. Initially, the Commission specified that funds be used for investments in the affected industry and, later, insisted on diversification. The low share of assistance funds spent on diversification has been raised as an important factor in the low levels of growth experienced in traditional ACP banana-producing countries, despite

substantial financing. The Commission and member states explicitly cited the precedent of the banana program as an example of a badly designed program. A major failure has been its tendency to support banana production in those countries that have limited potential to become competitive. It will not have contributed to the provision of public goods.

The EU Action Plan for Sugar, which from the beginning allowed for adjustment through increasing productivity, finding related production, or a total change in production thus attempted to avoid the problems of the banana scheme. Like the rum and banana schemes, it is an example of aid to provide adjustment assistance for countries which suffer losses because of trade reforms. It is an interesting precedent because it solves the problem that compensating the ACP for changes in European sugar policy is treated differently from aid by giving it a separate budget line additional to the European Development Fund (EDF) (see te Velde *et al*., 2006); it uses grants, and it bases eligibility on adjustment needs, not on need for infrastructure.

The Proinvest scheme for ACP countries provides direct support for the private sector and for intermediary organizations. The mechanism interacts with the private sector. Support may consist of a technical or financial diagnostic study of the enterprise, market surveys, feasibility studies, partner searches, financial forecasts for a project, assistance for project implementation, marketing assistance, training of enterprise staff, training of enterprise management, or other technical assistance. The scheme also finances financial intermediaries, such as investment promotion agencies and might as such contribute to the provision of governance public goods.

Other EU trade-related assistance is part of regional and country programs when the EC and partner countries have decided this as a priority. The ACP programs (through EDF) tend to be programs through National (such as Namibia, Kenya, Zambia, Ethiopia, Jamaica, Suriname, Dominican Republic, Rwanda, Ghana) or Regional Indicative Programs where trade and development or regional integration is a priority, or All-ACP programs. The interpretation of Aid for Trade by the EC is a fairly broad one, encompassing assistance to individual companies and institutions but also sectors, national governments and regions (the trade component in RIPs can be much higher than 50%).

Trade assistance under USAID is an example of a bilateral program which has grown as new areas were identified. It has combined general support with specific assistance in taking advantage of US trade programs such as the African Growth and Opportunity Act (AGOA). It has assisted both the public and the private sectors. African private sectors have found it more active and more useful than programs from other trade partners in helping them to access trade preference schemes. It has provided extensive support to ministries in their trade work. The US Millennium Challenge Account is an example of a growth/trade-related vertical fund that has emerged alongside traditional aid (USAID) programs.

Conclusion

This section has covered a number of vertical initiatives, both trade- and non-trade related, some of which address the provision of (international) public goods. Funds differ not only in terms of purpose, but also in terms of eligibility criteria and geographic implementation. Some funds have emerged out of specific concerns, e.g. the Montreal Protocol which addresses greenhouse gases and the Sugar Action Plan which provides payments to ACP Sugar Protocol countries that need to adjust after sugar sector reform. Others are more

general, e.g. the Millennium Challenge Corporation (MCC) focuses on growth and poverty reduction. This corresponds well to the discussions on aid for trade, with different solutions for different components of the spectrum covered by aid for trade.

There are quite a few funds that address the type of trade measures required at the national level (IF, part of EC TRA, JITAP, etc.), and this contributes to national knowledge public goods. However, far fewer programs address regional constraints or supply-side constraints directly (though the MCC could do some) or implementation costs of trade agreements (though current WTO assistance might fit with this, and so does the EC Sugar Action Plan for adjustment away from preferences). Indeed, reviews of PRSPs uncover very few direct regional links. Thus, there are significant gaps that the debate on aid for trade can address, in particular in relation to governance and knowledge public goods. Provided, of course, that budgeting procedures allow for the set-up of such funds (te Velde *et al*., 2006 discuss the budgeting difficulties that the European Parliament has in financing aid for trade programs).

The funds have very different ways of operating. Some take time to come to fruition, while other can do so more quickly. EC procedures tend to be slow, while bilateral funders tend to be faster. The EC has much of its TRA integrated in country programs (through country strategy papers), while for others this seems less the case (e.g. MCC, GAVI). But the disadvantage of this approach is that it is difficult to secure quick and targeted disbursement for immediate trade or supply needs if developing countries wanted this.

In some instances, vertical funds are well placed to deal with important (global and specific) issues. First, they may help to focus attention to important issues (e.g. the implementation of the Montreal Protocol, or the current adjustment to sugar sector reform, and indeed lack of trade support generally). There might be some rigidity and potential distortion of vertical funds, but where an issue has been neglected by donors, imposing rigidity and reversing past distortions may be required. In the case of the Montreal Protocol, quick agreement was found to fund a specific problem, the elimination of certain greenhouse gases according to certain timetables and based on national implementation programs. It also shows that global initiatives that contribute to international public goods are required to inform national programs.

Second, some issues require global coordination and involvement of a pool of expertise. For instance, research (and the CGIAR) is often seen to benefit from economies of scale. UNCTAD relies on expertise in the area of trade negotiations, the Global Fund relies on health expertise to create breakthroughs in the area of vaccines. The GAVI approach is helpful in bringing funders and private sector expertise together.

Any conclusions on the merits of different aid architectures must be seen in the context of the most important lesson from work on aid, which is that good plans and participation by recipient governments are the most important determinants of what works. It may be that a compromise between special funds and general assistance is to ensure that the special funds have broad aims (e.g. HIPC) and align their rules with the government and with other programs (e.g. common rules for government procurement). There are high risks and high benefits from budget support. One example of such a compromise is the Sector Wide Approach (SWAp). A SWAp is a process where donors give significant funding to a government’s comprehensive sector policy and expenditure program. A SWAp tends to have a joint review mechanism and performance monitoring system relying on the government's own performance assessment framework. It might be a means to ensure increased aid to a

sector, improve coordination in-country and making aid less fungible by setting clear sectoral programs but it should not lead to additional administrative requirements.

The SWAp is normally a hybrid of funding forms (Foster and Leahy, 2001). At one extreme it involves sector budget support when implementation and accountability concerns are being met. Where weaknesses exist, financing may be more mixed in the form of funds earmarked for specific purposes or project support – some of this could come from vertical funds. In practice, sector programs (and thus SWAps) have centered around lead implementation ministries, while it has been more difficult to fund activities that involve other ministries or NGOs or the private sector. This has implications for the debate on aid for trade, where the different categories need several SWAps; the broad definition of aid for trade has the challenge that it includes too many things: capacity building, infrastructure, private sector development, etc.

4 A public goods framework to address Aid for Trade

While a disadvantage of any framework is that one has to frame a complex issue with a sometimes arbitrary starting point, an advantage is that it provides a clear structure by separating out key issues. In this particular instance, we take various elements in the aid for trade discussion and then consider how these elements can best be provided. This can then be compared with the current situation and address gaps.

A framework to address the provision of aid for trade is based on four general questions:

1. *What is the rationale for providing the good in terms of its publicness?*

It is important to classify the activities under discussion by their degree of publicness. The more public good aspects an activity has, the less likely it is that a private firm can be solely responsible for providing it, because of the reasons given in Section 2. On the other hand, a public body may provide a private good, but needs a justification for why it does not let the private market take its place.

2. *How does the provision of public goods link in with development?*

Both public and private goods can contribute to development by overcoming market failures. Not all market failures require the provision of public goods, and other types of government interventions include the use of taxes and subsidies and setting of rules and standards. Section 2 argues that many market failures are most appropriately addressed through tax and subsidy policies – 'correcting' incentive distortions – or specific regulatory measures, rather than that providing a public good is necessary to address a specific market failure.

While public goods by definition benefit everybody, because everybody has the chance to consume the same public goods, it does not follow that certain groups or the country as a whole benefit in terms of economic development. The provision of public goods will have different effects in different areas.

Table 3 provides a mapping of how certain public goods may address challenges linked to economic development. Practical cost-benefit analyses and other impact studies will need to

accompany such theoretical mappings (the Copenhagen Consensus[6] in one such approach, though some will question the outcomes).

Table 3 Trade development, market failures and responses

Type (sources of failure)	Examples of market failures	Responses: policies and activities	Relevant aid for trade public goods
Coordination	Externalities ignored Linkages not exploited No policy coherence Complementarities	Capacity building for trade policy to identify linkages and externalities National trade strategy	Governance Knowledge
Technology Developing, adapting and adopting	Incomplete and imperfect information Network externalities	Promoting technology transfer and adoption Support for standardization and quality control	Knowledge
Skills formation	Externalities (in training workers) Imperfect information	Coordinate and/or subsidies for training	Knowledge
Capital markets Access to finance	Rationing and/or high interest rates	Micro-credit schemes or formal sector subsidy based on rational information about borrowers.	Knowledge

Source: Adapted from te Velde and Morrissey (2005).

3. What are the current gaps in the provision of the good?

Theoretically, public goods are underprovided. From a public point of view it is important to understand the gap to see by how much. Assessing this is not straightforward, as this depends on comparing what is already provided with what is needed in an optimal situation, which is difficult to obtain from interviews with key stakeholders alone.

4. What are the financing mechanisms to address the gaps (country programs, regional and global initiatives)?

First we need to establish the case for aid, and secondly the type of aid mechanism. There are three building blocks underpinning the case for aid financing of IPGs. First, the private sector will not provide a sufficient amount of public goods, as it will consider private rather than social benefits. This calls for some public sector engagement. Second, individual countries have insufficient incentives to make an optimal contribution to IPGs, given that not all benefits accrue nationally. This calls for a form of cooperation between countries. Finally, poor countries lack the resources to make a full contribution to the provision of IPGs. This justifies aid finance of IPGs in poor countries (te Velde, 2002; Mascarenhas and Sandler, 2004).

[6] See the project sponsored by the Economist and Bjorn Lomborg, http://www.copenhagenconsensus.com/Default.aspx?ID=158

However, the argument is more complex in practice. In particular, the following three issues are important. First, aid financing does not necessarily imply implementation or actual provision by donor agencies. Coordination with and sub-contracting to other actors, e.g. the private sector, can be part of providing the public good. Second, even if a pure public good could be identified, it is difficult to verify what the exact current contribution is to the provision of the good or how much the good is underprovided. Finally, there are several sources of financing IPGs. For instance, there are proposals for a Tobin tax on currency flows, an air travel tax, a carbon tax on carbon dioxide emissions, all of which can raise finance for the provision of IPGs. But there are also other, existing sources of finance, such as regular contributions by the private sector, donations by private firms, NGOs and charities, in addition to national sources.

With all the discussion on the need for finance, there remains very little on how exactly the funds would be collected and disbursed. National programs are funded through PRSP exercises or EDF cooperation cycles between the EU and ACP countries. But it is different for global causes. The International Finance Facility proposed by the UK (and operational in the area of health) is one example of how funds could be raised from the capital markets and of frontloading aid on the basis of long-term commitments. There are also certain public-private groups that work together to fund development of vaccines.

The aid architecture is changing and has to deal with major increases in aid over the coming few years, which raises questions about the effectiveness of aid, including issues such as harmonization, alignment and ownership (Rocha Menocal, Maxwell, and Rogerson, 2006). It has also has to deal with an increasing number of new initiatives and a large number of institutions providing IPGs. This raises questions as to the general setup of donor agencies, departments, organizations, and the benefits for these vis-à-vis national programs.

The OECD Development Assistance Committee with donor and aid recipients agreed at a High Level Forum in Paris in 2005 to reform the delivery of official development assistance to make it become a less competitive and self-interested flow of public resources and more a system of delivery of aid.[7] It is not clear how the Paris reforms would deal with global challenges (e.g. in terms of allocating aid across issues and countries), though clearly these have become more important (Kaul and Conceição, 2006). The proliferation of special funds may, unless genuinely additional (as aimed for in the aid for trade debate), divert real resources from other genuine development priorities, thereby harming or hampering the delivery of real IPGs. There is also the issue of substitution, whereby donors may sometimes claim IPG status in their development spending for activities which are not. Some argue that the same increase in aid (as currently planned) has never been promised to so many different causes.

Applying the public goods framework to Aid for Trade activities

This section covers these questions in relation to the components of aid for trade, and is summarized in Table 4. Two public goods are relevant; governance in the form of a global system of trade rules and knowledge nationally in the form of impact assessments and trade development studies and internationally in the form of awareness raising. Infrastructure is not a pure public good.

[7] Increasingly, support for social sector improvements having direct impact on the poor (and even the funding of their recurrent costs) have become the leading motive of post-debt relief assistance given to poor countries, even at the expense of support for economic development.

Some aid for trade activities will be more relevant for development than others. Infrastructure plays a key role. There is also evidence on the effects of knowledge and governance public goods.

The gaps are massive and clearest for infrastructure, but also significant for governance and knowledge activities contained in aid for trade. The gaps are less in diagnostics of national constraints to trade, and more in the area of regional constraints, and impact assessments of changes to trade rules, and follow-up. Importantly, there are still gaps in awareness-raising at a global regional and national level.

Table 4 A public goods framework for financing Aid for Trade activities

	Aid for Trade activities		
	Governance	*Knowledge*	*Infrastructure*
1. Rationale for the provision in public good terms (non-rivalry; non-excludability)	Global trade rules contribute to the provision of governance IPGs ad require global approaches	Impact assessment studies, trade policy analysis contribute to knowledge IPGs, some of which are regional. Aid for Trade awareness raising in a global activity	Tends to be described as a club good.
2. How does the public good relate to (economic) development?	Evidence suggests more stable and transparent rules will increase investment and growth	Knowledge and development Trade helps to set a conducive environment for development	Several studies find that infrastructure is crucial for investment and growth.
3. What are the current gaps in provision of the good and at what level (national, regional, global)?	Ongoing debate, regional networks important but mostly national level	Lack of economic and trade policy knowledge. Lack of relevant trade impact assessment, and lack of knowledge on regional trade constraints.	Large gaps in infrastructure as aid decreased and private sector did not fill gap in the past decade Commission for Africa recommended USD 20 bn increase in aid for African infrastructure. Nepad has a list of infrastructure projects.
4. What are the financing mechanisms to address the gaps (country programs, regional and global initiatives)?	**Global** coordination local implementation (**beyond country** program) or **regional** implementation in the case of regional trade rules.	Knowledge e.g. for trade policy, needs **national** approach, but also **regional**, to contribute to regional knowledge PGs). Awareness raising need to include global approach.	**Regional** development banks and regional groupings, **national** development programs.

As will have become clear, effective financing mechanisms are likely to differ substantially amongst key components of aid for trade activities. In this sense, it is unwise to speak of one global aid for trade fund. On the other hand, it will not work solving these issues based on national programs only. How does regional infrastructure get implemented? This probably needs some international co-ordination. How can knowledge on trade development policies

be coordinated? How can a system of global trade rules be developed and sustained? How can the profile of trade issues be raised? These are mostly international challenges. These may involve the provision of international public goods using global or regional approaches, global or regional funds, and global or regional co-ordination. The discussion in Section 3 indicated that there are varying experiences in the use of special or vertical funds; several have been successful (or not less successful than not addressing it or through solely national programs), so something could be learned.

The World Bank (2006) has also recognized regional constraints in delivering aid for trade. Multi-country programs constitute 2-6 percent of the portfolio of Regional Development Banks. The trade-related parts of World Bank lending for regional projects in the past few years amount to around one percent of total lending. One issue is that regional projects face higher transaction costs and donor funds are not suited for regional projects, but mandates and thinking tend to be on national lines. In developing countries themselves there may be too few incentives to co-operate regionally through the free-rider effect for non-participants. The World Bank argues that "The national focus of development assistance makes it more difficult to realize the potential benefits of cross-country cooperation in trade-related areas." This is serious. Donors coming together to draw up the Paris Declaration will not have fully appreciated the potential importance of regional projects. In this case it is preferential that some aid for trade activities are not drawn from the national level.

5 Conclusion

The currently used definition of aid for trade lumps together very different types of activities. We applied a public goods framework to aid for trade and argued that some aid for trade activities contribute more to public goods than others. This has implications for financing, as the different activities are likely to need different approaches and solutions. Now is the time to think about the operationalization of aid for trade to assess what is behind the notion of aid for trade funds, including the appropriate levels of financing.

We argued it is important to examine the possible purposes of funds more closely in order to assess a possible aid for trade architecture. We suggested that there have already been lots of special vertical funds in place and that there are theoretical and empirical reasons why some of these work. Not all vertical funds are rational, and some will raise the transaction costs of aid. Despite this, the purposes and benefits of aid for trade activities involve the provision of *international* public goods and we argued that some of these involve global approaches to complement and inform national approaches. The key point is that while the global/vertical funds need to take into account the aid principles, national programs on the other hand will need to take into account global challenges and solutions because relying on national solutions alone may not be the most efficient or effective way of addressing challenges. Hence it is important to consider the use of regional and other international approaches directly – and compare these with using national approaches to try to tackle international challenges indirectly (or by implementation without international co-ordination).

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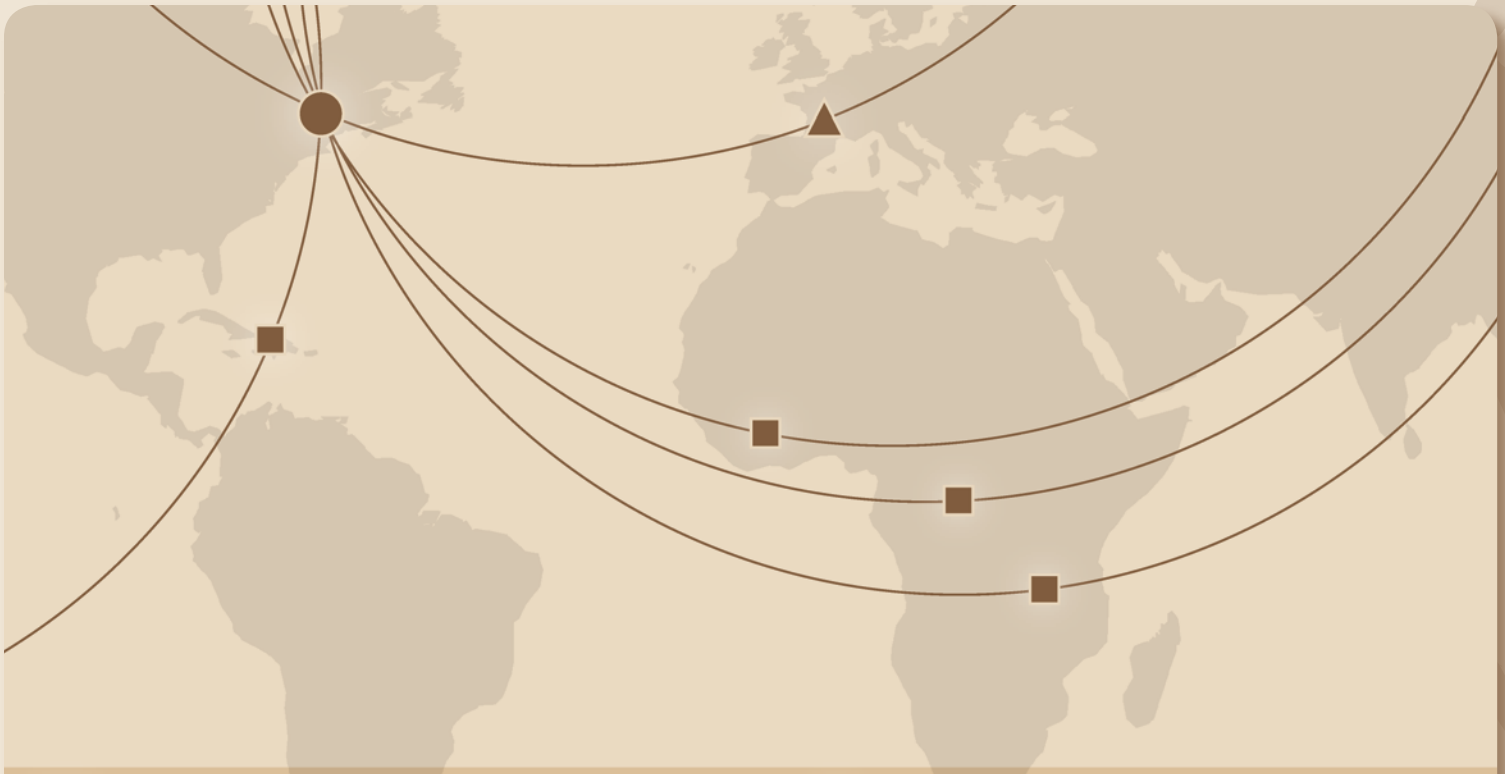
Acronyms

ACP	African, Caribbean and Pacific countries
AGOA	African Growth and Opportunity Act
AIDS	Acquired Immune Deficiency Syndrome
CGIAR	Consultative Group on International Agricultural Research
CRS	Creditor Reporting System
CSR	corporate social responsibility
DDA	Doha Development Agenda
EC	European Commission
EDF	European Development Fund
EPA	Economic Partnership Agreement
FTAA	Free Trade Area of the Americas
GAVI	Global Alliance for Vaccines and Immunisation
GEF	Global Environmental Fund
HIPC	Heavily Indebted Poor Countries
IDB	Inter American Development Bank
IF	integrated framework
IFF	International Finance Facility
IMF	International Monetary Fund
IPG	international public goods
ITC	International Trade Centre
LDC	Least Developed Country
JITAP	Joint Integrated Technical Assistance Program
MCC	Millennium Challenge Corporation
MDGs	Millennium Development Goals
NEPAD	New Partnership for Africa's Development
OECD	Organisation for Economic Cooperation and Development
NPG	national public goods
PRS/P	Poverty Reduction Strategy/Paper
SPS	sanitary and phyto-sanitary
SWAp	sector-wide approach
TRA	trade-related assistance
TRTA	trade-related technical assistance
UNCTAD	United Nations Conference on Trade and Industry
UNDP	United Nations Development Program
UNIDO	United Nations Industrial Development Organisation
USAID	United States Agency for International Development
WTO	World Trade Organization

ILEAP Analytical Support Structure



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