

# **Aid for Inclusive Trade:**

## **New thinking for Australia's Aid for Trade Agenda**

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# Executive Summary

1. Inclusive economic growth is a fundamental requirement for sustained poverty reduction. As a key driver of job creation, the diffusion of technology and transfer of commodities, international trade is a powerful enabler of economic growth. As such, trade is a critical pathway to achieving inclusive economic growth and poverty reduction in developing countries.
2. Aid for trade investments seek to increase the capacity of developing countries to promote economic growth and poverty reduction through greater engagement with global trade. Since 2006, donors have disbursed more than US\$320 billion in Official Development Assistance (ODA) to aid for trade initiatives. Aid for trade now represents approximately 30 per cent of global ODA flows each year.
3. After a decade of continued investment, global aid for trade has been effective at improving the exports and trade performance of developing countries. However, its impact on poverty reduction and inclusive growth has been less clear. There is growing evidence that raising the productive capacity of small-holder producers, and small and medium enterprises (SMEs) – particularly those run by women and those operating in the informal sector – is necessary, not only to reduce poverty, but to deepen the trade capacity of developing countries.
4. Now is an opportune time for both donors and partner governments to ensure that aid for trade investments fully realise their potential to enable people living in poverty to benefit from trade opportunities. The World Trade Organisation (WTO) and the Organisation for Economic Cooperation and Development (OECD), alongside major donors, are increasingly aware of the contribution that aid for trade interventions can make by directly addressing the barriers preventing vulnerable groups from accessing local, national and global markets.
5. Donors also recognise the value of aligning direct interventions that assist people living in poverty with aid for trade investments in infrastructure and trade reform. For example, efforts to facilitate the movement of goods across borders work best when complemented by efforts to build the capacity of small-holder farmers and SMEs to produce those goods.
6. As Australia's aid for trade portfolio grows in line with other major donors, this international experience provides important insights for the Australian Government. Going forward, the Australian Government and its partners should bolster aid for trade investments in direct interventions that increase the productive capacity of SMEs and small-holder farmers and producers, and enable them to link effectively to markets.
7. In particular, interventions that develop and connect small-holder producers and SMEs to local value chains, provide finance to marginalised SMEs and increase financial literacy help equip people living in poverty to engage beneficially with trade opportunities. This in turn increases the productivity and supply-side capacity of developing economies. Australia's aid for trade investments also have significant potential to promote women's economic empowerment through direct interventions that address the specific challenges facing women farmers and women-owned SMEs.
8. These interventions should be integrated within Australia's broader trade reform and facilitation efforts to complement and build upon the impact achieved by other aid for trade investments. Australia should also invest to strengthen its monitoring and evaluation systems to ensure it can better measure and attribute the impact of its aid for trade interventions on poverty reduction and inclusive growth.

# Introduction

## Objectives of this Paper

Aid for trade investments aim to enable developing countries promote economic growth and poverty reduction through greater engagement with global trade. Over the last decade, aid for trade has become an increasingly prominent form of Official Development Assistance (ODA) to developing countries, representing more than 30 per cent of global aid flows.<sup>1</sup>

Despite this heavy investment, the impact of aid for trade on poverty reduction in developing countries remains poorly understood. This is increasingly problematic as global aid flows contract and donors face intensifying pressure to justify aid expenditure.

This paper seeks to do three things.

**Part 1** explains the core concepts around aid for trade and how it is spent both globally and in Australia.

**Part 2** examines the impact of aid for trade investments on poverty reduction.

**Part 3** considers what the evidence on aid for trade's impact means for Australia's aid for trade priorities, drawing on World Vision's field experience where relevant.

The remainder of this section provides a brief background on the economic rationale for aid for trade and World Vision Australia's operational experience in aid for trade programming.

## Rationale of Aid for Trade

Economic growth is a fundamental requirement for sustained poverty reduction. Growth creates jobs and can generate new as well as improve existing employment opportunities for people living in poverty. Additionally, economic growth can bolster domestic tax resources and enable governments to provide citizens with essential services such as healthcare, education and basic infrastructure, which can in turn boost productivity.

However, economic growth alone is insufficient to reduce poverty in developing countries. Its impact on poverty reduction depends on the extent to which those in poverty are able to participate in, and benefit from, increased economic activity. Where the pace and pattern of economic growth excludes marginalised groups, growth quickly fails to be 'the tide that lifts all boats.'<sup>2</sup> In fact, empirical evidence suggests that inequality can significantly undermine headline economic growth.<sup>3</sup> Only inclusive economic growth can ensure poverty reduction is achieved, and that growth itself can be sustained.

As a key driver of job creation, the diffusion of technology and innovation, and the movement of commodities, international trade is undoubtedly a powerful enabler of economic growth.<sup>4</sup> Trade is a critical pathway to achieving inclusive economic growth as it expands domestic markets in developing countries. Trade opens new opportunities for work for men and women living in poverty by enabling them to access new consumers, products, and sources of finance.

In recognition of the role trade plays in reducing poverty, aid for trade has been a favoured tool of donors to help developing countries expand their trade capacity and realise the benefits of trade. Over the last decade, aid for trade has proved to be effective at lowering trade costs and raising exports in developing countries.<sup>5</sup> It has, however, been less

successful at reducing poverty and promoting inclusive growth.<sup>6</sup>

People living in poverty – small-holder farmers, micro, small and medium enterprise, workers, consumers, and disproportionately women – remain unable to fully access markets and the opportunities trade brings.

Australia, like most large donors, has steadily increased its investment in aid for trade in recent years. In 2014, the Australian Government announced a target to increase Australia's aid for trade funding to 20 per cent of the country's annual aid expenditure. By 2020, aid for trade will receive more annual funding as a proportion of the aid budget than either health or education.<sup>7</sup> Given Australia's role as the largest donor to Pacific countries – countries which continue to fare poorly on key human development indicators – the impact aid for trade has on poverty reduction and inclusive growth remains a particularly critical issue.

## World Vision's Experience in Aid for Trade

World Vision Australia values the contribution international trade can make to increasing livelihoods and poverty reduction in developing countries. World Vision Australia supports aid for trade initiatives that equip developing countries with the right policies, capacity and infrastructure to enable trade with local and international markets, and facilitate economic development and poverty reduction.

World Vision Australia has substantial experience developing and implementing aid for trade initiatives in developing communities across the world. World Vision Australia has deep programming expertise in building the productive capacity of people living in poverty, and enabling them to beneficially participate in trade. World Vision's economic development programs are focused on linking small-holder farmers and small and medium businesses to markets in regions as diverse as Southern and Eastern Africa, South-East Asia, the Pacific, the Middle East and Eastern Europe.

The World Vision partnership is also a member of Grow Asia, an initiative of the World Economic Forum and Association of Southeast Asian Nations (ASEAN), which seeks to support trade capacity and inclusive and sustainable agricultural development in South East Asia.

For further information see: <https://www.worldvision.com.au/get-involved/advocacy/australian-aid/aid-for-trade>

# Part I: The Purpose of Aid for Trade

The aid for trade agenda was borne out of a recognition that although international trade is an essential driver of growth and therefore poverty reduction, developing countries often lack the capacity to realise the benefits of trade. In response, the World Trade Organisation (WTO) launched the Aid for Trade Initiative in 2005, establishing aid for trade as the primary mechanism to increase the trade capacity of developing countries.<sup>8</sup>

## I.1 Goals of Aid for Trade

Aid for trade, like trade itself, is an inexact and complex process. Though definitions abound, the WTO defines aid for trade as being 'about helping developing countries, in particular the least developed, to build the trade capacity and infrastructure they need to benefit from trade opening.'<sup>9</sup> The WTO's Task Force on Aid for Trade added that aid for trade should assist developing countries increase exports and 'benefit from liberalised trade and increased market access.'<sup>10</sup>

The WTO Task Force also highlighted the contribution aid for trade should make to poverty reduction stating that:

aid for trade should help developing countries 'use trade more effectively to promote growth, development and poverty reduction and to achieve their development objectives, including the Millennium Development Goals (MDGs).'<sup>11</sup>

The Sustainable Development Goals (SDGs), the global development agreement replacing the MDGs, notes the importance of aid for trade in supporting poverty reduction and the sustainable development agenda. Goal 8 of the SDGs calls for increased 'aid for trade support for developing countries, in particular least developed countries' as a mechanism to 'promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.'<sup>12</sup>

### **Aid for Trade in Australia**

Australia's aid for trade policies reflect the broad goals of the Aid for Trade Initiative, stating that it will help developing countries 'benefit from the global rules-based trading system, implement domestic reform and make a real economic impact on the lives of their citizens.'<sup>13</sup>

## I.2 Types of Aid for Trade

The WTO recognises four broad categories of Aid for Trade spending:

- **Trade Policy and Regulations:** Includes supporting developing countries to develop trade strategies, negotiate and implement regional and international trade agreements.
- **Trade-related Infrastructure:** Includes assistance to develop the infrastructure (particularly roads, ports and telecommunications) necessary to connect domestic markets in developing countries to the global economy.

- **Productive Capacity Building:** Includes activities which strengthen the business enabling environment in developing countries and assist the private sector to increase exports and exploit their competitive advantage.
- **Trade-related Assistance:** Includes assistance to developing countries to manage the costs associated with trade liberalisation.

The Australian Government, along with the Organisation for Economic Cooperation and Development (OECD) and other major donors, has taken a similar approach in its aid for trade policy. Australia allocates aid for trade expenditure across the categories of (1) Trade Policy and Regulations, (2) Economic Infrastructure and (3) Building Productive Capacity. Trade-related Assistance is included in the Trade Policy and Regulations category.<sup>14</sup> For ease, this report uses these three categories throughout its analysis.

### I.3 Aid for Trade Volume<sup>i</sup>

Since the launch of the Aid for Trade Initiative, the WTO has led the call for 'more and better' aid for trade assistance to developing countries.<sup>15</sup> As Figure 1 shows, aid for trade flows have risen significantly year-on-year; as donors and partner countries increasingly identify trade as central to their development strategies. According to OECD data, aid for trade commitments reached US\$53.9 billion in 2015, an increase of US\$31.6 billion from the baseline average from 2002-2005.<sup>16</sup>

On average, aid for trade commitments reach around US\$40 to \$50 billion each year, representing approximately a third of global ODA flows.<sup>17</sup>

**Figure 1: Annual Aid for Trade Commitments and Disbursements**



Source: OECD-DAC Aid Database (2017)

<sup>i</sup> Annual disbursements data obtained from the OECD –DAC Aid Database (aid for trade statistical queries). Accessed 30 June 2017. Figures in current US dollars.

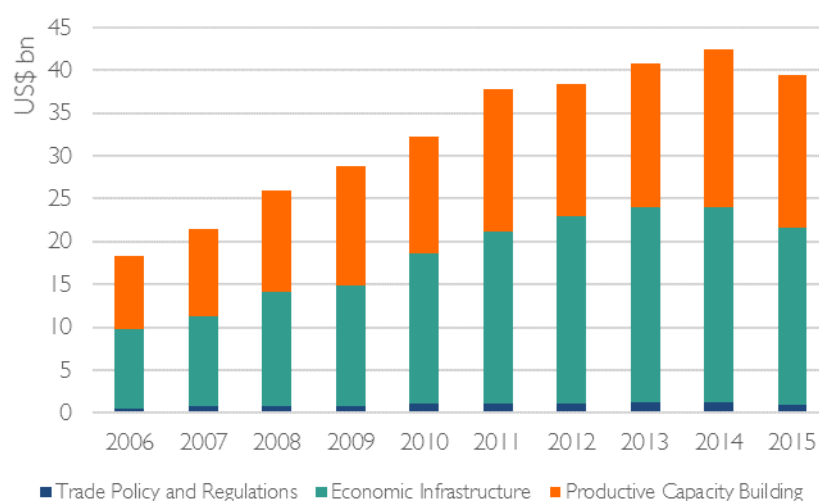
Unless otherwise stated, the remainder of this section will focus on cumulative aid for trade disbursements from 2006 to 2015 inclusive.

In aggregate terms, donors have disbursed US\$298.3 billion in ODA to aid for trade initiatives since 2006.<sup>18</sup> How this money has been allocated across the three categories of aid for trade provides important insights.

Since 2006, donors have predominantly provided aid for trade assistance in the form of economic infrastructure, amounting to US\$155 billion.<sup>19</sup> Over this time, aid for trade to productive capacity building reached US\$133.9 billion, while funding to trade policies and regulations reached US\$9.4 billion.<sup>20</sup>

As shown in Figure 2, the proportion of aid for trade expenditure invested in economic infrastructure has increased over time. On average, economic infrastructure has received 11 per cent more funding than productive capacity building annually since 2010.<sup>21</sup>

**Figure 2: Annual Global Aid for Trade Flows by Type**



Source: OECD-DAC Aid Database (2017)

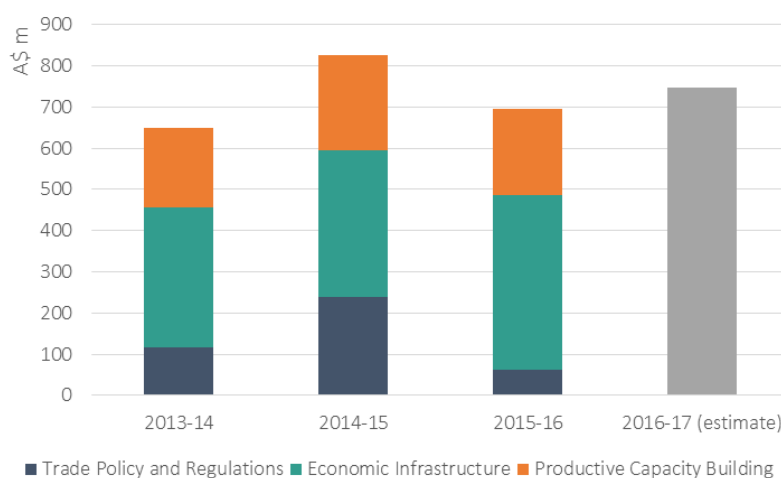
### Australian aid for trade volume

Following global trends, aid for trade spending in Australia is on an upward trajectory. In 2016-17, Australian aid for trade expenditure is expected to reach A\$748 million, an increase of almost \$A100 million from 2013-14.<sup>22</sup> The Australian Government has set a target of increasing aid for trade to 20 per cent of Australia's aid budget by 2020.<sup>23</sup> In 2015-16, aid for trade represented 17.3 per cent of the aid budget. This is projected to increase to 19.5 per cent by 2016-17.<sup>24</sup>

Australia's aid for trade expenditure has been more targeted at economic infrastructure than the global average. According to DFAT's Performance of Australian Aid 2015 report, Australia spent 61 per cent of aid for trade expenditure on infrastructure, 30 per cent for productive capacity building and 7 per cent on macro trade policy and regulations over the reporting period.<sup>25</sup> Prior to 2013, Australia spent 50-60 per cent on productive capacity building.<sup>26</sup>



**Figure 3: Estimated Annual Australian Aid for Trade Flows by Type**



Source: Percentages and annual figures obtained from DFAT Performance of Australian Aid 2013-14, 2014-15 and 2015-16. (Note: annual expenditure in Governance has been included as part of Trade Policy and Regulations.)

## **I.4 Aid for Trade and Poverty Reduction<sup>ii</sup>**

Given aid for trade is a sizable proportion of global aid flows, it is important to consider how much of this investment affects people living in poverty.

Both in Australia and globally, more than half of aid for trade funding has been invested in economic infrastructure, which typically facilitates high-volume trade.<sup>27</sup> Productive capacity building is the next largest category, covering a wide range of assistance that seeks to create an enabling environment for the private sector. While some of this spending does target small and medium enterprise (SME)<sup>iii</sup> and small-holder producers, there is a greater tendency towards scale and industry-level reform.

**On the whole, global aid for trade has underinvested in direct interventions that address the constraints and opportunities facing people living in poverty.**

Aid for trade investments which target economic infrastructure and regulatory, legal and institutional reform tend to favour larger businesses and producer groups operating in the formal sector.

This is borne out by the data. For example, direct support to the development of SMEs in the industrial sector amounted to around US\$7.6 billion between 2006 and 2015, representing around 5.5 per cent of expenditure in productive capacity building.<sup>28</sup>

Similarly, aggregate support to informal and semi-formal financial intermediaries, including micro-credit and saving co-operatives, reached just US\$4.1 billion since 2006, compared to the US\$31.6 billion allocated to support formal financial institutions, central banks and

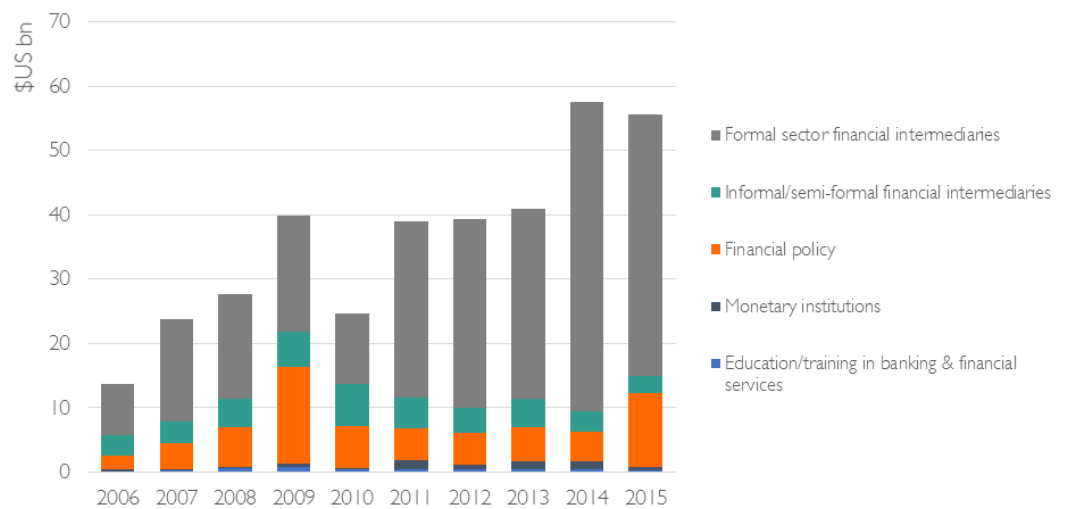
<sup>ii</sup> Annual disbursements data obtained from the OECD –DAC Aid Database (aid for trade statistical queries). Accessed 30 June 2017. Figures in current US dollars.

<sup>iii</sup> The definition of Small and Medium Enterprises (SMEs) varies across countries and development agencies. For example, the OECD defines Small and Medium Enterprises (SMEs) as independent, non-subsidiary firms which have fewer than 250 employees. The Asian and African Development Banks defines SMEs as firms with fewer than 50 employees.

financial policy.<sup>29</sup> Three quarters of the world's poor are 'unbanked' and do not have access to formal financial institutions.<sup>30</sup> Informal and semi-formal financial institutions – as well as training and education in banking and financial services – are critical to enabling people living in poverty to graduate to the formal financial sector over time.

Despite this, the relative investment in both informal and semi-formal financial intermediaries and education and training services has gradually decreased over the past ten years.<sup>31</sup> As Figure 4 shows, aid for trade disbursements to the formal banking sector during the same period have increased.

**Figure 4: Breakdown of Banking and Financial Services Expenditure since 2006**

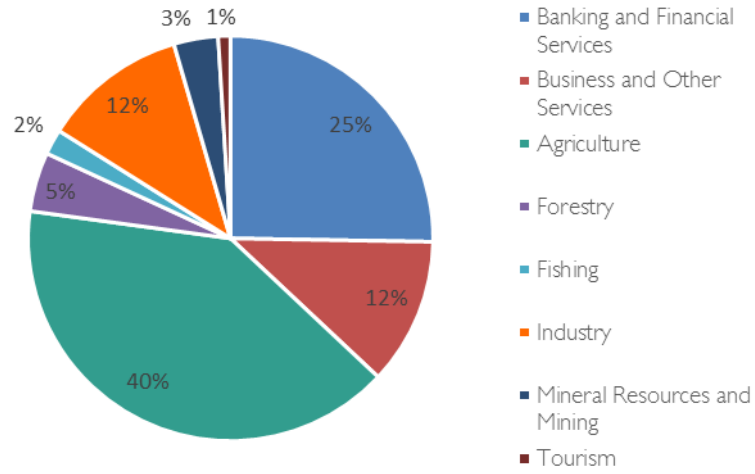


Source: OECD-DAC Aid Database (2017)

Aid for trade funding to agriculture is harder to deconstruct. As shown in Figure 5, 40 per cent of productive capacity building, or US\$54.5 billion, has been spent on improving agricultural productivity and food security. Much of this spending – close to a quarter – is focused on farm development, agricultural policy and institutional reform, and agricultural land and water resources.<sup>32</sup> Based on OECD case studies, these are areas which seem to predominantly, though not exclusively, benefit larger producers and farmers.<sup>33</sup>

By contrast, support to non-formal agricultural extension services, which are more likely to assist small-holder farmers improve their productivity, received around US\$1 billion between 2006 and 2015.<sup>34</sup> This is again problematic for development outcomes. Growth in small-holder agriculture is central to achieving broad-based poverty reduction as the vast majority of the world's poor depend on small-holder farms for their livelihoods. Moreover, these farms provide over 80 per cent of the food consumed in developing countries.<sup>35</sup>

**Figure 5: Breakdown of Productive Capacity Building Expenditure since 2006**



Source: OECD-DAC Aid Database (2017)

## Part 2: The Effectiveness of Aid for Trade

Measuring the effectiveness of global aid for trade has been a significant challenge for donors and partner governments.<sup>36</sup> The complexity of the factors that drive trade performance make it particularly difficult to isolate and attribute the impact of aid for trade. This has been exacerbated by global underinvestment in establishing rigorous monitoring and evaluation (M&E) systems for aid for trade interventions. The World Bank, among others, has highlighted the urgent need to strengthen the evidence base for aid for trade through improved evaluation systems.<sup>37</sup>

This has caused problems for donors and governments who are under increasing pressure to justify aid funding and demonstrate aid's effectiveness. Aid for trade expenditure has attracted greater scrutiny due to the amount of funding and attention it has received over the last decade.

### 2.1 Does Aid for Trade Reduce Poverty?

Against this backdrop, there is growing recognition that aid for trade must not only 'increase the volume and value of trade' but increase the impact trade has on poverty reduction in developing countries.<sup>38</sup>

However, the question of whether, and to what extent, aid for trade impacts poverty reduction remains largely unanswered.

Empirical evidence on this question is scant. A recent evaluation of the UK's Department for International Development (DFID) and the European Commission's aid for trade programs found there to be very little publically available information on the impact of aid for trade interventions on those living in poverty.<sup>39</sup> Though both donors place poverty reduction at the centre of their policy goals, this has not been reflected in the design, implementation and evaluation of aid for trade programming.

An ODI review of global aid for trade found this problem to exist across most donors with aid for trade programs generally failing to 'adequately measure and evaluate the actual impact on poor and excluded groups.'<sup>40</sup> A 2011 meta-review of 162 evaluations of aid for trade interventions found that most evaluations did not provide sufficient insight on whether the interventions impacted on poverty reduction.<sup>41</sup>

Much more work has been done on aid for trade's impact on economic performance. On balance, the empirical literature confirms that aid for trade has been effective in raising exports and improving the investment climate of recipient countries.<sup>42</sup> OECD research shows that \$1 invested in aid for trade generates an additional \$8 of exports for all developing countries, and \$20 of exports for the poorest countries.<sup>43</sup>

A 2009 study found that a 1 per cent increase in investment in trade policy and regulations could generate an increase in global trade of \$81.8 million.<sup>44</sup> Other studies show that aid to economic infrastructure has the most significant impact on boosting exports from developing countries.<sup>45</sup>

There is limited evidence on the extent to which this economic impact has translated into poverty reduction outcomes. Up until recently, aid for trade donors and proponents have assumed that where aid for trade improves trade performance and growth, welfare gains

for poor households will necessarily follow. This has led donors to prioritise macro-level aid for trade investments in areas that drive economic growth, such as economic infrastructure and the reform of enabling environments for large businesses.

These assumptions are now shifting as donors and governments struggle to quantify the poverty impact of aid for trade.<sup>46</sup> Growing global inequality has also raised doubts about whether headline economic growth effectively 'trickles down' to those in poverty.<sup>47</sup>

The OCED has acknowledged that there is no 'a priori reason to anticipate growth from trade will automatically' benefit people living in poverty.<sup>48</sup>

Rather, the impact of trade and growth on poverty reduction depends on how inclusive that growth is, and how increased trade – directly and indirectly – changes the economic prospects of marginalised individuals and households.

### **Effectiveness of Australian Aid for Trade**

In line with the challenges facing other donors, there is a lack of publicly available evidence of how Australia's aid for trade programming impacts poverty reduction and inclusive growth. A 2016 evaluation conducted by the Office of Development Effectiveness (ODE) within the Department of Foreign Affairs and Trade (DFAT) considered the effectiveness of Australia's aid for trade investments in trade facilitation and assistance.<sup>49</sup> Promisingly, the evaluation found that DFAT's investments showed significant potential to impact poverty reduction.

However, the ODE found that the programs evaluated had yet to establish robust monitoring and evaluation systems necessary to determine the impact of interventions. The ODE recommended that more should be done to strengthen Australia's ability to 'determine the benefits attributable to specific aid for trade interventions, and how these benefits make differences to people's lives.'<sup>50</sup>

## **2.2 Building Capacity of People Living in Poverty**

Aid for trade investments can make a critical contribution to ensuring vulnerable groups are better equipped to exploit trade opportunities.

Increasing the trade capacity of developing countries requires multifaceted investment across different groups – large businesses, micro enterprise, SMEs, small-holder producers, and men and women working in the informal sector. Investment in infrastructure and in the enabling environment for large enterprise is critical to facilitate the movement of goods, reduce trade costs and stimulate broader economic growth. However, this needs to be complemented by investment in supply-side capacity and in increasing the productivity of the labour force.

Small-holder producers and SMEs – the major source of income and employment for people living in poverty – face numerous obstacles which hamper their integration into the global economy. Without interventions that focus directly on these barriers, such as lack of finance and market information, 'outdated technology' and 'weak technical and entrepreneurial skills,' they are unable to connect to local and global markets, and do not beneficially engage with trade.<sup>51</sup> This seriously undermines the impact of trade on poverty reduction.

There is growing evidence that empowering small-holder farmers and SMEs is also important for boosting trade performance. These groups have enormous potential to

increase productivity and quality, reach scale and sell to export markets.<sup>52</sup> Evidence also shows that women's economic empowerment can 'boost exports, increase economic growth and achieve positive development outcomes.'<sup>53</sup> Women-led SMEs and women entrepreneurs have a critical role to play in global trade and development.

### Empowering Small Business Leads to Trade

World Vision and the World Bank have been working closely with small-holder cocoa producers in Papua New Guinea, particularly in Bougainville. Bougainville was a leading producer of cocoa prior to the civil war. The Productive Partnerships in Agriculture Program supports economic development by boosting the productive capacity of 7,000 cocoa farmers across the country. Farmers receive training in land rehabilitation, building fermentaries and crop management, helping them significantly increase their productivity and crop yields. The program also encourages farmers to improve the quality of produce, and to build demand-driven relationships with buyers in local and global markets.

Over time, farmers have been able to adopt efficient, market-responsive practices and have addressed the key bottlenecks in their value chains. Farmers now directly sell their produce to exporters and are exporting to international markets including Malaysia.

## 2.3 Shifting the Balance of Aid for Trade

The development community increasingly recognises the potential of aid for trade to specifically address the barriers that prevent people living in poverty from benefitting from trade openness.

### In their 2017 review of global aid for trade, the WTO and OECD called for a greater focus on 'aid for inclusive trade.'

The review also highlighted the increased attention being given to tracing the direct and indirect impacts of aid for trade on poverty reduction.<sup>54</sup> In particular, both the OECD and WTO emphasised connecting SMEs to international markets as a key development priority. The OECD has separately called for aid for trade donors to invest in interventions that connect 'poor farmers to markets,' and 'enhance supply-side capacity to ensure the benefits of export growth also reach poor groups.'<sup>55</sup>

Similarly, the Overseas Development Institute (ODI), a leading development think-tank, has argued that aid for trade must be recalibrated to enhance the poverty reduction impact of trade.<sup>56</sup> Major donors such as DFID and the European Union (EU) have recently prioritised efforts to strengthen the poverty focus of their aid for trade interventions.<sup>57</sup> Germany's Gesellschaft für Internationale Zusammenarbeit (GIZ) has developed a manual to elevate the role of aid for trade in catalysing poverty reduction and inclusive economic growth.<sup>58</sup>

Donors also recognise the value of integrating direct interventions for poor and vulnerable groups within a broader approach to trade integration.<sup>59</sup> By way of example, investments in cross-border infrastructure and in simplifying customs procedures and quality standards for an export good are important ways to increase trade performance. However, to impact poverty reduction and inclusive growth, these interventions should be coupled with programs that increase the productivity and capacity of small-holder producers and farmers to meet those export standards.

## Part 3: What this means for the Australian Aid Program

The global context for aid for trade is changing rapidly. Recent contractions in the world economy has increased pressure on donors to demonstrate 'value for money' for taxpayer-funded aid programs. Increasingly, donors and partner governments expect aid for trade to improve trade performance while also ensuring that people living in poverty benefit from increased trade openness.

This international experience offers important insights for the Australian Government as Australia enters a new phase in its aid for trade policies and programming. After a period of consolidation, Australia's aid for trade expenditure is expected to reach 19.5 per cent of the aid budget in 2016-17 – all but achieving its target of increasing aid for trade to 20 per cent of the aid budget by 2020. Now is an opportune time to review and update Australia's aid for trade strategy so that it not only reflects the growth in Australia's aid for trade portfolio, but is fit for purpose for the shifting global aid for trade landscape.

The remainder of this section examines areas where Australia could strengthen its approach to aid for trade, and enhance its contribution to inclusive economic growth and poverty reduction.

### 3.1 Strengthening the Poverty Impact of Australia's Aid for Trade Portfolio

Australia's aid for trade strategy is clear in its focus on poverty reduction, stating that aid for trade will support opportunities for 'job creation, increased incomes and improved livelihoods for the poor.'<sup>60</sup> The approaches Australia will employ include: 'working with the private sector in areas that significantly impact on the poor', and encouraging 'economic opportunities for women.'<sup>61</sup>

Australia currently allocates around 60 per cent of its aid for trade expenditure to economic infrastructure, more than the global average which hovers around 50 per cent.<sup>62</sup> 30 per cent of Australian aid for trade disbursements are allocated to building productive capacity, compared to the global average of around 45 per cent.<sup>63</sup>

While the importance of infrastructure investment has been established in practice and empirically, it is more effective when coupled with increases in labour force and supply side capacity. Australia's aid for trade portfolio could be strengthened by increasing investment in the productivity and capacity of micro enterprises, SMEs, small-holder farmers and producers – particularly women and those operating in the informal sector.

This is especially true for countries in the Indo-Pacific region. Pacific economies are particularly reliant on the agricultural sector which is a critical source of livelihoods, employment and food security for more than eight million people across the region.<sup>64</sup> Most of this agriculture lacks scale and is focused at the family-community level. There is significant potential to commercialise and scale-up these traditional forms of farming to become new sources of income and job creation for the Pacific.<sup>65</sup> Aid for trade has an important role here.

Australia's aid for trade investments can make a key contribution

to programs that directly assist people living in poverty to engage beneficially with local, national and global markets.

Going forward, Australia's aid for trade investments can do more to build the productive capacity of poor communities in our region to ensure they are equipped to benefit from trade openness. These interventions should be integrated as part of Australia's broader trade facilitation and reform efforts. Where possible, investments in economic infrastructure, institutions and trade policies should be complemented by direct interventions that increase supply-side capacity in SMEs and small-holder producers to ensure they can capitalise on increased trade opportunities.

In particular:

**Australia's aid for trade investments have significant potential to boost the productivity of small-holder farmers and producers to meet market demand**

To ensure poverty reduction and inclusive growth, Australia should increase the amount of aid for trade it invests in building the productive capacity of small-holder farmers. Small holder farmers and producers, particularly women, often lack access to the information, expertise and funding necessary to produce at scale and connect to markets. Direct interventions such as local value chain development (LVCD) programs can be an important aid for trade tool as they increase the ability of these groups to sell produce to national and international markets, and increase household income and wellbeing.

LVCD programs are informed by a detailed market assessment to determine market demand and trends, and analyse entire value chains – including all actors involved. Farmers and producers are given access to critical market information on demand and prices, and technical assistance to improve productivity. Where scale is an issue, farmers are assisted to form producer groups to improve their ability to negotiate with input suppliers and buyers.

According to the OECD, 'linking farmers to markets and connecting them to deeper and more competitive value chains' is essential for integration into global markets and 'successful globalisation.'<sup>66</sup> LVCD programs should be responsive to, and integrated within, broader aid for trade activities so that efforts to facilitate the movement of goods, for example, are complemented by direct interventions that increase the capacity of poor farmers to produce those goods.

It is worth noting here that while it is important to consider all actors within a market system, including local government and the private sector, this paper calls for greater support to poor producers. Increasing trade's impact on poverty reduction sustainably, requires direct interventions which specifically address the capacity constraints preventing vulnerable farmers and producers from engaging in markets.



### Working with producers to build trade capacity and link to global markets

World Vision Australia is working with cashew farmers in Indonesia to improve productivity and increase their ability to sell to local and international markets. An assessment of the cashew market showed that producers were hampered by a lack of pest control and crop protection. Farmers did not have the capital to purchase plant protection products from private sellers until after harvest. World Vision worked with farmers and suppliers to establish contracts to supply plant protection services to farmers which would be paid for at harvest.

This significantly increased the productivity of farmers; the average farmer doubled production of cashews and increase annual profits by 40 per cent. Improvements to cashew yields and quality facilitated increased cashew exports, including to export markets such as Australia.

### **Australia's aid for trade investments can be a powerful tool to enable small and medium enterprises connect to markets**

Most SMEs in developing countries operate in informal markets, characterised by low productivity and sub-standard products, thereby limiting their ability to engage in trade.<sup>67</sup> This depresses economic growth and trade capacity in developing countries, and hinders the impact trade has on poverty reduction.

Arguably the single biggest problem facing SMEs in developing countries is the lack of finance to start new or expand existing businesses, or to invest in productivity-enhancing measures. More than half of all SMEs do not have access to credit – a number which increases significantly when informal enterprises are taken into account. The credit gap for formal and informal SMEs in developing countries is estimated to be US\$2.6 trillion.<sup>68</sup>

Australia's aid for trade investments can play an important role in addressing this gap by investing in programs that provide finance to Small and Growing Businesses (SGBs) in developing countries. These programs enable SMEs to expand, achieve improvements in their productivity and quality, sustain and generate local employment and reach export markets.

### Small and Growing Businesses (SGB) Finance: Helping small and growing businesses to reach export markets

World Vision Australia has piloted a new instrument that provides finance for small and medium businesses in Sri Lanka. The program targets small business that require loans between US\$ 5,000 to \$25,000 – a loan size too large for microfinance and too small for banks and financial intermediaries. Businesses are also provided with ongoing business coaching and mentoring to boost their technical, managerial and marketing skills.

In three years, the program has supported 120 small businesses (53 women-led), disbursing more than US\$518,000 in loans and reaching 6,600 people living in poverty. Businesses have been assisted to raise productivity, diversify their products and link to export markets. For example, Janaki received a loan of US\$4,150 which she used to finance operating expenditure and purchase key machinery and inputs. This enabled her to increase productivity and boost monthly profits from US\$172 to US\$688, employ 10 additional staff and increase the scale of her business. As a result, she was able to connect to regional and international markets and is now exporting to countries including Australia.

### **Australia's aid for trade investments can contribute to enabling women to engage in beneficial trade**

Women's participation in economic activity is critical to promoting inclusive economic growth and poverty reduction in developing countries. In emerging markets, women-owned SMEs represent 31 to 38 per cent of SMEs in the formal sector, and far more in the informal sector.<sup>69</sup> Aid for trade initiatives must support women's economic empowerment and address the particular barriers preventing women from engaging in trade.

While gender equality is a core goal of the Australian aid program, Australia's aid for trade investments have 'historically performed poorly' on incorporating gender considerations.<sup>70</sup>

To address this, Australia should increase its aid for trade investments in programs that assist women living in poverty to engage effectively with markets. In practice, for example, WVA's Local Value Chain Development (LVCD) programs and SGB Finance programs target female beneficiaries by acknowledging the unique barriers that women face when engaging in mainstream livelihood activities.

Savings groups are also a particularly effective tool to build the capacity of women living in poverty to engage in financial markets and overall economic activity. Savings groups work by enabling the vulnerable to safely save their own money, thereby creating a pool of capital from which members can borrow to invest in income-generating activities. Women in developing countries are the predominant beneficiaries of savings groups, which provide them with basic financial services they otherwise lack access to, and increase their financial literacy and confidence.

Field evidence shows that savings groups enable women to invest in small businesses and improve agricultural productivity, as well as graduate to formal financial institutions in the future. This provides them with a critical foundation to then link to local and global markets. A 2017 randomised evaluation conducted by the Innovations for Poverty Action (IPA) found that savings groups contributed to significant improvements to women's economic empowerment and financial inclusion. The groups also led to a 6 per cent increase in new businesses in treatment villages and increased monthly business profits by 24 per cent.<sup>71</sup>

#### **Savings Groups Link Women to Markets**

World Vision operates more than 21,000 savings groups, reaching close to 400,000 members around the world. Almost 80 per cent of savings group members are women. In the Pacific region, World Vision has established over 300 savings groups which reach 5,668 members – more than half of which are women.

Australia should also invest to improve the evidence base for its aid for trade programming. In particular:

### **Australia should determine the poverty impact of its aid for trade programming**

As a growing proportion of Australia's aid budget, it is critical that Australia's aid for trade investments sufficiently contribute to poverty reduction and inclusive growth. Currently, there is little publically available information on how Australia's aid for trade programming impacts poverty reduction in our partner countries. A recent report by the ODE evaluated the impact of Australia's trade facilitation investments on the trade capacity of partner

countries. However, this focused on a narrow form of aid for trade and does not provide an analysis of how the aid for trade portfolio as a whole impacts poverty. DFAT should undertake a review of Australia's broader aid for trade portfolio with a specific focus on how effective these investments have been to reduce poverty and promote inclusive economic growth.

**Australia should strengthen its monitoring and evaluation systems for aid for trade initiatives both in Australia and across OECD donors**

Determining the impact of aid for trade interventions is a notoriously difficult exercise. As a result, though some quantitative analysis has been done, case studies and narratives are the most commonly used tool to assess aid for trade interventions. The OECD and WTO collect these cases studies as part of their evaluation of global aid for trade every two years.

Some of these evidentiary challenges could be addressed by improving the M&E systems of donors. Most large donors, including the EU and DFID, have acknowledged that the M&E systems within their aid for trade programs need to be strengthened. Critically, current M&E practices do not sufficiently measure the impact of aid for trade initiatives on poverty reduction outcomes.

As recommended by the ODE, Australia should invest to improve M&E frameworks across its aid for trade investments, and ensure that poverty reduction outcomes are captured, analysed and used to improve programming. As a starting point, NGOs and other implementing partners already gather detailed community-level data which can assist DFAT assess the poverty reduction impact of direct interventions. Australia should also work with other OECD members to streamline M&E systems, including the use of clear indicators and evaluation methods, across donors to strengthen the evidence base for global aid for trade initiatives.

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