

Trade in Services: A Holistic Solution to New-Found Issues in Trade Law?

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Trade, Law *and* Development

Vol. 12, No. 1

2020

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Published by:

The Registrar, National Law University, Jodhpur
ISSN : 0976-2329 | eISSN : 0975-3346

Anirudh Shingal, *Aid for Trade in Services:
Definition, Magnitude and Effects*
12(1) TRADE L. & DEV. 342 (2020)

AID FOR TRADE IN SERVICES: DEFINITION, MAGNITUDE AND EFFECTS

ANIRUDH SHINGAL*

This paper reviews findings from recent literature on the trade effects of Aid-for-Trade (AfT) which has now begun to examine the impact of this aid on services trade in a significant departure from only looking at merchandise trade and investment. The paper also discusses the major transmission channels for the trade-enhancing effects of AfT and considers both direct and spill-over effects of AfT on services trade. Recent work suggests that AfT allocated to services activities may be effective in enhancing services exports of small value exporting countries, which is a significant finding from the perspective of the objective of AfT disbursement. It also provides scope for export diversification, global value chain (GVC) integration and enhancing firm productivity in recipient countries.

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I. INTRODUCTION

The Aid-for-Trade (AfT) initiative was launched at the World Trade Organization's (WTO) Hong Kong Ministerial Conference in 2005. It was based on the recognition that negotiations for lowering trade barriers would benefit developing countries more effectively if complemented with development assistance targeted at improving the supply side of the economy.¹ In keeping with this recognition, the international development community has provided significant volumes of AfT since the early 2000s.² Much of this assistance has been allocated for improving the quality of economic infrastructure; productive capacities of firms; and efforts to lower trade costs through trade facilitation projects. Since the focus of most global efforts at AfT allocation has been on trade in goods, the literature of most empirical economics is devoted to examining the effects of these efforts on different dimensions of merchandise trade. Only recently has attention shifted towards studying the effects of AfT on services trade.³

The focus on services emanates from the increasing role that services are playing in all sectors of the economy and in international trade. A wide range of producer services activities such as finance, information and communications, transport, logistics and professional services are inputs into modern production processes. As a result, services play an important role in economic development. The availability and cost of services determines economic opportunities and the performance of manufacturing and agricultural sectors. Services play an important role in the process of structural transformation, and in the inter-sectoral reallocation of labour

¹ Bernard Hoekman, *Aid for Trade: Why, What and Where Are We?*, in UNFINISHED BUSINESS? THE WTO'S DOHA AGENDA 233 (Will Martin & Aditya Mattoo eds., 2011).

² OECD TRADE COMM. AND THE WTO COMM. ON TRADE AND DEV., *AID FOR TRADE AT A GLANCE 2017: PROMOTING TRADE, INCLUSIVENESS AND CONNECTIVITY FOR SUSTAINABLE DEVELOPMENT*, (2017), https://www.oecd-ilibrary.org/docserver/aid_glance-2017-en.pdf?expires=1584449565&id=id&accname=guest&checksum=3E018D96C822BA14BF3A27A743C5B080.

³ Esteban Ferro et al., *Aid to the Services Sector: Does it Affect Manufacturing Exports?*, 37(4) WORLD ECON. 530-541 (2014) [hereinafter Esteban Ferro et al.]; M. Zarzoso et al., *Is Aid for Trade Effective? A Panel Quantile Regression Approach*, 21(4) REV. DEV. ECON. 175-203 (2017) [hereinafter M. Zarzoso et al.]; Bernard Hoekman & Anirudh Shingal, *Aid for Trade and International Transactions in Goods and Services*, 28(2) REV. INT'L ECON. 320-40 (May 2020) [hereinafter Hoekman & Shingal (2020a)].

and capital out of agriculture,⁴ including shifts between services activities, e.g., growth in business and information services. Realisation of many Sustainable Development Goals (SDGs) also depends on the performance of a range of specific services sectors.⁵

Not surprisingly, even the bulk of AfT is allocated to sectors classified as services according to the Organisation for Economic Co-operation and Development (OECD).⁶ These include transport and storage infrastructure and information and communications technology (ICT) services. At the same time, however, trade costs for services are higher than those for goods and the rate of decline observed in services trade costs since the early 2000s has been much less than that for goods.⁷ This said, during the 2000s, the group of Least Developed Countries (LDCs) taken together expanded their services exports more rapidly than the world average, suggesting services are an area of revealed comparative advantage for them. The LDC share of global trade in services rose from 0.4% in 2005 to 0.8% in 2015, with commercial services exports growing by 14% over this period, more than twice the rate of other countries.⁸ Thus, AfT recipients may be ideal targets to benefit from global aid efforts in the context of services trade.

II. WHAT IS SERVICES AfT?

The OECD Secretariat is the repository of data on Official Development Assistance (ODA) committed and disbursed by donor countries in recipient countries. This data has been available for a large sample of countries and sectors since 1995. AfT is one component of the overall ODA and comprises of the following categories according to the OECD:

⁴ Ronald Schettkat & Laca Yocarini, *The Shift to Services Employment: A Review of the Literature*, 17(2) STRUCTURAL CHANGE & ECON. DYNAMICS 127-147 (2006).

⁵ Matteo Fiorini & Bernard Hoekman, *Services Trade Policy and Sustainable Development*, 112(C) WORLD DEV. 1-12 (2018).

⁶ Hoekman & Shingal (2020a), *supra* note 3.

⁷ Sebastien Miroudot & Ben Shepherd, *Trade Costs and Global Value Chains in Services*, in RESEARCH HANDBOOK ON TRADE IN SERVICES 66 (Pierre Sauve & Martin Roy eds., 2016).

⁸ WTO, WORLD TRADE STATISTICAL REVIEW (2016).

- Technical assistance for trade policy and regulations (e.g., helping countries develop trade strategies, negotiate trade agreements, and implement their outcomes);
- Trade-related infrastructure (e.g., building roads, ports, and telecommunications networks to connect domestic markets to the global economy);
- Productive capacity building, including trade development (e.g., supporting the private sector to exploit their comparative advantages and diversify their exports);
- Trade-related adjustment (e.g., helping developing countries with the costs associated with trade liberalisation, such as tariff reductions, preference erosion, or declining terms of trade);
- Other trade-related needs, if identified as trade-related development priorities in partner countries' national development strategies.⁹

However, the OECD's Creditor Reporting System (CRS) does not provide data that exactly matches all of the above AfT categories. Only parts of the ODA data are reported as aid going towards building economic infrastructure and the creation of "productive capacity." The former includes several services sectors such as transport, storage, and information and telecommunications networks, for all of which data is reported separately. Meanwhile, aid for productive capacity covers all remaining sectors of the economy, including the following three services: banking and financial services, business and other services, and tourism. While not all of the ODA data reported under these headings is trade-related, data reported under these six sectors are the closest approximation of AfT allocated to services.

While the OECD's sector definitions of AfT are taken as given, there may be concerns whether annual AfT disbursements adequately capture the allocation and implementation of AfT within recipient countries and across sectors. Estimation challenges are further compounded by the considerable variation across countries between types of AfT and variation in the time required for disbursing commitments, implementing projects and the duration of AfT projects.¹⁰

⁹ OECD, *Aid for Trade - Data*, <https://www.oecd.org/aidfortrade/data/> (last visited May 05, 2020); *See also*, Aid for Trade Task Force, *Recommendations of the Task Force on Aid for Trade*, WTO Doc. No. WT/AFT/1 (July 27, 2006).

¹⁰ Bernard Hoekman & Anirudh Shingal, *Aid for Trade and Trade in Services* (EUI Working Paper RSCAS 2020/32, 2020) [hereinafter Hoekman & Shingal (2020b)].

However, most empirical literature on this subject, abstracts from such data quality issues, both in the context of AfT definitions and services trade. In fact, while bilateral services trade data would be ideal to examine the effects of AfT between donor and recipient countries, the availability of such data is hugely limited for the sample of low-income and least-developed countries that are major recipients of such aid. Most analyses of services trade effects of AfT are thus based on aggregate data.

III. THE MAGNITUDE AND DISTRIBUTION OF SERVICES AfT

Total AfT disbursements increased from USD 9 billion in 2002 to an average of USD 21 billion in 2006-2008 to USD 58 billion in 2017.¹¹ Asian and African countries have been the major recipients of AfT disbursements, each region accounting for around 40% of the global AfT disbursed since 2002.¹² Significantly, further analysis of the aid data reveals that most AfT goes to middle-income countries (close to two-thirds of ODA and more than 95% of other official flows) as opposed to LDCs, which witness a comparatively slower rate of decline in trade costs.¹³ This stylised fact of AfT disbursement thus seems inconsistent with its underlying objective i.e. enhancing the trade capacity and potential of LDCs.

The global distribution is qualitatively similar for AfT allocated to the six sectors classified as services. AfT mapped to these six categories increased from USD 5 billion in 2002 (59% of the total AfT) to USD 23 billion in 2015 (72.4%).¹⁴ Thus, most AfT over the period has been allocated to services, of which Asian and African countries are the major recipients in value terms, and African and Pacific economies are the largest recipients relative to their gross domestic products.

In terms of sectoral composition, the transport and energy sectors have been the largest recipients of global ODA disbursements, accounting for 46% and 30%,

¹¹ *Supra* note 2; *See also*, United Nations Conference on Trade and Development, *Policies to Promote Trade*, UNCTAD, (May 5, 2020), <https://sdgpulse.unctad.org/policies-to-promote-trade/>.

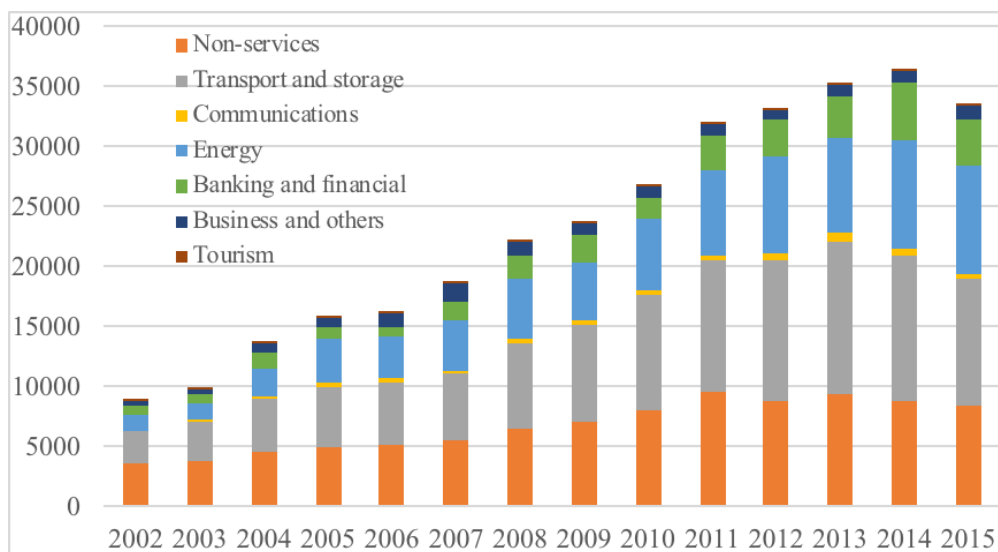
¹² Hoekman & Shingal (2020a), *supra* note 3.

¹³ U.N. DEP'T OF ECON. & SOC. AFFAIRS, COMM. FOR DEV. POL'Y, AID FOR TRADE: BUILDING PRODUCTIVE AND TRADE CAPACITIES IN LDCS, CDP POL'Y REV. NO. 1 (Oct. 2016) [hereinafter U.N. CDP Report (2016)].

¹⁴ Hoekman & Shingal (2020a), *supra* note 3.

respectively, of the total AfT disbursed to services sectors over 2012-2015 on an average. (see Figure 1)

Figure 1: Sectoral distribution of global AfT (USD MLN)



Source: Hoekman and Shingal (2020a)¹⁵

This pattern also holds if we look at the distribution of sectoral AfT in services across geographical regions (see Table 1). The only exception to this trend is Europe where the AfT targeting banking and financial services exceeds the AfT for the energy sector (although the largest share still goes to transport services).

Table 1: Geographical distribution of AfT in services by sector (USD MLN)

AfT in services (avg. 2002-2015)	Africa	America	Asia	Europe	Pacific	Global
Transport & Storage	2942.6	474.8	3690.5	611.5	154.6	7771.3
Communications	158.9	46.6	185.0	60.1	9.1	450.6
Energy	1826.0	424.8	2780.1	393.4	36.5	5394.1
Banking & Financial	791.1	206.0	858.6	508.1	6.4	2296.1

¹⁵ *Id.*

Services							
Business & Other Services	376.0	89.7	498.0	144.1	12.6	1094.3	
Tourism	45.5	21.5	28.2	6.6	4.3	105.0	
SERVICES	6140.2	1263.3	7718.3	1723.7	223.5	17111.3	

Source: Bernard Hoekman & Anirudh Shingal (2020a)¹⁶

IV. AfT AND TRADE: WHAT ARE THE CHANNELS?

From a macroeconomic perspective, aid supplements domestic savings, permitting more investment, which in turn leads to higher rates of economic growth in the recipient country.¹⁷ An increase in growth also increases the absorption capacity of the recipient, including for imports from donor countries. Aid is often conditional upon structural reforms in the recipient country and if these reforms include trade liberalisation then there is a direct effect of AfT on trade. Alternatively, the effect is indirect insofar as other reforms stimulate economic growth, which in turn enhances trade. But these effects can work in the opposite direction if aid crowds out domestic investment or if aid is tied to counterpart funds or if aid is fungible.¹⁸ Similarly, the ‘Dutch disease’ effects of aid can lead to an appreciation of the real exchange rate in the recipient country, increasing the demand for imports, worsening the external balance and making the recipient even more ‘aid-dependent’.

In contrast, if aid is tied to donor exports to the recipient, it becomes an instrument of trade policy.¹⁹ Tied aid can also have dynamic effects in the recipient country, encouraging follow-up orders and expanding future exports from the donor country. At the same time, given the tendency for tied exports to be over-priced, higher prices of imported capital goods can stall growth and the subsequent

¹⁶ Bernard Hoekman & Anirudh Shingal, (2020a), *supra* note 3; For Europe, the average is over 2002-2013 as the European countries in the sample did not receive any AfT in 2014-2015 as reported in the OECD database.

¹⁷ Howard White, *The Macroeconomic Impact of Development Aid: A Critical Survey*, 28(2) J. DEV. STUD. 163-240 (1992).

¹⁸ Peter Heller, *A Model of Public Fiscal Behavior in Developing Countries: Aid, Investment and Taxation*, 65 AM. ECON. REV. 429-445 (1975).

¹⁹ Oliver Morrissey, *An Evaluation of the Economic Effects of Aid and Trade Provision*, 28 J. DEV. STUD. 104-129 (1991).

trade capacity of the recipient country. Thus, tied aid may increase trade flows in the short run but it decreases them in the long run. Moreover, the recipient country might reduce overall imports if its terms of trade deteriorate as a result of high cost tied aid,²⁰ so the effect on donor exports is likely to depend on the degree and direction of trade diversion.

In sum, while aid may be expected to have a positive impact on aggregate trade, there are several potential reasons why such an impact might not be observed. Thus, considerable ambiguity persists on the major transmission channels for the trade-enhancing effects of AfT, “not to speak of the relative effects on trade in opposite directions.”²¹

In the context of services trade, aid allocated to economic infrastructure (transport, ICT and energy) is expected to have the most direct effect on economic growth and trade, especially on recipient exports.²² When donors target AfT by selecting infrastructure projects that primarily serve their own export interests, they also enhance recipient imports.²³ As shown above, economic infrastructure accounts for the bulk of AfT allocated to developing countries over 2002-2015 and all its three constituent sectors are classified as “services” by the OECD Secretariat. This, together with the increasing servicification of economic activity, explains the *a priori* positive and most direct relationship between AfT allocated to services activities and trade of recipient countries (both merchandise and services).

V. DIRECT EFFECT OF SERVICES AfT ON TRADE

Analysis of AfT and aggregate trade data suggests that AfT targeted at services have benefitted those manufacturing sector that have used such services relatively more intensively, the most.²⁴ An examination of the effects of AfT on aggregate

²⁰ Lucia Tajoli, *The Impact of Tied Aid on Trade Flows Between Donor and Recipient Countries*, 8(4) J. INT. TRADE & ECON. DEV. 373-388 (1999).

²¹ Birgit Meyer et al., *Who Benefits from Aid for Trade? Comparing the Effects on Recipient Versus Donor Exports*, 50(9) J. DEV. STUD. 1275-1288 (2014)[hereinafter Mayor et al.]

²² M. Cali & Dirk Velde, *Does Aid for Trade Really Improve Trade Performance?*, 39(5) WORLD DEV. 725, 740 (2011); Mariana Vijil & Laurent Wagner, *Does Aid for Trade Enhance Export Performance? Investigating the Infrastructure Channel*, 35(7) WORLD ECON. 838-868 (2012).

²³ Meyer et al., *supra* note 21.

²⁴ Esteban Ferro et al., *supra* note 3.

goods and services exports suggests that AfT mainly promotes goods exports for small-value exporting countries that are recipients of such aid.²⁵

Bilateral analysis, based on an augmented structural gravity model,²⁶ suggests that AfT, in particular the aid allocated to services activities, especially for economic infrastructure, has a positive effect on donors' merchandise imports from recipient countries.²⁷ A doubling of donor-to-recipient AfT is associated with a 3.8% increase in the donor's goods imports from the recipient on average. This is a novel finding, which is found to be robust across different lag structures (used to allow trade to adjust to AfT) and it provides evidence of complementarities between services AfT and goods trade in the bilateral data.

It turns out that the existing analysis of AfT effects based on aggregate data may not have appropriately accounted for endogeneity in the AfT-trade relationship.²⁸ Doing so more effectively results in no effects of AfT and its sub-types being observed on both aggregate goods and services trade.²⁹ However, it may be possible that AfT and its broad sub-types have an effect on goods and services trade for small-value exporting and importing economies relative to large-value countries. If this were the case, then such a finding would be more consistent with objectives of the international donor community as it would enable integration of small and less-developed aid recipients into global trade.

Significantly, this is exactly what extant research suggests, especially in the context of services exports.³⁰ More specifically, the effects of AfT allocated to services, including economic infrastructure and productive capacity building, as well as AfT allocated to trade policies and regulation are both larger and more precisely

²⁵ M. Zarzoso et al., *supra* note 3.

²⁶ The gravity model is now the workhorse in bilateral analysis and essentially relates trade between any two trading partners to the size of their economies and inversely to the distance between them. The latter is taken as a proxy for trade costs between trading partners along with indicators for common language, currency, legal systems, colonial antecedents and contiguity. Gravity models have also been used extensively to examine the effects of preferential trade agreements on bilateral trade, both goods and services.

²⁷ Hoekman & Shingal (2020a), *supra* note 3.

²⁸ This means, for instance, that existing trade in certain sectors drives aid allocation towards them ("reverse causality") or that certain unobserved factors influence both AfT and trade but are not accounted for in estimation.

²⁹ Hoekman & Shingal (2020b), *supra* note 10.

³⁰ *Id.*

estimated for small-value services exporting countries, suggesting that AfT meets its intended objective of supporting such countries. The effects of AfT and its broad sub-categories on services imports follow a similar pattern as services exports but are smaller in magnitude. In contrast, AfT allocated to services activities have more limited and smaller effects on merchandise trade relative to those observed for services trade. While there is considerable heterogeneity in the effects of AfT allocated to individual services sectors, AfT allocated to non-services activities is not associated with a statistically significant positive effect on either exports or imports of goods and services.

An important implication of these results for AfT design and implementation is that the heterogeneity of trade matters for responses to AfT. Thus, from a donor perspective, the same volume of aid allocated to services activities may be more effective for small-value services exporters and importers. If the objective also includes maximising returns on aid allocation from both the individual donor and the international donor community perspectives, then these findings show that the marginal gains from aid to small-value trading economies may be larger, which has important implications for aid-targeting. Moreover, in so far as some of this aid also enhances recipient imports from donors (and even recipient exports to donors in a world of GVCs where cheaper imported inputs matter), it also strengthens the political economy argument in favour of aid disbursement.³¹

VI. AfT AND SERVICES TRADE: SPILLOVER EFFECTS

While services account for about a quarter of global trade on a balance of payments basis, the share of services in total trade, doubles in value-added terms. The share of services embodied in manufacturing exports across sectors ranges from 30-35% while the within-services value-added share of services is as high as 90%.³² This further emphasises the role that AfT can play in integrating both developing country and LDC recipients into regional and GVCs and the scope of services trade in both facilitating such integration and benefitting from it.

Similarly, AfT can also facilitate diversification of export patterns and production structures of recipient countries towards services, especially where such structures

³¹ Hoekman & Shingal (2020b), *supra* note 10.

³² WTO SECRETARIAT, WORLD TRADE REPORT 2019 ON THE FUTURE OF SERVICES TRADE (2019), https://www.wto.org/english/res_e/booksp_e/00_wtr19_e.pdf.

are concentrated in a few agriculture or manufacturing sectors. AfT allocated to ICT infrastructure in particular can promote diversification of exports towards services transacted via the internet (Mode 1 services trade in WTO GATS parlance), which together account for more than a quarter of global services trade.³³ Also, given that Mode 1 trade is often a precursor to Foreign Direct Investment (FDI) in services, this can also facilitate Mode 3 services trade or commercial presence inside the territory of the recipient; this is the most dominant mode of service delivery, accounting for nearly 60% of global trade in services.³⁴

At the micro-level, AfT can also improve firm productivity via its positive effects on exports and the link between exporting, the incentive to export and firm productivity in the heterogeneous firm literature. AfT can also have a positive effect on decarbonisation and climate change by promoting trade in environmental and green services. Moreover, green financing has become a viable investment option for companies seeking to park capital in low-risk, high-capital instruments that fund clean energy infrastructure projects, buildings with clean energy facilities, research and innovation, etc. AfT can thus also supplement capital requirements of recipient countries in these areas.

Data from the World Bank's World Development Indicators shows that the share of female participation in the labour force tends to be high in sectors such as ICT, banking and finance, other business services and tourism and related hospitality services. Thus, AfT allocation to these service activities can also have a spill-over effect on gender issues and female employment in developing countries by enhancing trade and employment opportunities in these services.

Similarly, AfT-induced benefits can also create an environment for reform in sectors where the political economy has been traditionally protectionist. A case in point is legal services in India, where AfT allocated to improving the legal infrastructure within the country could be used to incentivise liberalisation of legal services to foreign participation as a *quid pro quo*. Positive effects of AfT allocated to economic infrastructure in general on online legal transcription services exports, for instance, could trigger such a response.

³³ *Id.*

³⁴ *Id.*

VII. CONCLUSION

Many dimensions of the potential relationship between AfT and the trade performance of recipient economies have been studied in the literature on this subject. A common characteristic of the extant body of research is that it mostly focuses on the effects of AfT on merchandise trade, and to a lesser extent, on investment flows. The analysis in this paper complements existing work by focusing on AfT and trade in services.

AfT allocated to services and non-services activities may not be associated with statistically significant positive effects on either aggregate merchandise or services trade, once endogeneity in the AfT-trade relationship is properly accounted for, in estimation. This finding, however, is not inconsistent with the theoretical AfT-trade literature which explains why AfT may and may not have trade-enhancing effects.

It is however possible that trade effects of AfT are more discernible at the disaggregated level and for small value exporting and importing countries. This is exactly what recent research suggests. The obvious implication of such findings is that policymakers need to target AfT more carefully. They need to avoid a 'one-size-fits-all' approach, as one may not observe the same effects of even the same types of AfT across different countries. Thus, generalisation may not be an ideal strategy when donors decide where to disburse aid.

Moreover, given that most of AfT goes to middle-income countries, a shift in the pattern of aid allocation is warranted, giving more attention to LDCs and landlocked countries that have more difficulties in integrating into international markets. In fact, given that some LDCs have difficulties in drawing up fundable projects, more technical assistance in the identification of trade constraints could also be useful.³⁵

Finally, given the potential time lags involved in the impacts of AfT disbursements, it may well be the case that the time period for empirical analysis is not long enough to observe effects of AfT and its sub-types on aggregate trade flows. Assessing such longer term effects of AfT on trade, remains an important agenda for future research, including by modes of services supply.

³⁵ U.N. CDP Report (2016), *supra* note 13.

The world is going through an unprecedented health and economic crisis at present, emanating from the novel Coronavirus (COVID-19). Services trade is getting more severely affected and will also take longer to recover in this crisis than it did during the 2008 global financial crisis because nearly 75% of global services trade is transacted via modes that require some form of physical proximity between buyers and sellers and the latter is the first casualty of social distancing and related practices in the wake of COVID-19.³⁶

The UN has already called for a US\$ 2.5 trillion stimulus package for small developing and less-developed countries that are hugely reliant on tourism and related hospitality services as these are likely to be the most severely affected.³⁷ Re-allocating global aid in favour of such countries and not imposing prohibitive barriers to trade in services on health grounds will together determine how quickly economies recover in the aftermath of this pandemic.

³⁶Anirudh Shingal, *Services Trade and COVID-19*, VOX CEPR POL'Y PORTAL (Apr. 25, 2020), <https://voxeu.org/article/services-trade-and-covid-19>.

³⁷ United Nations Conference on Trade and Development, *UN Calls for \$2.5 Trillion Coronavirus Crisis Package for Developing Countries*, UNCTAD (Mar. 30, 2020), https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2315&utm_source=CIO+-+General+public&utm_campaign=7ce0d564d9-EMAIL_CAMPAIGN_2019_05_17_11_42_COPY_01&utm_medium=email&utm_term=0_3d334fa428-7ce0d564d9-70442497.