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**DOHA DEVELOPMENT REPORT AND AID FOR TRADE**

Attached for the September 18, 2006, Development Committee Meeting is a progress report entitled "Doha Development Report and Aid for Trade," prepared by the staff of the IMF and the World Bank.

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INTERNATIONAL MONETARY FUND AND THE WORLD BANK

**Doha Development Agenda and Aid for Trade**

Prepared by the Staffs of the IMF and the World Bank

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## EXECUTIVE SUMMARY

This paper summarizes recent developments in the Doha Round negotiations, and aid for trade. As requested by the Development Committee last September, it reviews existing mechanisms for cross-country and regional aid for trade needs. It proposes possible options to overcome the coordination and capacity problems affecting regional cooperation.

**On the Doha Round negotiations, the paper notes that a *de facto* suspension of negotiations was announced in late July.** WTO members expressed their disappointment that it was not possible to reach a deal at this stage. Staffs urge WTO members to quickly return to the negotiating table, as failure to achieve a more rapid conclusion of the talks means a significant opportunity foregone to boost the world economy and strengthen its institutions and, in particular, to raise the growth prospects of poorer countries.

**Aid for trade has always been outside the scope of the single undertaking of the Doha Round and there is broad agreement that it is a development priority.** Task forces in Geneva formed to provide recommendations to enhance the Integrated Framework (IF, as proposed by the staffs in a September 2005 paper to the Development Committee), and on aid for trade more broadly have now completed their reports, which are summarized in the paper. The Aid for Trade Task Force underlined the central role of country ownership and of mainstreaming trade into countries' development strategies, and called on donors to provide predictable and additional funding. The IF Task Force recommended the creation of an independent secretariat to manage the IF, and endorsed a funding target of US\$400 million.

**The Bank and Fund have advocated an ambitious outcome to the current multilateral negotiations and have undertaken various activities to support countries in addressing adjustment and taking advantage of the opportunities of more open global trade.** At the country level, Bank and Fund staffs have scaled up support for trade-related reform, through diagnostics and policy dialogue, financial assistance, and technical assistance and capacity building.

**The section on regional and cross-country aid for trade reviews the potential benefits of regional cooperation, why it may be undersupplied, and options for bolstering support for regional cooperation.** It concludes that regional cooperation on trade-related projects can help promote the competitiveness of low-income countries in ways that purely national interventions cannot, or can only do less efficiently.

**The paper considers three possible options to help overcome the coordination and capacity problems that hamper progress in regional cooperation on infrastructure and trade-related regulation.** One is to improve existing grant instruments and strengthen the monitoring of regional initiatives and funding. A second is to establish a dedicated grant funding mechanism that would mobilize new resources for "upstream" analysis and project preparation. A third option is to mobilize dedicated grant funding to support a broader agenda, which would also cover implementation costs associated with cross-border projects.

## I. BACKGROUND

1. At the 2005 Annual Meetings, Bank and Fund staffs submitted a joint paper to the Development Committee (DC) and the International Monetary and Financial Committee (IMFC) which reported on progress in the World Trade Organization (WTO) negotiations under the Doha Development Agenda in the run-up to the Hong Kong SAR Ministerial in December 2005, and presented proposals on aid for trade.<sup>1</sup>
2. In the communiqués of both the DC and the IMFC, Ministers emphasized that a successful outcome to the Doha Round by the end of 2006 remained of critical importance for global growth and poverty reduction and agreed that key areas for action were: (i) a major reform of agricultural trade policies to expand market access and eliminate trade-distorting subsidies; (ii) action to open markets in manufactures and services; and (iii) increased aid for trade to address supply-side constraints and enhance the capacity of developing countries to take advantage of expanded trade opportunities.<sup>2</sup> Ministers endorsed staffs' proposal for an enhanced Integrated Framework for Trade-related Technical Assistance for LDCs (IF), and a strengthened framework for assessing adjustment needs. They asked the Bank and the Fund to examine further the adequacy of existing mechanisms to address regional or cross-country aid for trade needs and explore new mechanisms as appropriate and urged them to better integrate trade-related needs into their support for country programs.
3. This paper updates the Boards of the Bank and the Fund on progress in the WTO negotiations under the Doha Development Agenda (DDA) and aid for trade since April 2006, reports on ongoing trade-related activities of the Bank and the Fund, and responds to the request to examine regional and cross-country aid for trade.<sup>3</sup>

## II. STATUS AND PROSPECTS OF THE DOHA ROUND AS OF JULY 31, 2006

4. *A de facto* suspension of the Doha negotiations was announced in late July after it became clear that it would not be possible to gather the political will to bridge remaining gaps. This impasse came after the breakdown of negotiations among Ministers of the "G6" (Australia, Brazil, the EU, India, Japan and the US) in Geneva on July 23<sup>rd</sup>, amid disagreement on the level of ambition in agricultural market access and on reductions in domestic subsidies. Market access for manufactures—another major point of contention—was not discussed at the G6 meeting in view of the deadlock in agriculture.

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<sup>1</sup> See <http://www.imf.org/external/np/pp/eng/2005/091905.htm>.

<sup>2</sup> See <http://www.imf.org/external/np/cm/2005/092505.htm> and <http://www.imf.org/external/np/cm/2005/092405e.htm>.

<sup>3</sup> At the time of the 2006 Spring Meetings, staffs submitted "*Trade Progress Report: The Doha Development Agenda and Aid for Trade: Hong Kong and Beyond*" to the Development Committee as a background paper, which updated developments on the Doha Round and Aid for Trade since September 2005. See [http://siteresources.worldbank.org/DEVCOMMINT/Documentation/20890708/DC2006-0005\(E\)-TradeProgress.pdf](http://siteresources.worldbank.org/DEVCOMMINT/Documentation/20890708/DC2006-0005(E)-TradeProgress.pdf).

5. WTO Members have uniformly expressed their disappointment while stating that they remain committed to a successful Doha outcome. However, a new negotiating schedule may take some time to emerge, leaving the negotiations adrift. Failure to achieve a more rapid conclusion of the talks means a significant opportunity foregone to boost the world economy and strengthen its institutions and, in particular, to raise the growth prospects of poorer countries. It also poses some risks. The blockage of the main multilateral channel for trade reform will invite the further proliferation of bilateral solutions, and there are risks of increased litigation. Especially if the world economy were to slow down, there could be a renewal of protectionist trends around the world.

6. It is still too early to assess whether these risks will materialize. The multilateral trading system has faced challenges before, including similar circumstances and fears during the Uruguay Round, and has re-emerged with renewed strength. During the interregnum in the negotiations it is crucial that existing trade rules and WTO disciplines continue to be observed. Foreign market access and a predictable framework for trade are important for all countries, but especially for poorer countries for whom export markets can be critical for economic prospects and poverty alleviation.

7. Irrespective of the suspension of the Doha Round, efforts to assist developing countries to take maximum advantage of existing trade opportunities and to use them as a lever for growth need to be maintained. In this context, the Bank and the Fund are continuing to step up their trade-related support for members, and the donor community in general is on record with significant commitments in this area. The Bank and Fund can provide support in a number of ways, including through the provision of technical assistance and advisory services. Some of these actions are to be covered under the general rubric of "Aid for Trade".

8. The implications of the suspension of the talks for the aid for trade agenda, however, are unclear at the present time. Aid for trade has always been outside the scope of the single undertaking of the Doha Round and there is broad agreement that it is a development priority. The expectation, still to be tested, is that previous donor commitments on aid-for-trade will be honored. There is an emerging consensus within both the trade and development communities, and one that staffs will continue to promote, that aid for trade must be implemented within the parameters of the Paris Principles on Aid Effectiveness (harmonization, alignment, country ownership, and management for results), using existing development institutions and mechanisms with proven comparative advantage.

9. Looking forward, the staffs will continue to support trade reforms and the implementation of a behind-the-border agenda supportive of trade integration. Furthermore, staffs—together with partners such as the WTO and UN agencies, as appropriate—intend to promote the following messages:

- The suspension of the negotiations represents a "time out" and does not imply the death of the Doha Development Agenda; staffs will advocate the importance of a prompt resumption of the negotiations and argue there should be no back-sliding on

progress that had already been made, such as the offer to eliminate agricultural export subsidies by 2013 and provide duty-free/quota-free access for exports from LDCs.

- Regardless of what happens in the multilateral discussions, all countries can benefit from reforming their own trade regimes. Countries should carefully consider stepping up trade reforms as part of strategies to promote economic efficiency and growth and reduce poverty, or to stem budgetary waste.
- Preferential trade arrangements can, if properly designed, benefit their members, especially if combined with a non-discriminatory reduction in external barriers; if designed badly, the cost of such agreements, in trade diversion, confusion, and demands on limited institutional capacity, may well exceed the benefits. More broadly, such agreements cannot substitute for multilateral liberalization, and their excessive proliferation can undermine the multilateral trading system itself.

10. In this context, Bank and Fund staffs will continue to work closely with developing countries to support and encourage efforts to integrate trade into national strategies, with emphasis on the broad policy framework as well as the logistical bottlenecks that constrain trade. Staffs will highlight and advocate the reform of trade practices in developed countries that hamper development efforts, especially in the poorest countries. Finally, they will step up their joint efforts with other development partners to build and expand aid for trade, while ensuring that aid effectiveness principles are observed.

### **III. STATUS OF AID FOR TRADE**

#### **A. The Rationale for Aid for Trade**

11. The significant trade liberalization undertaken by the developing world over the past two decades has been associated with rapid growth in a number of formerly poor countries, especially in Asia. Countries with export-oriented policies have grown faster than those with inward-oriented policies that block integration and discourage competition. The increase in per capita incomes in these countries has been accompanied by a—sometimes dramatic—decline in the incidence of poverty.

12. Although trade can be an important engine of growth, many poor countries face considerable infrastructure and other supply-side constraints to participating in global markets. Trade reform is also a “global public good” in that all countries generally benefit from one country’s policy reforms (e.g., lowering of tariffs and other trade barriers) and investments in trade infrastructure (e.g., customs reforms and ports), and benefits are increased when reforms are undertaken by a number of countries concurrently. However, the benefits of reform are not fully captured by the reforming country itself, leading potentially to “under-investment” in reforms. Aid for trade can thus be an important complement to

trade reform and global market opening.<sup>4</sup> Nevertheless, it is not a substitute to ambitious liberalization under the Doha Round.

13. Efforts to provide aid for trade, like any other aid, need to take account of countries' absorptive constraints, whether at the project implementation, institutional or macroeconomic level. Nevertheless, it is useful to note that both trade reforms and aid for trade can also be complementary to the broader growth in aid: trade reforms and aid for trade can play a role in *managing* scaled-up aid inflows, by encouraging aid absorption and containing or mitigating the consequences of upward pressures on real exchange rates.

14. For instance, more open trade policies can counteract the negative impact that surges in aid, which can raise real exchange rates, might have on the competitiveness of exports. Lower import tariffs reduce costs for the export sector, both directly by making imported inputs available more cheaply and by diverting fewer resources into import-competing sectors. And of course, openness spurs competition and learning. Aid for trade, in turn, can tackle bottlenecks hampering supply and productivity in the non-tradable sector—such as roads, storage, ports, distribution—enabling the sector to expand supply instead of increasing prices, and thus benefiting the competitiveness of tradable sectors.<sup>5</sup> Finally, customs reform, and trade facilitation more generally, can reduce transaction costs for trade, thus countering the effects of real exchange rate appreciation (see also Box 1).

**Box 1: Managing and Absorbing Large Aid Inflows: The Role of Trade Measures**

Fund staff is modeling the role that trade measures can play in helping authorities to manage and absorb large aid inflows. Results indicate that trade-related measures that lower trade transaction costs help to reinforce the effect of tariff cuts in containing real exchange rate pressures arising from large aid inflows (i.e., Dutch disease). Moreover, trade policy can compare favorably with other policies aimed at managing the impact of large aid inflows, which are typically contractionary. For instance, while trade policy measures are associated with consumption growth, typically monetary adjustment policies rely on domestic sterilization. As such, monetary policies entail a building up of international reserves and the contraction of consumption.

**B. WTO Task Forces**

15. Since last September, two task forces have been established to provide recommendations on how to move forward with aid for trade. In October 2005, a Task Force was set up at the WTO in Geneva to present recommendations for enhancing the Integrated Framework (IF). Shortly thereafter, at the Hong Kong Ministerial meeting in December 2005, Ministers called for the establishment of a Task Force on Aid for Trade more broadly, which was set up in February 2006, as well as a separate complementary process on assessing the prospects for aid for trade funding, headed by WTO Director General Lamy.

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<sup>4</sup> Aid for trade comprises: technical assistance for capacity building and institutional reform, as well as financial support for diagnostic studies, investments in trade-related infrastructure, and assistance to offset adjustment costs, such as support to help countries make the transition from tariffs to other sources of revenue.

<sup>5</sup> See “Effective Aid for Trade: Local Accountability and Global Review”, OECD, COM/DCD/TD(2006)4.

Meanwhile, donors have also announced increased commitments for aid for trade.<sup>6</sup> This section provides a brief update on these developments.

**Box 2: The Integrated Framework**

The Integrated Framework for Trade-Related Technical Assistance (IF), first established in 1997, is a cooperative interagency effort (involving the IMF, the International Trade Centre, UNCTAD, UNDP, the World Bank, and the WTO) supported by bilateral donors aimed at facilitating coordination of trade-related technical assistance and promoting an integrated approach to assist the LDCs in enhancing their trade opportunities. Although initially the IF made little tangible progress toward its objectives, in 2000 it was revamped into a mechanism for mainstreaming trade into national economic plans and poverty reduction strategies. An IF Trust Fund was established with contributions by donors to finance Diagnostic Trade Integration Studies (DTIS) and certain related activities. Work in the first three countries began in May 2001 and at present, approximately forty DTISs have been undertaken, or are in the pipeline. These diagnostic studies include a comprehensive appraisal of barriers to trade and typically cover market access, trade policy, transportation, trade facilitation and the investment framework, as well as the overall macroeconomic situation and an assessment of the institutional setting.

**The IF Task Force**

16. Partly as a follow-up to the DC endorsement of the Bank and Fund staffs' recommendation for an enhanced IF, a task force of donors and LDCs was established in October 2005 to operationalize these proposals.<sup>7</sup> The work of the Task Force was to be based on three objectives: (i) increased, additional and predictable funding on a multi-year basis; (ii) strengthened in-country machinery, including through mainstreaming trade into national development plans and poverty reduction strategies; more effective follow-up to diagnostic trade integration studies; and improved co-ordination amongst all IF stakeholders; and (iii) improved decision-making and IF management structure to ensure an effective and timely delivery of the increased financial resources and other support.

17. Following consultations, including with Bank and Fund staff, the Task Force presented its recommendations to the IF Steering Committee in Geneva, which approved them on July 5, 2006 (see Attachment I). The main recommendations are:

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<sup>6</sup> For example, in July 2005 the European Commission announced an increase in trade-related assistance of €300 million per year to a total of €1 billion per year, which EU member states have pledged to match by 2010. Later in the year, the UK indicated that it will treble its aid for trade to £100 million per year by 2010. Japan promised US\$10 billion for aid for trade over three years, and the U.S. stated it will double its aid for trade to \$2.7 billion per year by 2010.

<sup>7</sup> The IF Task Force was chaired by WTO Ambassador Donald Stephenson of Canada and included representatives of LDCs and donors. Benin, Finland, France, Italy, Japan, Lesotho, Nepal, Norway, Senegal, Sweden (Secretary), U.K., U.S., Zambia and the European Commission were represented on the Task Force.

- creation of a new executive secretariat in Geneva, administratively housed in the WTO Secretariat (with a strong firewall around it) which would take operational decisions, manage the IF trust fund and report to a board consisting of donors, recipients and agencies;
- supporting a significant strengthening of capacity in each LDC recipient country, funded by the IF, to manage the IF process, including the capacity to contract IF agencies for diagnostic work, capacity building, project preparation studies and other activities within the scope of the IF;
- a funding target of US\$400 million over an initial five-year period; and,
- a monitoring and evaluation framework (currently there is no single framework, making it difficult to measure results).

18. These recommendations respond to the concerns raised in the Bank/Fund staff paper on Aid for Trade discussed at the Development Committee in September 2005, and with the key suggestions and principles put forward by Bank and Fund staffs during the consultations.<sup>8</sup> However, the Task Force did not agree with the suggestion that the IF should be expanded to include non-LDC low income developing countries, although it noted that a similar mechanism to the IF could be useful for other countries.<sup>9</sup> The Aid for Trade Task Force also reiterated the need to establish a similar mechanism for non-LDC IDA-only countries in its recommendations.

19. Staffs are broadly supportive of the direction that the enhanced IF has taken. The strengthened ownership of LDCs and donors will be an essential pillar for enhancing the effectiveness of the IF, and in light of donors' interest in the work of the Task Force, the prospects for raising the funding needed for the enhanced IF have improved significantly. At the same time the staffs have also expressed concerns shared with the Task Force and within the IF governing bodies about the need to establish adequate mechanisms to provide support in-country, thus bridging the gap between an independent Secretariat housed in Geneva in the WTO and the implementation of programs at the country level. Development effectiveness must be the overriding consideration for the IF implementation structure agreed upon by the negotiating parties (donors and LDCs) in Geneva.

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<sup>8</sup> These principles included that the new governance structure should align accountability, incentives, and capacity to act, in a structure that engages all stakeholders (beneficiaries, donors and agencies); and that it should not only deliver priority capacity building and other projects, but strive to ensure consistency, regardless of the agencies and donors involved, in helping LDCs integrate trade reforms into their broader policy frameworks.

<sup>9</sup> In this regard, a recent communication to the Aid for Trade Task Force from Guyana, Honduras, Kyrgyz Republic, Mongolia, Nicaragua and Sri Lanka (WT/AFT/W/20, June 21, 2006) argued that aid for trade should be prioritized to LDCs and other IDA-only eligible countries and explicitly references the September 2005 DC paper.

20. Going forward, transition teams comprising donors, LDCs, and agencies are being established to provide more specific inputs for implementation in three key areas: (i) institutional issues, including staffing of the Executive Secretariat for the IF; (ii) defining the in-country approach and programming issues; and (iii) launching the replenishment process for the IF Trust Fund, with a view to operationalizing the enhanced IF by January 2007.

### **The Aid for Trade Task Force**

21. The WTO Aid for Trade Task Force, established in February 2006 pursuant to the Hong Kong SAR Ministerial Declaration, is focusing on the scope of aid for trade and how it relates to the development dimensions of the Doha Round, the operationalization of aid for trade and identification of appropriate delivery mechanisms.<sup>10</sup> The question of the adequacy of financing for aid for trade is being addressed by DG Lamy in separate consultations. While donors have expressed their intention to channel significant resources towards aid for trade, these commitments remain largely untested.

22. The report of the Task Force was discussed by the WTO General Council on July 27 (see Attachment II). It articulates the rationale for aid for trade, places aid for trade in the overall development context, and contains a series of proposals for further work and eventual operationalization. There had so far been no unified definition of aid for trade, and the report provides a welcome clarification:

- Projects and programs should be considered as “aid for trade” if these activities have been identified as trade-related development priorities in the recipient country’s national development strategies.
- The scope of aid for trade is correspondingly broad. It covers assistance for trade policy and regulation (including training, analysis, and institutional and technical support), trade development activities (including trade and investment promotion, business support services, trade finance and other activities), development of trade-related physical infrastructure, building productive capacity, and support for trade-related adjustment.

23. The broad scope of aid for trade implies that monitoring and evaluation will be challenging. The Task Force recommends establishment of a monitoring body in the WTO, which would undertake a periodic global review based on reports from several different sources.<sup>11</sup> The reviews are to be followed by an annual discussion on aid for trade, convened in the WTO General Council to give political guidance. Furthermore, an assessment of aid for trade—for donors and recipients—is to be included in WTO Trade Policy Reviews.

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<sup>10</sup> The Task Force comprises 13 members: Barbados, Brazil, Canada, China, Colombia, the European Union, Japan, India, Thailand, the United States and the coordinators of the ACP (Africa, Caribbean and Pacific), African and LDC groups. It is chaired by WTO Ambassador Mia Horn af Rantzien of Sweden in her personal capacity.

<sup>11</sup> Including from countries and regions, donors, relevant multilateral agencies, and the private sector

**Box 3: Main Recommendations of the Aid for Trade Task Force<sup>12</sup>**

The Report of the Task Force establishes that aid for trade should be guided by the Paris Declaration on Aid Effectiveness, applicable to all parties involved (donors, agencies and beneficiaries). The specific recommendations from the Task Force include:

**Strengthening Needs Identification at the Country Level**

- Implement the recommendations for an enhanced Integrated Framework.
- Explore the necessity of establishing a similar, but separately funded, in-country-process for non-LDCs "International Development Assistance (IDA)-only" countries, if such mechanisms do not already exist or can be improved upon.
- Urge agencies, donors and governments in other developing countries to work together to establish similar processes if they do not already exist. These processes should be modelled to the specific circumstances and needs of the country concerned, building on what already exists where possible and appropriate.
- Urge donors and agencies, together with regional banks and organizations, to step up their efforts to identify regional, sub-regional and cross-border needs, including those related to regional integration.

**Strengthening Donor Response**

Donors and agencies should:

- Integrate trade and growth issues more effectively in their aid programming;
- Further strengthen their trade expertise both in the field and in capitals;
- Use needs assessment processes (where available), and their results, as a basis for their programming;
- Move towards a programme/sector/budget approach, if country owned, if mainstreamed in national development strategies and if a robust system of financial accountability is in place;

**Strengthening the Bridge between Needs and Donor Response**

*Country level*

- Recipient countries should mainstream trade into national strategies, such as PRSPs, formulate trade strategies, and propose priority trade projects for donor financing.
- The division of responsibility for funding and implementing Aid-for-Trade projects and programmes should be addressed through country-based processes such as PRSPs or Consultative Groups, if necessary complemented with a partner conference focusing specifically on trade-related support.

*Regional level*

- Explore the merits of establishing a Regional Aid-for-Trade Committee, comprising sub-regional and regional organizations and financial institutions, to oversee the implementation of the sub-regional and regional dimensions of Aid for Trade, to report on needs, responses and impacts, and to oversee monitoring and evaluation.

*Global level*

- Strengthen the collection and analysis of data on trade policies and their impact, the facilitation of knowledge sharing, and the development of guidelines. Funding for such activities needs to be secured;

**Strengthening Monitoring and Evaluation**

- A global periodic review of Aid for Trade should be convened by a monitoring body in the WTO, based on reports from several different sources, to be published if feasible on the WTO web page.
- Donors should report on funds dedicated for Aid for Trade, how they intend to meet their announced Aid-for-Trade targets, the Aid-for-Trade categories covered, and their progress in mainstreaming trade into their aid programming.

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<sup>12</sup> The complete list of recommendations of the Aid for Trade Task Force can be found in the Attachment II.

24. The Task Force proposals are summarized in Box 3. They represent a comprehensive attempt to address weaknesses and gaps along the full breadth of the assistance process, including the recipient (“demand”) side of aid for trade, the donor response, and the “bridge” between “demand” and “response”. The following highlights selected proposals:

- The Task Force establishes that aid for trade should be guided by the Paris Declaration on Aid Effectiveness, applicable to all parties involved (donors, agencies and beneficiaries).<sup>13</sup> It underlines the centrality of country ownership and country-driven approaches, and of the commitment of governments to fully mainstream trade into their development strategies. In this context, the Task Force notes that effectiveness requires selectivity, by focusing aid for trade on countries that can demonstrate results.
- The Task Force recommends exploring the establishment of an in-country process modeled on the Integrated Framework, but separately funded, for non-LDC IDA-only countries, if such mechanisms do not already exist or can be improved upon. This is consistent with the recommendations put forward in the joint Bank-Fund paper considered by the Development Committee in September 2005.
- The Task Force recommends strengthening the diagnosis of needs, costing of projects, preparation of project proposals, and the coordination of donor responses in relation to regional and cross-border issues. Section IV provides guidance on options for operationalizing these recommendations. The Task Force recommends exploring the merits of establishing a regional aid for trade committee to oversee and monitor the implementation of aid for trade in this area. However, staffs see little merit in establishing such a committee at the WTO, whose regional focus—as a trade body—is on free trade agreements. Instead, regional and cross-border aid for trade should be covered by the overall monitoring effort for aid for trade.

25. The report itself stops short of providing concrete recommendations for operationalizing these proposals. The Task Force recommends that the Director General of the WTO establish an ad hoc consultative group to follow-up on its recommendations. We are awaiting the results of these consultations.

26. To conclude, staffs welcome the progress made to date on aid for trade and the improved prospects for more funding for this area. The Aid for Trade Task Force report provides a good basis for promoting this agenda. Staffs agree that aid for trade must be implemented within the parameters of the Paris Principles on Aid Effectiveness (harmonization, alignment, country ownership, and management for results). In order to be effective, aid efforts must be linked to viable growth strategies, build on complementarities

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<sup>13</sup> Including key principles such as country ownership, mutual accountability, aligning aid to national development strategies, effective donor coordination, harmonization of donor procedures, use of programme-based aid modalities, managing for results, transparency, and predictable and multi-year commitments.

with the private sector, and ensure that aid can be absorbed. However, more work is needed to operationalize the Task Force recommendations, particularly with respect to support for non-LDCs in the articulation of trade integration strategies, addressing the needs of the growing regional and cross-country agendas, and establishing systems to monitor and evaluate progress and results. In this context, staffs consider it important to avoid the establishment of new and unproven institutional arrangements to manage and deliver aid for trade, and recommend building on existing donor coordination structures where feasible.

### **C. Update on IMF and World Bank Aid for Trade Initiatives**

27. As noted in last year's Development Committee Communiqué, the Bank and Fund have been active advocates of an ambitious outcome to the current multilateral negotiations and developed various initiatives to support countries in addressing adjustment and taking advantage of the opportunities of more open global trade. At the country level, Bank and Fund staffs have scaled up support for trade-related reform, through diagnostics and policy dialogue, financial assistance, and technical assistance and capacity building (see Table 1 and Box 4 for examples). The number of countries taking advantage of this support has been increasing. Neither institution's work in this area is linked to or conditioned on the Doha negotiations, but is grounded in the rationale set out in Section III.A. Nevertheless, demand for Bank and Fund support is expected to increase further once the Doha Round concludes.

28. The Fund has continued to conduct its regular policy dialogue on trade with member countries in the context of Article IV consultations and Fund-supported programs, but recent years have seen a broadening of instruments of support. As endorsed by the IMF Executive Board in November 2005, the Fund's initiatives cover:

- Fund financial support for adjustment, augmented by the Trade Integration Mechanism (TIM), and the option to use floating tranches to support trade reform in Fund-supported programs. In July 2006, Madagascar became the third country to avail itself of support under the TIM, following Bangladesh and the Dominican Republic in 2004 and 2005, respectively. Total funding for the three countries under the TIM amounted to US\$175 million, plus US\$129 million that could be drawn in case of a deterioration of trade-related shocks. Several regular, ongoing Fund arrangements support adjustment in the context of domestic trade reforms. Thus far, there has been no request for the incorporation of floating tranches related to trade adjustment into Fund arrangements.
- Diagnostic support and policy discussions. Assessments were made of the revenue impact of trade liberalization in a range of countries, combined with policy advice for mitigating measures, primarily in the context of Article IV Consultations. Box 4 provides illustrations of specific diagnostic work in this area. The Fund conducted a high-level policy dialogue with Caribbean countries based on an analysis of the size and macroeconomic implications of preference erosion in the sugar and banana sectors, and is serving a role as facilitator in discussions on regional integration in the Maghreb, and on trade policy in the Central Asian Regional Economic Cooperation (CAREC) countries.

#### **Box 4: Policy Analysis in Action**

Finance Secretaries from ten Caribbean countries gathered in Washington at the time of the 2006 Spring Meetings to discuss Fund estimates of the impact of banana and sugar preferences erosion. Simulation results suggest that the erosion of these preferences will have a significant impact on a relatively small number of countries in the Caribbean. Discussions on adjustment and financing needs will follow at a regional and at a country level in coming months.

In November 2005, World Bank staff produced the Kenya Diagnostic Trade and Integration Study, which identified Kenya's poor quality of transport and trade facilitation as a major constraint to export competitiveness. The study pointed out that improving land and sea routes along the Northern Corridor which links the port of Mombasa with Nairobi, inland Kenya as well as Uganda, Northern DRC, and Rwanda would enhance not only Kenya's trade competitiveness but also have significant benefits for neighboring countries through reduced transport costs and faster transit times.

This analysis was a key input in designing the recently approved World Bank East Africa Trade and Transport Facilitation Project, a US\$200 million project with components in 4 countries: Kenya, Tanzania, Uganda and Rwanda. The project aims to enhance transport and logistics efficiency along key corridors by reducing non tariff barriers and uncertainty of transit time. It provides both investment support for enhancing infrastructure at the ports of Mombasa and Dar-es-Salaam as well as institutional support for strengthening the Northern Corridor Transit Agreement between Kenya and the Great Lakes countries.

IMF staff simulation results on the potential fiscal impact of tariff reductions in various Doha Round scenarios suggest that less than ten percent of developing countries would face a fiscal impact of greater than 1 percent of GDP. Fund TA can assist these countries to design offsetting revenue measures to cope with any revenue losses arising as a result of obligations under the Doha Round, or regional/bilateral trade agreements.

The Fund has been asked to play a role as facilitator in a regional policy dialogue between Algeria, Morocco, and Tunisia. A first conference was held in Algiers in November 2005 and focused on trade facilitation. A work program was agreed upon that involves harmonizing trade regulations and eliminating trade distortions; further simplifying and reducing customs tariffs; reforming customs procedures; streamlining document processing; and improving payment systems.

- An increased focus on trade and trade facilitation issues in technical assistance for customs and tax reform. Apart from conducting technical assistance missions in these areas, the most prominent project over the past year has been a joint World Bank-IMF-World Customs Organization (WCO) program, intended to facilitate a successful outcome to the WTO negotiations on trade facilitation and address the concerns of developing country members. The staffs are working jointly in a program of seven study missions to assess the likely costs of implementation of a trade facilitation agreement, as well as contributing to regional workshops and seminars. The Bank and Fund's involvement in this project will also inform future work on the possible reorientation of technical assistance in customs administration, including priorities for the short- to medium-term, and lead to a better understanding of the linkages between the work on trade facilitation at the WTO, the Integrated Framework and the aid for trade initiative.

29. The World Bank's focus in the past year, in addition to significant research and advocacy linked to the Doha Round, has been to continue to strengthen the role of trade, as part of the broader growth agenda in country and regional policy dialogues and programs.<sup>14</sup> Key pillars of the Bank's work have been research in areas such as the impact of trade on poverty, as well as export growth and diversification, diagnostics that range from comprehensive trade strategies to specific trade related issues such as value chain analyses for specific products and markets, and financial and technical assistance support. The development and implementation of this program is already benefiting from and taking into account the lessons and recommendations drawn from the 2006 Independent Evaluation Group (IEG) Report on Trade (see Annex II).<sup>15</sup> Specifically, Bank work has included:

- At the country and regional level the strong increase in trade diagnostics that started some four years ago continues with force. In the last year alone, the Bank carried out trade diagnostic work (i.e., comprehensive analytical studies of country trade policy settings and of opportunities for and obstacles to participation in international trade) for more than twenty countries. Information and analyses are no longer a major constraint to the Bank's policy dialogue on integrating trade into most country programs. The Bank's diagnostic work falls mainly into four broad categories: (a) comprehensive diagnostics for countries where the knowledge base was incomplete or outdated and which are not beneficiaries under the Integrated Framework<sup>16</sup>; (b) comprehensive diagnostics in the context of the Integrated Framework<sup>17</sup>; (c) more narrowly focused diagnostics<sup>18</sup>; and (d) regional studies.
- World Bank trade-related lending has increased significantly compared with the low levels of the late 1990s and early 2000s. Trade related lending for FY06, at roughly US\$1.6 billion, exceeds lending for FY05 (US\$1.1 billion) and FY04 (US\$1.3 billion) and is almost three times higher than trade related lending for FY03 (US\$566 million) (see Annex I). This resurgence in trade-related lending is driven largely by Bank financing of trade related infrastructure in Africa and Latin America.

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<sup>14</sup> Salient parts of the research and advocacy program have been the joint World Bank-IMF-WCO program to support the WTO negotiations on trade facilitation, as well as the new knowledge and information shared through the publication and dissemination of four books: "Trade, Doha and Development—A window into the Issues"; "Poverty and the WTO—Impacts of the Doha development Agenda"; "Agricultural Trade Reform and the Trade Development Agenda"; and "The WTO and Agriculture—Critical Perspectives on the Global Trading System and the WTO".

<sup>15</sup> The report is available at: <http://www.worldbank.org/ieg/trade>.

<sup>16</sup> Recent examples include Ecuador, Kenya, Mauritius, Mexico, Mongolia, Peru, Nigeria, and Pakistan.

<sup>17</sup> Recent examples include Angola, Burkina Faso, Lao PDR, Rwanda, Sierra Leone, Uganda, Tanzania, and Zambia.

<sup>18</sup> Examples include trade and poverty analysis in the context of the cotton sector reforms for Benin, Burkina Faso and Mali, trade in services analysis for Mauritius and Zambia; and cost of compliance analyses of a potential WTO agreement on trade facilitation for Egypt, Paraguay, Rwanda, Senegal, and Sri-Lanka.

One feature of trade related lending for FY06 has been the development of important regional projects in Africa such as the East Africa Trade and Transport Facilitation Project, the West and Central Africa Air Transport Safety and Security Project, and the West Africa Power Pool Project.

- Development Policy Lending (DPL) operations for FY06 supported at least some aspects of trade reforms in Burkina Faso, Ghana, Madagascar, Mali, Tanzania, and Rwanda in Africa, as well as Bangladesh, Colombia, El Salvador, Georgia, Mexico, Ukraine, and Vietnam. While this is a positive development, still more could be done to strengthen the link between trade and growth in many countries and to use DPLs to support implementation of more comprehensive growth and competitiveness strategies. Bank management is committed to addressing this issue (see Annex II).
- Capacity building has an important role to play in this area, and, accordingly, the World Bank Institute has continued to expand its programs on trade significantly. Thanks to strong partnerships with local, regional, and other international institutions, the World Bank Institute delivered or contributed to 64 learning programs in FY06 reaching more than 3,000 participants around the world helping to address issues ranging from WTO accession (Russia and Vietnam), trade policy in the context of bilateral agreements (Egypt and Thailand), agricultural trade (for Mediterranean countries and for Africa), and regional integration (Eastern and Southern Africa).

**Table 1. Instruments of IMF/World Bank Aid for Trade**

Type of Assistance	IMF	World Bank
Financial Assistance	<ul style="list-style-type: none"> <li>• Regular Fund facilities</li> <li>• Trade Integration Mechanism (TIM) as part of regular Fund facilities</li> <li>• Floating tranches</li> <li>• Exogenous Shocks Facility</li> </ul>	<ul style="list-style-type: none"> <li>• Investment lending</li> <li>• Development policy lending (budget support)</li> </ul>
Research	<ul style="list-style-type: none"> <li>• Preference erosion</li> <li>• Tax Revenue and Trade Liberalization</li> <li>• Trade-related Balance of Payments Vulnerabilities</li> </ul>	<ul style="list-style-type: none"> <li>• Country Competitiveness and Export Growth</li> <li>• Impact of Global Trade Reforms</li> <li>• Trade and Poverty</li> <li>• Trade Facilitation &amp; Logistics Standards</li> <li>• Trade in Services</li> </ul>
Diagnostic/Analytical Support and Policy Dialogue	<ul style="list-style-type: none"> <li>• Design of trade reform</li> <li>• Fiscal impact of tariff reductions</li> <li>• Assessing and managing preference erosion and changes in food terms of trade</li> <li>• Impact of financial services liberalization on regulatory and supervisory framework</li> </ul>	<ul style="list-style-type: none"> <li>• Country Diagnostic Trade Integration Studies (IF)</li> <li>• Country Growth and Competitiveness Reports</li> <li>• Country Economic Memorandum with focus on trade</li> <li>• Trade and Transport Facilitation Audits/Value Chain Analysis</li> <li>• Standards Assessment and Strategy</li> <li>• Investment Climate Assessments</li> <li>• Trade in Services Country Studies</li> </ul>
Technical Assistance/ Capacity Building	<ul style="list-style-type: none"> <li>• Redesign of tax systems in the face of tariff revenue loss</li> <li>• Customs administration reform / trade facilitation</li> </ul>	<ul style="list-style-type: none"> <li>• Support to Trade Facilitation Negotiations</li> <li>• Support to WTO Accession</li> <li>• WBI Capacity building events: <ul style="list-style-type: none"> <li>Services</li> <li>Trade and poverty</li> <li>Agricultural trade</li> <li>Analytical tools (WITS)</li> <li>Regionalism</li> <li>Standards</li> </ul> </li> </ul>

**Mauritius: An example of Bank-Fund collaboration on Aid for Trade and Adjustment**

30. Mauritius is a specific example where World Bank and IMF staff are working together, drawing on their comparative expertise, to address Mauritius' request for assistance in accessing Aid for Trade. This combined support for Mauritius is an example of how staffs can respond effectively to a demand from country authorities. As a middle-income country, Mauritius does not have access to mechanisms such as the Integrated Framework to provide diagnostics and coordinate donors around trade-related priorities. However, Mauritius is facing significant external shocks from preference erosion for sugar and textiles exports, compounded by high oil prices, which are coming on top of an already challenging macroeconomic environment, characterized by declining growth and a worsening public sector debt burden. The response of the government has been to seize the opportunity to embark on an ambitious program of economic reform, including trade liberalization, to move

Mauritius from dependence on declining trade preferences to being a globally competitive trader, including in services.

31. At the request of the Government of Mauritius, Bank and Fund staff have provided in-depth analytical and technical assistance support in identifying key elements of a reform program. The IMF has advised on budgetary measures that will be central in the restructuring process, while strengthening the social safety net. The World Bank has focused on how Mauritius might improve its trade competitiveness, through a combination of tariff reduction and simplification, tax and regulatory reforms to encourage investment and to tap new sources of future growth, while protecting low-income workers during the transition process and providing new opportunities for the unemployed. Moreover, an IMF-sponsored consultant is also assisting the authorities in monetary and financial sector policy formulation. Bank and Fund staffs have been working with Mauritius to identify prospects for possible donor funding associated with the aid for trade initiative.

32. Going forward, the authorities are seeking an IMF/World Bank assessment of their reform strategy to help mobilize financial support in the context of donor commitments on aid for trade. Mauritius plans to showcase its economic reform program on the margins of the Annual Meetings in Singapore. The government has asked the World Bank, in the context of aid for trade, to provide financing and technical assistance through a series of programmatic loans and selected infrastructure projects.

#### **IV. REVIEW OF MECHANISMS FOR CROSS-COUNTRY/REGIONAL PROJECTS<sup>19</sup>**

33. In their September 2005 Aid for Trade paper, Bank and Fund staff raised the issue of whether existing instruments and mechanisms were adequate to realize the benefits of regional cooperation. At that time it was highlighted that purely country-driven PRSP or national development processes could result in under-investment in cross-country and regional initiatives. Coordination requires analysis to help national governments identify areas where there is a high payoff to regional cooperation, be it on policies or infrastructure (including as potential mechanisms to achieve purely national objectives). But undertaking such analysis and identification is in itself a public good that is affected by collective action problems as is the financing of such programs. This section briefly reviews the potential scope for regional cooperation to be beneficial, why it may be undersupplied, existing structures and instruments for regional cooperation, and options for bolstering support for regional cooperation.<sup>20</sup>

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<sup>19</sup> This section is based on analysis carried out by World Bank staff.

<sup>20</sup> The analysis in this section has been informed by visits to and consultations with staff working on regional and cross-country projects in the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, and the European Commission, and has benefited from interactions with and inputs from World Bank operational staff in the various regions that have experience with cross-country projects.

34. The section concludes that regional cooperation on trade-related projects can help promote the competitiveness of low-income countries in ways that purely national interventions cannot, or less efficiently. However, achieving regional cooperation on infrastructure and trade-related regulation is difficult, as illustrated by the many examples of regional integration initiatives that have foundered. The needed coordination is impeded by uncertainty regarding the distribution of benefits and fears of asymmetric implementation costs and free riding. Even in the EU—with supra-national institutions and financial mechanisms through which poorer regions are provided with transfers aimed in part at supplying regional public goods—cooperation is not assured.

35. To bolster the capacity of low-income developing countries to realize the potential benefits of regional cooperation, there is a case for supporting regional (multi-country) projects through grant financing of the aspects of regional cooperation that might not otherwise attract adequate financing, such as identification, feasibility and cost/benefit analysis, the consultations and consensus-building process, and technical assistance and capacity building for the national and regional bodies concerned. In addition to funding such “upstream” activities, there may also be a case for grant co-financing of the implementation of regional projects to help overcome coordination problems and the failure of countries to adequately internalize costs and benefits of regional investments. Any mechanism to enhance assistance for regional cooperation would need to be demand-driven, with projects proposed supported by the countries concerned, and open to any implementing body.

#### **A. Why Regional Cooperation Matters**

36. Regional cooperation is defined here to include both cooperation on trade-related regulatory policies (i.e., “policy integration” of measures that result in fragmented markets or affect their contestability, such as health and safety standards for products) and cooperation on infrastructure projects that will benefit more than one country. The two are closely linked: policy reforms to remove impediments to regional market integration may also be needed in order to fully benefit from regional investments in infrastructure. And investments in regional infrastructure could be less than optimal where, for example, they serve to reinforce the trade diversion effects of discriminatory regional trade agreements, rather than enhancing the benefits of nondiscriminatory policies and low external tariffs.<sup>21</sup>

37. Cooperation can occur in the context of formal regional integration agreements (RIAs), but need not. Much regional cooperation occurs outside the ambit of formal RIAs—examples of infrastructure cooperation are listed in Box 6 later in this section. The focus in what follows is thus on the mechanisms through which policy and infrastructure

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<sup>21</sup> To be beneficial, regional cooperation should increase countries’ competitiveness in the world market, as opposed to promotion of activities which will primarily lead to the creation of closed blocs and trade diversion costs for other developing countries. Regional integration agreements that have pursued the latter as opposed to pursuing a strategy of integrating into the world economy have generally failed to deliver sustained economic benefits to members and been detrimental to non-members.

cooperation amongst countries can best be supported, not on the best means of supporting implementation of RIAs or regional economic communities (RECs).

38. The potential benefits of regional cooperation can be large, particularly for small, very poor, and landlocked countries. To trade, countries need to be competitive, and cross-border infrastructure and policy cooperation (harmonization, mutual recognition, adoption of common regulatory systems) can help lower trade costs. Landlocked countries—of which there are over 20 amongst the low income countries—can be dependent on action by neighbors to ensure their access to key trade and transport links. The establishment of a transport corridor linking two or more countries can be a mechanism that reduces trade costs both directly and indirectly by increasing the incentives of all countries involved to monitor “performance” on the corridor. Non-tariff barriers are a major impediment confronting traders in low-income developing countries—red tape, corruption, internal tax and regulatory controls. These are matters that may be difficult for national governments to address—international cooperation can help focus political attention on these problems.

39. Recent World Bank research using data reported in *Doing Business in 2006* (the average time it takes to get a 20-foot container of an identical good from a factory in the largest business city to a ship in the most accessible port), finds that each day of delay reduces export volumes by more than 1 percent on average. Delays have an even greater impact on exports of time-sensitive goods, such as perishable agricultural products. To give an example, if Uganda reduced factory-to-ship times from 58 to 27 days (the world median), exports are predicted to increase by 31 percent. An alternative measure of the impact is that this is equivalent to Uganda bringing itself 2,200 km closer to its main trading partners—two-thirds the distance from Kampala to Cairo. Being landlocked adds an average 19 days for exports and 25 days for imports. Part of the problem is caused by numerous checkpoints within countries that affect both internal and cross-country transport costs. On the road between Lomé and Ouagadougou there are some 34 checkpoints, one every 25 km.

40. For land-locked countries this trade cost agenda is directly linked to enhancing competitiveness on world markets. Addressing the agenda is a regional matter—cooperation is required with neighbors to bring costs down. There is a large literature documenting the trade-impeding effects of national borders: even if there are no formal trade restrictions such as tariffs, most recent estimates suggest that regulatory differences reduce trade by a factor of six relative to domestic trade. Each additional border to be crossed increases compliance costs. Regional cooperation can lower costs and enhance global competitiveness of exporters by removing duplication, realizing economies of scale by spreading the fixed costs of regulatory enforcement and related services over a larger area, and promoting greater competition. Small island states such as the countries of the Pacific and the Caribbean also face significant challenges that can be eased by regional cooperation. They face higher trade costs in infrastructure due to high sea and air transport rates and high telecommunications costs. However, in the case of island states, regional infrastructure needs are often quite different from those of landlocked countries, revolving more around the realization of scale economies than access to transport networks.

41. There is considerable scope for regional cooperation to address capacity constraints in poor countries and realize economies of scale. Recent Diagnostic Trade Integration Studies for LDCs identify numerous examples where regional cooperation is the appropriate mechanism to address trade-related costs and constraints. These include cooperation on product standards, certification and accreditation systems; transport links and policies (e.g., cabotage restrictions), and customs harmonization. There is also considerable scope to expand cross-country cooperation in infrastructure beyond transport and trade facilitation, e.g., power and telecommunications. Regional cooperation in all these service sectors may include regulatory harmonization, development of common accreditation systems or mutual recognition of qualifications, as well as regional institutions to implement and enforce common norms.

42. There are a number of challenges that impede regional cooperation on trade-related policies and infrastructure. They include the need to identify potential joint projects that will benefit all participating countries, obtain agreement on a division of the costs and benefits to all countries, obtain financing for the project, develop and implement the needed supporting policies, both national and regional, and to put in place effective management bodies, including regional regulatory bodies where needed (Box 5).

**Box 5: Benefits and Challenges of Regional Cooperation**

A feature of regional cooperation projects is that the associated national investments will have benefits that accrue in part to regional trading partners. Regional cooperation is often aimed at the provision of regional public goods, such as harmonization of financial regulations and mutual recognition of product standards. But the incentives for countries to free ride can result in under-provision. A common example is the financing of the regional management or regulatory body that is needed to ensure the smooth operation of a regional project. One reason the institutions required are often under-funded by participating governments is because of the free rider problem, that is, benefits from one country's investment are realized partially by other countries. In principle, this might be overcome by allocating investments and operating costs to countries proportionate to the benefits they receive. But given the large degree of uncertainty in estimates of the distribution of benefits, it is typically difficult for countries to agree on a cost-sharing formula, and in many cases, it may be difficult to exclude from the benefits those who do not shoulder their share of the costs.

Even in cases in which there is no free rider problem, there may be coordination problems. For example, a highway that links cities on different sides of an international border will benefit both countries. Yet if only one country builds the road up to the border and the other does not, the investment may be of little value. Although transfers and user fees should in principle be able to generate the required cooperation by addressing distributional concerns, in practice coordinating investments of policy actions in two countries has transaction costs, and differences in priorities across countries, uncertainty about the overall costs and benefits and their distribution, and disagreements about cost sharing may block realization of a regional project. Coordination problems are obviously magnified as the number of countries involved increases. A concrete current example is the East Africa submarine (EASSy) cable project, which will provide broadband telecom access to the 22 African countries involved. To ensure that there is open access to the cable—necessary for competition to minimize prices and fully utilize capacity—it will be necessary to put in place a regional regulatory framework and pursue policy convergence in each country.

A final challenge confronting regional cooperation is created by the instruments available to support it. As discussed further below, these tend to be nation-centric, requiring a series of country-specific loans, credits or grants. The associated transactions costs can be large. They may impede the realization of a project and can substantially raise the overall cost (see para. 44).

## **B. Instruments to Support Regional Cooperation**

43. There is a wide range of existing experiences with trade-related regional cooperation, with varying degrees of ambition and success. The EU is the most far-reaching inter-governmental cooperative effort extant aimed at regional integration. Mechanisms to support regional cooperation and integration of markets are much less developed in other regions of the world, both in terms of institutions to foster coordination, assist in and monitor implementation, and the magnitude of resources allocated to cross-country projects—although in part this reflects the more limited integration ambitions of most RIAs/RECs. In addition, less funding is directed towards the provision of regional projects than in the EU. Regional, or multi-country, projects are generally a small proportion—ranging from 2 to 6 percent—of the portfolio of regional development banks (RDBs).<sup>22</sup> The trade-related components of new World Bank lending for regional projects in FY05 and FY06 totaled \$136.6 million and \$378.9 million, respectively, or 0.6 percent and 1.6 percent of total lending. Annex III reviews some of the existing structures in developing regions aimed at furthering regional cooperation in both policy and infrastructure, as well as the support that has been given by the development community for such cooperation.<sup>23</sup>

44. The development banks, both regional and the World Bank, focus almost exclusively on national interventions to support multi-country projects. Experience suggests that large-scale regional projects can be financed if governments decide these are a priority, have the borrowing capacity and potential concerns about the distribution of costs and benefits of a project can be addressed (Box 6). However, lending for regional trade-related projects is limited owing to the difficulties in securing agreement between countries and the appropriate guarantees for multi-country loans. The fact that loans and credits have to be repaid is another serious limitation. Loans can only be made to revenue earning, creditworthy regional entities unless the repayment obligation is assumed by their member governments. Many important regional bodies are not revenue earning and are dependent on financial contributions from their member governments, which themselves often face serious fiscal constraints in low income countries, or grants from donors. More fundamentally, a key issue is that regional projects are less likely to find their way into national development plans as a result of coordination problems.

45. Coordination requires analysis to help national governments identify areas where there is a high payoff to regional cooperation, be it on policies or infrastructure (including as potential mechanisms to achieve purely national objectives). But undertaking such analysis and identification is itself affected by collective action problems. Overcoming coordination and capacity problems is not an agenda that lends itself to debt-finance. In the EU, for example, grant resources to identify projects and pursue policy integration play an important

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<sup>22</sup> The share is highest for the Caribbean Development Bank.

<sup>23</sup> Given space constraints and the plethora of RIAs/RECs and the institutions that may support regional cooperation efforts, the discussion in Annex III is illustrative.

role in attaining agreement on the provision of regional public goods. Absent such “upstream” resources for identifying mutually beneficial projects, the scope for—and feasibility of—realizing regional projects declines significantly.<sup>24</sup> This is not to say no such resources exist. For example, the AfDB has an amount of up to US\$161 million under its grant funding window for regional projects during 2005–2007, and the IDB has created a US\$20 million fund for technical cooperation for regional infrastructure under IIRSA (see Box 6) as well as a US\$10 million fund for regional public goods. However, available grant funding tends to be institution-, region- or program-specific.

**Box 6: Examples of Regional Cooperation in Infrastructure**

*The Initiative for the Integration of Regional Infrastructure in South America (IIRSA)*, launched in 2000, supports the development and integration of energy, transport and telecommunications infrastructure across 12 South American countries. The IDB, the Andean Development Corporation (CAF) and the Financial Fund for the Development of the River Plate Basin (FONPLATA) provide technical support and financing to countries. IIRSA has identified physical infrastructure requirements for ten integration hubs in the region and 335 related projects, involving an estimated US\$37.5 billion investment. From this set governments have selected 31 priority projects worth US\$5.8 billion for implementation through 2010.

*The Puebla-Panama Plan (PPP)*, launched in 2001, focuses on a number of areas including trade facilitation, infrastructure development (roads, energy, telecommunications), and tourism services in southern-Mexico and Central America. The plan is supported by the IDB, the Central American Bank for Economic Integration (CABEI), and ECLAC, with the IDB acting as financial coordinator. A multi-billion, multi-year program that is to run through 2020, the PPP is financed by contributions from participating countries, the private sector, and bilateral and multilateral donors.

In Central America, as part of the Puebla-Panama Plan, *SIEPAC, a power grid involving 6 countries* (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama), financed by the IDB and the Spanish government through a series of national concessional loans, aims at integrating the regional electricity markets. It operates under a Framework Treaty for the Electricity Market in Central America which created two regional commissions to regulate the market and operate the regional system.

In Africa, the World Bank-supported *West Africa Power Pool* aims to establish a well-functioning, cooperative power pooling mechanism for West Africa, as a means to increase access of the citizens of ECOWAS to stable and reliable electricity at affordable costs. A similar power pool project is also underway for *Southern Africa, along with a gas pipeline in West Africa*.

The World Bank also supports transit and transport corridor projects in the major regions of sub-Saharan Africa. These aim to improve access of land-locked countries to export markets and reduce trade costs and transit times for all participants. For example, the *East Africa Trade and Transport Facilitation Project* aims to improve the trade environment through the effective elimination of tariff barriers in the EAC Customs Union Area, to enhance logistics services’ efficiency along key corridors by reducing non-tariff barriers and uncertainty of transit time, and to improve railway services in Kenya and Uganda.

<sup>24</sup> A major distinction between regional cooperation efforts in the European context and in other regions is the amount of grant resources allocated to overcoming coordination and capacity problems. An example is the Energy Community of South East Europe (ECSEE), which seeks to establish integrated regional energy markets in South East Europe. The World Bank is supporting this through Adaptable Program Loans. However, technical assistance for institutional/systems development and project preparation and implementation, as well as the strategy paper for energy trade in South East Europe were largely financed by the EU, as are the multi-country mechanisms for ECSEE coordination.

46. In the case of IDA-14 a specific share—US\$ 1 billion out of the total of US\$34.4 billion—is dedicated to support regional projects.<sup>25</sup> While this credit financing is important in providing an incentive for governments to consider cross-country cooperative projects, IDA does not provide grant funding for regional projects, and there are constraints on using credits to directly support non-revenue earning regional implementing bodies.<sup>26</sup> A multi-donor trust fund that is being established within the World Bank recognizes the gap in existing instruments to support regional projects in Africa. One of the objectives of the Africa Catalytic Growth Fund (ACGF) is to complement IDA resources to support the Africa Action Plan by making available additional grant funding for initiatives to facilitate regional integration, including components of multi-country projects (involving three or more countries) to be implemented by non-sovereign regional institutions. The ACGF has received a £200 million commitment from the United Kingdom.

47. Access to such grant resources can greatly reduce the transactions costs associated with a national approach to support regional cooperation. These can be disproportionately large. An example is a World Bank supported project to strengthen the Eastern Caribbean Telecommunications Authority (ECTEL). This involved loans and credits to five member countries of the Organization of Eastern Caribbean States (OECS) in the amount of some \$540,000 each. Although the primary recipient was ECTEL, a non-sovereign regional body, the need to develop a series of linked country loans/credits generated project preparation, transactions and supervision costs that were substantially greater than what would have been needed if there had been access to a regional or multilateral facility to support ECTEL directly.<sup>27</sup> The same is true of the Regional Trade Facilitation project in Southern and

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<sup>25</sup> The regional funding agreed for IDA14 is based on an envelope of up to SDR 300 million per annum for regional projects, with SDR 100 million coming from the participating countries' IDA allocations and the balance of SDR 200 million coming from a special set-aside provision. With their 1/3 contribution, countries are therefore able to leverage the remaining 2/3 of project costs. The national contribution ensures ownership in the regional projects, while recognizing the need for additional incentives to address the externalities affecting regional cooperation.

<sup>26</sup> IDA can provide credits to eligible regional entities through the IDA pilot program for regional projects. This specifies that: "In some cases where project costs or benefits cannot readily be split into country components, such as in the case of a regional center of excellence, a legally eligible regional entity could take on an IDA credit on behalf of the region, in accordance with the relevant provisions of the Articles of Agreement of IDA." In such cases, the credit would be made to an eligible regional institution, and the 1/3 of costs normally charged to country allocations would be waived. This flexibility has allowed a \$5 million credit to be provided to the African Trade Insurance (ATI) Agency as part of a Regional Trade Facilitation Project. It should be noted that 'legally eligible' has been interpreted as meaning financial recourse to one or more sovereign states, i.e., the provision makes possible such funding if a regional body is established with an instrument that has the character of a treaty and that provides such recourse. None of the RECs in Africa would meet this criterion.

<sup>27</sup> Another example from the LCR region is the Emergency Recovery Project, aimed at improving security at ports in the Eastern Caribbean. This required a series of national loans/credits for upgrading of security regulations and enforcement, a portion of which was used to jointly fund the Department of Civil Aviation, one of the regional implementing bodies. One consequence of the country-by-country lending approach was that countries purchased different brands of equipment, preventing economies of scale in both purchasing and maintenance.

Eastern Africa, which includes the creation of an African Trade Insurance Agency (ATI), a project which aims to catalyze trade and investment through provision of trade insurance and related services. This project required a series of credits for each participating country, giving rise to a series of implementation status and completion reports with associated transactions costs.<sup>28</sup>

48. Another example from the Caribbean is a regional facility to allow CARICOM governments to purchase insurance against a major hazard event such as a hurricane. Efforts by the World Bank to implement a regional project to provide such insurance were launched in 2001, based in part on a 1998 feasibility study undertaken at the request of the CARICOM Secretariat for a Caribbean Catastrophe Reinsurance Fund. The project was prepared by the World Bank and involved technical assistance loans/credits of some \$680,000 per OECS member. A minimum of four countries was required to make the project viable, but in the event only three signed and ratified the agreement. One of the countries that ultimately decided not to participate in the project—Grenada—was subsequently devastated by a major hurricane in September 2004. Post 2004, efforts to establish a proposed Caribbean Catastrophe Risk Insurance Facility (CCRIF) were supported by a Japanese PHRD grant, reducing the need for governments to borrow for the technical assistance required. While this has helped move the project forward, this source of grant funding requires a national implementing agency, as do many other existing grant mechanisms.

49. Turning to examples of constraints imposed by existing instruments in the African context, several of the RECs in Africa (ECOWAS, SADC, COMESA and EAC) have, separately, requested support from the World Bank to help launch project preparation and development facilities to identify and prepare priority regional projects listed in the NEPAD Short Term Action Plan. Lack of technical preparation of priority projects is a major reason NEPAD regional projects are not being implemented rapidly. While limited financing is available from other sources, World Bank engagement is desired by the RECs because of the Bank's project experience and capacity, the linkages to the national policy dialogues required to align regional policies and the Bank's strong engagement in donor harmonization. A lack of grant resources has implied the Bank has not been able to assist in financing the requested project preparation facilities. Similarly, the lack of a grant financing instrument for regional projects seriously constrains the Bank's ability to help build up the capacity of important but non-revenue earning regional trade and regulatory institutions.

50. A final example concerns regional cooperation on infrastructure. Like other Rift Valley countries, Malawi experiences prolonged power outages impacting all sectors of the economy. Almost all of Malawi's generation comes from hydroelectric stations on the Shire River, the level of which is declining sharply with levels on Lake Tanganyika. A solution is

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<sup>28</sup> Currently efforts are ongoing to respond to the decision of participating countries and the ATI Board and General Assembly to convert current country-specific IDA-funded contributions to its capital into pooled equity capital for the Agency. Pooling would allow greater leveraging of capital and diversification of risk, remove country-specific underwriting constraints, and encourage greater private equity participation. It would also convert the project into a truly regional one.

to connect Malawi to the Southern African Power Pool, with a new transmission line to a bulk supply point in Mozambique. The World Bank has provided financing to Malawi through the Southern Africa Power Pool APL. Most of the line, however, needs to be constructed in Mozambique, which has only a limited incentive to do so. In a world with no transaction costs and perfect information on benefits, this problem would be resolved by payments from Malawi to Mozambique. But the reality is that the size of the necessary payments is highly uncertain, and there is no obvious mechanism through which they could be effected. The line would have been constructed at the commencement of IDA 14 if Mozambique's investment burden could have been reduced through a partial regional grant and brought into line with perceived benefits.

### **C. Possible Ways Forward**

51. The foregoing discussion indicates that loan financing for regional infrastructure is in principle available, and that there are a variety of mechanisms that can support regional policy cooperation. However, the emphasis of the development community is predominantly and appropriately on country-driven programs. Using country-based instruments to support multi-country cooperative projects can generate high transaction costs, and, in the case of small, poor countries may impede implementation of regional projects. The national focus of development assistance makes it more difficult to realize the potential benefits of cross-country cooperation in trade-related areas.

52. It is not possible to estimate unmet demand for viable regional projects with any precision, but consultations with project staff and management of key regional development banks, the World Bank, and the European Commission revealed a commonality of views that regional projects face far greater development constraints in practice than do national projects. In particular, difficulties in securing appropriately flexible funding of upstream activities have acted as a disincentive to engaging countries on such projects in the early stages. There was also a widely held view that existing instruments could usefully be supplemented by additional and more flexible grant funding to address coordination problems and to facilitate the realization of regional projects. Looking forward, there is a case for a multilateral effort to address these constraints in the context of new initiatives in aid for trade.

53. There are several options that could be considered in overcoming the coordination and capacity problems affecting regional cooperation. One is to improve existing grant instruments and mechanisms complemented by greater monitoring of the extent to which identified needs and priorities have been addressed. A second is to establish a dedicated grant funding mechanism that would mobilize resources to both address coordination problems and support regional management and regulatory bodies. A third option is to mobilize dedicated grant funding to support a broader agenda, going beyond grants for upstream analysis and related "software" to cover as well all or part of the implementation costs associated with cross-border projects.

54. The first option would involve donors responding to proposed regional projects through existing bilateral and multilateral facilities. As noted previously, a number of the development banks have grant-based funding mechanisms that can be used to support

regional cooperation in trade-related areas. All these facilities face many demands to address broad agendas and could benefit from additional grant resources for regional projects. A case in point is the Africa Catalytic Growth Fund. Consideration could also be given to enabling IDA to provide grant as well as credit financing for regional projects.<sup>29</sup> The extent of the support provided for regional projects could be monitored through the DAC/WTO database and/or a new WTO-based clearing-house mechanism as recommended by the WTO Task Force on Aid for Trade (see Attachment II).

55. This option recognizes that the current systems and mechanisms to support regional initiatives could be improved and with the help of a monitoring system, duplications could be avoided and gaps in support identified. However, this option may do little to directly address the coordination or capacity constraints that affect cooperation in regions where grant funding mechanisms to support regional cooperation do not exist, or if actions are not taken to remove constraints on the ability of regional implementing agencies to directly access funds. By itself, additional monitoring of country requests and donor responses may also do little to promote the use of regional solutions where these would be most efficient.

56. The aim of the second option would be to complement existing instruments by providing access to dedicated grant financing aimed at facilitating coordination, helping overcome coordination and public goods problems (see para. 57) as well as supporting regional policy and regulatory reforms. This option has considerable merit as a vehicle for addressing the constraints to the growing regional and cross-border agenda identified earlier. The creation of a dedicated facility would provide a focal point for donors interested in supporting regional cooperation projects. It would also establish a vehicle to address gaps and support regions that presently have only limited access to grant-based resources for regional cooperation.

57. While the precise features, governance and scope of any trust fund would need to be developed, including the relationship with existing facilities and funds, key matters to be determined include eligibility and coverage. Activities that could be supported might include upstream analysis, such as identification of the costs and benefits of regional cooperation on policy integration, infrastructure, and other joint regional facilities such as specialized education or research institutions; project preparation; and capacity building and technical assistance, including strengthening the capacity of regional implementing bodies. In the case of policy cooperation projects, the facility might provide full funding in cases where amounts are relatively small or the counterpart is a non-sovereign regional entity. As is the case under the first option noted above, it would be important to put in place reporting and monitoring mechanisms that generate information on both regional “demand” and the support provided.

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<sup>29</sup> Regional projects supported through IDA will be reviewed as part of the upcoming IDA14 Mid-Term Review. It can also be noted that there is an ongoing IEG review of regional projects. Both reviews will provide further guidance on alternative approaches to support regional cooperation and possible options for strengthening existing instruments to support such cooperation.

58. A third option could be to go beyond a dedicated funding mechanism addressing the ‘software’ issues just described, and extend the scope of grant financing to cover a share of the costs associated with large-scale infrastructure projects or other joint regional facilities, where such costs arise disproportionately in the territory of a country compared to the benefits received from that country from the project. The design of this option would need to protect the funding for the important “software” side of regional cooperation, set out in option two, from the potentially much larger financial demands of politically attractive “hardware” projects. Consideration of this option would be part of a re-direction of ODA that is already being pledged to aid for trade, and should not be entertained if it came at the expense of crowding out other existing development efforts.

59. In order to minimize both the setup and operating costs of a financing mechanism for regional cooperation, funds under options two or three could be established in an existing development institution. Given that the issue spans many countries, it should be open to all developing countries, with priority given to projects involving low-income countries and small, middle-income countries for which regional integration is a central part of their development and growth strategy. It is important that substantial resources for regional projects not be de-linked from countries and country ownership. Although the RDBs and World Bank are likely to be major implementing agencies, with a trust fund facility serving as a lever for scaling up existing or planned regional programs and activities—e.g., in the case of the World Bank, the proposed Africa Catalytic Growth Fund—it should be flexible and open to any implementing body designated by the governments involved.

60. At this time it is not possible to determine the financing requirements associated with any of these options with precision. But consultations undertaken in the preparation of this paper suggest that additional grant financing of regional projects in the range of US\$500 million over five years could be absorbed in Africa alone.<sup>30</sup> Technical assistance and other “software” components of infrastructure projects normally account for around 5–10 percent of the overall project investment. Many projects will include both policy harmonization and infrastructure components (e.g., development of a regional certification system may require regulatory changes, technical assistance and construction of relevant testing facilities, as well as the creation or strengthening of a regional regulatory or implementation agency). There is a significant backlog of regional investments in Africa as well as other regions. In the case of Africa, current regional lending operations have already used about half of the total allocation for regional projects under IDA-14, and there is considerable unmet demand implied by the NEPAD short-term action plan of already identified priority regional projects. As noted previously, there is also unmet demand for financing of project preparation facilities for RECs in Africa.

61. Estimates of unmet demand for both regional software and hardware projects under the different options require detailed technical work in collaboration with the major regional

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<sup>30</sup> This assumes funding is made available for upstream analysis and project preparation, as well as for support to regional bodies tasked with implementation of regulatory harmonization, policy alignment and management of regional cooperation.

development banks and bilateral donors. Additional work is also needed with respect to the governance structure and management of a potential trust fund (options two or three). Further reflection is also required on strategies for supporting a sustained long term effort to build up the capacities of important regional institutions. Staff could undertake more detailed analysis of the different options if directed to do so.

## **V. ISSUES FOR DISCUSSION**

62. Do Directors agree that the suspension of the Doha Round negotiations makes it all the more imperative that developing countries be assisted to take maximum advantage of trade opportunities, that developed countries be strongly urged not to back away from offers made that affect developing countries, and that the Bank and the Fund should strengthen their efforts to help countries in the trade policy area?

63. Do Directors agree that there is a gap in addressing cross-country and regional aid for trade needs? If so, Directors' views are sought on the three options presented in Section IV.C.

64. Do Directors agree that Bank and Fund staff should continue their efforts to strengthen the assessment of adjustment needs for member countries arising from trade liberalization, so that existing assistance mechanisms can be better utilized?

**Annex I**

**World Bank Trade-Related Lending**

<b>World Bank Trade-Related Lending FY03-06</b>								
	<b>Approved FY03</b>		<b>Approved FY04</b>		<b>Approved FY05</b>		<b>Approved FY06</b>	
	<b>Projects</b>	<b>Commitment (US\$ mil)</b>	<b>Projects</b>	<b>Commitment (US\$ mil)</b>	<b>Projects</b>	<b>Commitment (US\$ mil)</b>	<b>Projects</b>	<b>Commitment (US\$ mil)</b>
<b>Regions</b>								
AFR	8	37	15	441	17	232	17	414
EAP	2	138	4	83	6	126	5	112
ECA	10	131	4	183	17	424	14	227
LCR	5	60	11	365	7	233	11	720
MNA	1	4	3	158	-	-	-	-
SAR	3	197	2	53	2	64	4	139
<b>Total Trade lending</b>	<b>29</b>	<b>566</b>	<b>39</b>	<b>1,282</b>	<b>49</b>	<b>1,080</b>	<b>51</b>	<b>1,611</b>
<i>including</i>								
LDC	9	74	15	415	20	276	14	396
LIC	11	237	17	507	22	328	22	572

## **Annex II**

### **Implementing the Recommendations of the IEG Evaluation on Trade at the World Bank**

In 2006, the Internal Evaluation Group (IEG) finalized its evaluation of the Bank's support for trade for 1987–2004. The report recognized the very important role the Bank had played in its advocacy role towards a pro-development global trading system, anchored in strong research and dissemination. At the same time, the evaluation highlighted that despite the overall increase in operational trade economic and sector work (ESW), the Bank had done less well in mainstreaming trade in Country Assistance Strategies and sector activities and policies, although the trend was improving. To address this issue IEG made three key recommendations. First, to strengthen the operational linkages on trade among different sector units and for the Trade Department to facilitate this process by providing strategic guidance on how to integrate different sector aspects of reforms including greater integration of the Poverty Reduction and Economic Management (PREM) and Private Sector Development (PSD) Vice-Presidencies' work on trade. Second, to strengthen knowledge management efforts including the establishment of a Thematic Group jointly with other networks. Third, to more systematically address poverty and distributional outcomes in trade-related projects.

Bank management endorsed these recommendations and working with the Operational Vice Presidencies and other anchors developed a strategy and a program to better integrate trade into operations. A broad strategy and action plan was endorsed by the Regional Vice Presidents on April 2006. Some salient aspects of this strategy and its implementation are discussed below.

Work has commenced with the Africa, South Asia and Middle east and North Africa Regions (where trade integration with Bank support is a high priority) to develop business plans to mainstream trade in selected countries where trade integration could be a major catalyst for growth and conditions for that dialogue are favorable. Close working relations between PREM and PSD will be critical and those links are being established under the leadership of the Regions. Knowledge management activities continue to grow working in an integrated manner with the World Bank Institute. A new thematic group, the "Competitiveness and Export Development Forum" is being established with the active participation of PSD regional staff and management and a program of knowledge creation and dissemination on policies to promote export growth and diversification is underway. This program will provide the broad cross-sector framework and tools that will support the policy dialogue by the Regions. Finally, the Bank is continuing to work to better address poverty and distributional impacts in its trade lending. Detailed work on cotton reform and welfare simulations has been prepared for Mali, as well as for Benin and Burkina Faso. In all these countries, the results have been used to inform lending operations (Development Policy Loans). Furthermore, capacity building has been provided to local researchers in four French African countries (Benin, Burkina Faso, Cameroon, and Senegal) to analyze linkages between trade liberalization and impacts on poverty.

### **Annex III**

#### **Regional Cooperation in Developing Regions**

This Annex provides a brief and non-comprehensive summary of major regional integration and cooperation efforts in different regions, as well as examples of the support that has been given by development institutions to regional cooperation.

##### **Africa**

There are numerous regional organizations and RECs in Africa, a number of which are overlapping. In West Africa the West African Economic and Monetary Union (UEMOA) and the Economic Community of West African States (ECOWAS) are the primary RECs and increasingly are cooperating. The Economic and Monetary Community of Central African States (CEMAC) and the East African Community (EAC) are pursuing market integration, as is the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC). The African Union has a mandate to coordinate these various regional integration programs, and the Economic Partnership Agreements (EPAs) negotiations process with the EU. The New Partnership for Africa's Development (NEPAD) is a focal point for regional cooperation and integration. RECs play a key role in NEPAD implementation, but limited engagement by member countries of RECs in agreeing on policy and project priorities constrain implementation of NEPAD priority programs. Capacity constraints of REC secretariats are another impediment to regional cooperation. These factors help explain why the African Union/NEPAD has had limited success in fostering regional cooperation.

The NEPAD initiative has raised the profile of the regional integration agenda, both policy-based (e.g., banking and financial standards) and infrastructure development.<sup>31</sup> The AfDB will host the Africa Infrastructure Consortium Secretariat, and is tasked with facilitating cooperation on infrastructure development between itself, the African Union (AU), NEPAD, RECs and the members of the Consortium. Both the AfDB and the World Bank have created Departments for Regional Integration to consolidate and strengthen support for regional cooperation and trade in Africa. Priority is being given by the AfDB to the promotion and development of regional infrastructure, but in partnership with the AU, UNECA, the intention is also to assist capacity building of African RECs. The World Bank is seeking to help countries to extend national development plans in ways that offer practical opportunities to accelerate growth through regional and sub-regional approaches and projects.

A key objective of the Africa Action Plan (AAP) is to support regional integration among Africa's economies. The World Bank has pledged to work with development partners and the private sector to support implementation of customs unions—including customs facilities and

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<sup>31</sup> Four areas for intervention are highlighted in the NEPAD short-term action plan for infrastructure: facilitation (creating the policy, regulatory and institutional framework); capacity-building for implementing institutions; mobilizing financing for already identified priority investment projects; and identification of new priority projects.

systems—and to fill the gaps in regional infrastructure, especially trade corridors, regional power systems and telecommunications. For example, under the AAP the Bank will increase support for 23 Sub-Saharan countries under the Trade Facilitation Initiative to about US\$ 530 million (compared to about \$ 80 million for FY01-FY03) by end FY06. The Bank has also committed to develop capacity in regional institutions and RECs to help implementation of NEPAD initiatives.

### **Latin American and the Caribbean**

There are also numerous RECs in Latin American and the Caribbean (LAC), including the Andean Community, the Caribbean Community (CARICOM), the Central American Common Market and Mercosur. Through a Department for Integration and Regional Programs, the Inter American Development Bank (IDB) delivers trade-related technical assistance to LAC countries and RECs, guided by a regional programming exercise for each of these four integration groups: Examples of projects include border development initiatives in the Andean Community, the creation and operation of the Caribbean Regional Negotiating Machinery, and institutional strengthening of the Mercosur Secretariat. The World Bank has also supported countries to pursue regional cooperation through technical assistance and lending operations, a recent example being supporting Central American countries to prepare for and implement the Central American Free Trade Agreement (CAFTA-DR). There have been major examples of cross-border regional cooperation in infrastructure in the region, as well as successful efforts at policy integration. An example is a World Bank-supported project to strengthen the capacity of the Eastern Caribbean Telecommunications Authorities (ECTEL) and national regulators to develop a modern interconnection regime and enhance access through a Universal Service Fund.

### **Asia**

Regional integration within South Asia is limited, despite mechanisms such as the South Asian Regional Economic Cooperation (SAARC) supported by the Asian Development Bank. South Asia's rapid growth in recent years has generated interest in, and political support for, increased regional integration. On January 6, 2004, the South Asian countries signed a South Asia Free Trade Agreement (SAFTA). Opportunities for regional cooperation include addressing the problems of energy shortage, lagging and land-locked regions, and poor trade facilitation. The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), established in 1997, involves Bangladesh, Bhutan, India, Myanmar, Nepal, Sri-Lanka, and Thailand, is a potential mechanism to promote opportunities for trade, investment, and tourism, between South and Southeast Asia. The World Bank Group in the South Asia Region is actively working, in collaboration with donor agencies (DFID, ADB), the private sector, policy makers and civil society, to support regional cooperation aimed at promoting development and reducing conflict in the region. The Bank has prepared a number of regional reports (e.g., India/Bangladesh trade, Pakistan/India trade, regional trade facilitation, regional energy trade), to support regional development.

In East Asia, formal RIAs have been less prevalent than in other regions until recently—ASEAN being a major exception, whose members have a considerable agenda for economic integration, and plans for a free trade and investment area by 2020. However, regional

cooperation has been actively pursued by most countries in the region, including through APEC and the Pacific Islands Forum. For example, the ADB has been the focal point for the Greater Mekong Subregion Regional Cooperation Strategy and Program. This has focused on regional physical infrastructure investments to promote trade, connectivity and cross-border facilitation, with an emphasis on “economic corridors” to link different parts of the sub-region to each other, complemented by specific policy integration initiatives, including river navigation agreements and border development plans. The Program has helped to deliver improved infrastructure and bolstered confidence in regional cooperation, reflected in treaties such as the 2003 GMS Cross-Border Transport Agreement and periodic GMS Summits. Major regional infrastructure projects have been identified and implemented through national loans, coordinated and financed by regional bodies such as the ADB as well as the World Bank and bilateral agencies. In the Mekong region, Thailand is leading the Ayeywady-Chao Phraya – Mekong Economic Cooperation Strategy (ACMECS), a framework for cooperation between Cambodia, Lao PDR, Myanmar, Thailand, and Vietnam. It promotes cooperation in areas including trade and investment, agriculture and industry, transport linkages, and tourism, with \$2.5 million as seed money from the Thai Government.

### **Europe and Central Asia**

Regional cooperation in Eastern Europe has revolved very much around the EU in the context of Association Agreements and the process of preparing for accession to the EU for accession candidate countries. The EU has worked with development agencies to foster greater cross-country cooperation. An example is the Joint Office for South East Europe (SEE), set up to support the European Commission and the World Bank in their role as coordinators of international assistance for the reconstruction and development of SEE. The Office provides the secretariat function to an Infrastructure Steering Group, which acts as a coordinating mechanism to facilitate the development of regional infrastructure and monitors progress in the implementation of regional projects in SEE.

The Trade and Transport Facilitation in Southeast Europe Program (TTFSE), managed by the World Bank, fosters trade by promoting more efficient and less costly trade flows across the countries in Southeast Europe and provides European Union-compatible customs standards. The program seeks to reduce non-tariff costs to trade and transport, reduce smuggling and corruption at border crossings, and strengthen and modernize the customs administrations and other border control agencies. The program is the result of a collaborative effort between the national governments in the region, the World Bank, and the United States in collaboration with the European Union. A second phase of the program, TTFSE II, currently under preparation, goes beyond TTFSE by embracing further aspects of trade facilitation by ensuring effective collaboration between all agencies active at border crossings (Customs, road administration, border police, phytosanitary and veterinary controls), all modes of transport in the region and all border crossings on the main corridors running through Southeast Europe and connecting the region with its neighbors.

Regional cooperation among Central Asian Republics has focused on efforts to establish, operate and maintain transport and transit corridors. The ADB launched the Central Asian Regional Economic Cooperation (CAREC) program in 1997 to promote regional economic cooperation, with transport, energy and trade priority areas for regional projects and policy

integration. The latter is being pursued through a cross-country Ministerial-level institutional framework to encourage dialogue and consensus building. Projects include assistance for trade facilitation, repairing regional transport networks and developing transport corridors and a transcontinental rail link.

### **Middle East and North Africa**

Regional cooperation has been a long-standing feature of trade relations of countries in the MENA region. Major recent RIAs include the Unified Economic Agreement between members of the Gulf Cooperation Council (GCC) and the Greater Arab Free Trade Area (GAFTA). The GCC is the most ambitious and effective REC in MENA, having achieved a customs union in 2003. Bilateral Euro-Mediterranean Partnership Agreements have been signed between the EU and many countries in the region, and Jordan, Bahrain and Morocco have concluded agreements with the US. The EU and regional partners are seeking to create an integrated Euro-Mediterranean regional space and ultimately the creation of the Euro-Mediterranean Free Trade Area. Through the European Neighborhood Policy, the EU has also offered the prospect of greater integration of markets through selective regulatory harmonization with EU legislation, supported by technical assistance. Most assistance provided by the EU and other donors has been country-specific. For example, national programs accounted for over 95 percent of the total assistance provided (during 1995–2001, of a total of €1,058 million in EU assistance for economic reforms, only €27 million was for regional projects). The EU has recently proposed a deepening of the integration with most MENA countries, within the framework of its new neighborhood policy. The World Bank has started discussions with countries to find ways to support this initiative.

## **Attachment I**

### **Recommendations of the Task Force on an Enhanced Integrated Framework<sup>32</sup>**

#### **Preamble**

The Task Force endorses the mission of the IF. The goal of the IF is to enhance the capacity of LDCs to integrate into the multilateral trading system in order to reduce poverty and benefit from increased market access. The Task Force reaffirms the mandate of the IF:

- to mainstream trade into LDCs' national development plans such as Poverty Reduction Strategy Papers (PRSPs);
- to assist in the coordinated delivery of trade-related technical assistance in response to needs identified by LDCs;
- to develop the capacity of LDCs to trade, including through capacity building and addressing supply constraints.

In the light of the evolving situation the IF should complement the current aid for trade discussions and other related initiatives.

Commitment to mainstreaming trade into the national development processes such as the PRSP process is critical to achieving Millennium Development Goals. The IF is a tool and a means to an end. It is a process feeding into the broader framework for donor support and programming around a country's development planning and priorities.

The Task Force wants to strengthen the IF process, building on the existing structure and modalities wherever possible, and to continue to benefit from the full participation of the six IF Agencies (IMF, ITC, UNCTAD, UNDP, WTO and the World Bank).

The enhanced IF should be guided by the aid effectiveness principles set out in the Paris Declaration, such as donor harmonization, using country systems, promoting ownership and involving stakeholders such as the local private sector. The strength and potential that the IF concept offers could be considered as a methodology for further delivery of trade related assistance.

Pursuant to the Hong Kong Ministerial Declaration, the enhanced IF should be comprised of the following three specific elements:

- Provide increased, predictable, and additional funding on a multi-year basis;

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<sup>32</sup> Available as WT/IFSC/W/15, June 2006 on the WTO's website ([www.wto.org](http://www.wto.org)).

- Strengthen the IF in-country including through mainstreaming trade into national development plans and poverty reduction strategies; more effective follow-up to diagnostic trade integration studies and implementation of action matrices; and, achieving greater and more effective co-ordination amongst donors and IF stakeholders, including beneficiaries;
- Improve the IF decision-making and management structure to ensure an effective and timely delivery of the increased financial resources and programmes.

## **1. Scope**

It is proposed that the current Window 1 should be modified to support greater in-country capacity and should cover a core package of activities. It is proposed to call this “Tier 1”. The current Window 2 should be modified to facilitate greater implementation of activities identified as priorities in the Action Matrix. It is proposed to call this “Tier 2”.

### **1.1 Coverage**

The coverage of the IF should be enhanced to include:

- Upstream activities—capacity building to help prepare countries for undertaking a DTIS and integrating the DTIS into their national development plans such as the PRSP;
- An expanded DTIS to include broader trade-related issues such as needs assessment for infrastructure including related policy design, cross-cutting and regional issues when so requested, and response to needs emanating from on-going trade liberalisation processes and new trade rules, including the DDA;
- Periodic updates to the DTIS as and when necessary;
- Downstream activities covering integration with the national development plan, preparation for implementation of projects and programs identified in Action Matrices, and implementation of projects, including projects targeted at removing supply-side constraints, according to criteria to be developed.

The core areas eligible for intervention as defined in the modalities for Window 2 would remain the same and would support bridging activities identified in action matrices. The existing terms of reference for Window 2 include the following items:

- Institution-building to handle trade policy issues;
- Strengthening of export supply capabilities;
- Strengthening of trade support services;
- Strengthening of trade facilitation capacity;
- Training and human resource development;
- Assistance in the creation of a supportive trade-related regulatory and policy framework to encourage trade and investment.

### **1.2 Modalities**

Tier 1: This would provide resources from the Trust Fund that are available to all IF countries for core functions, taking into account the availability of alternative funding and building on existing activities in the trade sector. This would cover:

- upstream HR capacity building;
- preparation and/or updating of a DTIS;
- provision of support to the national implementation unit and key institutions, including human resource capacity and small capital equipment such as computers, etc;
- assistance to facilitate integration into the national development plan.

Tier 2: This would provide funding from the Trust Fund for activities as identified in the Action Matrix, taking into account the availability of alternative funding and quality of projects. The Trust Fund would provide bridging funding to jump start activities identified in the DTIS such as project preparation, feasibility studies as well as funding of smaller projects including seed projects. Illustrative activities/projects include:

- assistance to implement specific WTO and other trade policy commitments;
- preparatory activities for infrastructure development and infrastructure projects;
- activities to harmonize action matrices with national development plans such as PRSPs, and to prioritise and provide cost benefit analysis leading to project design and implementation;
- further assistance to the national implementation unit and key institutions;
- assistance to develop a national trade plan and/or sectoral programmes;
- assistance with project design for regular programming processes such as World Bank Consultative Groups and UNDP Round Table meetings;
- Independent implementation of small projects identified in DTIS Action Matrices.

For the larger implementation activities as identified in the Action Matrix, such as infrastructure, support should be sought from mechanisms outside of the IF Trust Fund for example through World Bank Consultative Groups and UNDP Round Tables. One of the objectives of the IF is to help leverage these resources and to ensure coherence. Information on other resources for the implementation of activities outlined in action matrices should be included in IF reporting.

### **1. 3 Country coverage**

The IF is for LDCs.

### **2. In-country management and operations**

The IF needs to be better aligned, integrated and sequenced with the PRSP and similar national development plans as well as with Trade Policy and Private Sector Development programmes. The aim should be to harmonise around one common approach for the economic sectors, to be determined in country as appropriate. While it is imperative that

LDCs mainstream trade into development planning, the donors and agencies also need to do better at integrating trade into their planning and programming.

While the IF recipient countries have a diversity of in-country governance and management structures, some best practices have been identified. The IF should build on and strengthen existing structures that have been identified as working best, including those identified in the IF Simulation workshop held in Addis Ababa in September, 2005.

## **2.1 Institutional mechanisms**

To provide senior level engagement and coordination, and to provide political commitment, a high level inter-ministerial committee should be established. This should be led at the Ministerial level and be coordinated by the Ministry of Trade, Finance, Planning or any other Ministry as best determined by each country. The close collaboration of the Ministries of Trade, Planning and Finance is critical.

To support the development of the DTIS and implementation of the action matrices a broad-based stakeholder process including government, private sector and civil society representation should be established.

To improve the implementation of the IF, the IF Focal Point should be strengthened including through the creation of a national implementation unit where necessary. The Focal Point, who is appointed by the national authorities, is responsible for coordinating in country IF activities in consultation with the IF Secretariat. The IF will provide resources as appropriate to strengthen this capacity, including the provision of secretariat resources (human and physical), preferably through engagement of local expertise. This unit could be set within an appropriate government department or set outside normal government structures, as per specific country requirements. The Focal Point should report to the inter-ministerial committee as part of the development planning process.

To provide an effective response and avoid duplication, the agencies, donors and beneficiaries need to work together through local processes. To this end it is vital that an effective local donor facilitator, with clear terms of reference adapted to the local situation, be appointed by donors in consultation with the local authorities. The main objective of the donor facilitator is to help mainstream trade into donor programming to ensure timely implementation of the action matrices.

The IF agencies have a critical role to play at the country level in the mainstreaming of trade into development. The role each agency plays in the IF program in each country will be determined through a dialogue among the agencies, local development authorities, the IF Focal Point and the IF Secretariat. Key elements of their role include participation in the diagnostic process, implementation, local fund management, and monitoring and evaluation. To facilitate the involvement of agencies at the country level, a program approach should be adopted. In order to fully play their role, Agencies should make the required trade and development expertise available to the local level and, to support this, to reinforce their core capacity in the trade and development area.

## **2.2 The DTIS process**

It is important that the recipient country itself take the lead in the preparation and/or updating of its DTIS, including selecting in consultation with the IF Secretariat the executing entity. The DTIS team should include local expertise and should work closely with the national PRSP team.

To facilitate consistency, information sharing and implementation, a global template for undertaking the DTIS should be developed to guide the process. The ultimate quality control of the DTIS would rest with the recipient country supported by the executing entity. The DTIS should be a living document, sequenced and synchronised with the national development planning process such as the PRSP; possibly through the creation of a national trade plan. The Focal Point should take the lead for updating the DTIS and for integrating it into the national development plan. All six of the IF agencies have valuable contributions to make to the DTIS process. Normally all six agencies would have a role from the start of the process.

## **2.3 Linkages between the LDC capitals and Geneva**

The IF in country process should be driven from the countries rather than from Geneva.

The Focal Point should actively develop strong linkages with the IF Secretariat, and an ongoing process of information sharing between the Focal Point and the IF Secretariat should be maintained.

The IF should be an umbrella for other national and regional trade capacity initiatives.

## **2.4 Role of the IF Agencies**

The Agencies will continue to play an active role in the implementation of the IF. As described above, each country, in consultation with the IF Secretariat, would decide which agencies or organizations are best suited to carry forward IF activities, building on their comparative advantages and mandates. The participation of the IF agencies in projects and programs should be on a fully costed basis.

## **3. Governance, overall management and administration**

The Task Force recognizes that the effectiveness of the IF is hindered by the existing fragmented management structure and sub-optimal division of responsibilities among the different agencies, principally among the WTO (Secretariat), the World Bank (diagnostics) and the UNDP (Trust Fund), and by a lack of a clear accountability framework.

The Task Force does not propose to create a new organization. The main aim of the proposed approach is to transfer responsibility to the country level while consolidating management and administration. In order to build on the strengths of the existing structures as much as

possible, the Task Force recommends a modified management and governance structure by proposing to keep the IF Steering Committee as the overall governing body, to transform the IFWG into a Board with greater recipient and donor participation, and to turn the Secretariat into an Executive Secretariat with a Chief Executive Officer. The IF would continue to rely on the agencies in achieving its mandate.

### **3.1 Steering Committee**

The Steering Committee, based on the existing IF Steering Committee, should provide overall policy direction, review progress and provide a platform for the exchange of experience. It should meet at least once per year.

### **3.2 Board**

Reporting to the Steering Committee would be a Board. This Board, based on the current IF Working Group, should remain small but be rebalanced. It should continue to include representatives of the recipients, the donors and the agencies. The Board should meet as regularly as necessary to conduct its business, to provide oversight and policy direction, and to decide programme criteria and allocative criteria.

### **3.3 Secretariat**

The Secretariat needs to integrate management functions at the global level to improve delivery (efficiency and effectiveness) and provide for greater accountability. Accordingly, it should become an Executive Secretariat with a Chief Executive Officer accountable to the Board. The CEO would be selected by the Board.

The Task Force recommends that the IF Secretariat be a small, independent unit located in Geneva and that it be administratively housed in the WTO Secretariat, with a strong firewall around it.

The IF Secretariat would:

- service the governing bodies;
- propose to the Board an annual work program and budget including allocations for staffing;
- propose to the Board programme and allocation criteria;
- prepare annual substantive and financial reports;
- coordinate support to countries;
- undertake financial management, including management of the Trust Fund;
- identify new sources of funds;
- maintain close links with the national implementation units;
- maintain close links with the implementing agencies;
- provide outreach to stakeholders;
- share best practice including through a website;
- oversee monitoring and evaluation;

- undertake other responsibilities to be delegated by the Board;
- develop strategies to include the private sector in the work of the IF.

While recognising that the Board and CEO should determine the new staffing structures for the IF Secretariat, the Task Force recommends that the CEO be recruited on merit by the Board and report directly to the Board. Staff will also be recruited on merit. Staff appointed to the existing IF Programme Implementation Unit should be integrated into the Executive Secretariat.

### **3.4 Local governance**

Consistent with Section 3 above, the Focal Point should be responsible for IF implementation at the national level.

## **4. Monitoring and Evaluation**

Currently there is no adequate single monitoring and evaluation framework for the IF, making it difficult to measure results.

- An effective monitoring and evaluation system needs to be developed and implemented at both global and national levels on a priority basis;
- To encourage sharing of experience, the Steering Committee should showcase at each of its sessions the in-country experience of some IF members;
- Links should be maintained with the OECD to benefit from the WTO/OECD/DAC database on trade related assistance;
- An independent auditor should be appointed.

## **5. Funding**

The Task Force recommends that there should be greater predictability of funding for the recipients as well as greater levels of funding, including identification of new sources of funds.

### **5.1 Level of funding**

At its Annual Meeting in 2005 the WB/IMF Development Committee took note of an estimate from staff that an amount of US\$200–400 million over five years would be required, based on anticipated requirements for 40 countries. An exercise based on the above recommendations has been undertaken to provide an indicative costing for the enhanced IF (see Annex).

The CEO, once appointed, should thereafter prepare a three-year rolling workplan and budget which would be subject to approval by the Board.

### **5.2 Donor commitments and supply of funding**

Predictability of funding is important. Donors should make multi-year indicative pledges over a three to five year period where possible, even though actual commitments/ obligations may be on an annual basis. There should be multilateral and bilateral funding. Earmarking of funds is generally not desirable, although there could be some flexibility in the way donors fund certain aspects of the IF.

### **5.3 Sources of funding**

New donors should be identified and invited to participate, including from the private sector, at both national and international levels.

### **5.4 Allocation of resources**

Tier 1 funding for core activities should be predictable. Disbursement should be decided by the Focal Point in consultation with the IF Secretariat.

Tier 2 funding will be based on requests submitted by the Focal Point to the IF Secretariat.

## **6. Transitional Arrangements**

The Task Force makes these recommendations understanding that some areas require further elaboration. The Task Force further recognizes that it will be important to ensure the continuity of ongoing and planned IF activities during the transition period.

## **Attachment II Recommendations of the Aid for Trade Task Force<sup>33</sup>**

### A. MANDATE

The Hong Kong Ministerial Declaration invited the WTO Director-General to create a Task Force to provide recommendations "on how to operationalize Aid for Trade" and "on how Aid for Trade might contribute most effectively to the development dimension of the DDA". It states that "Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade. Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the DDA, particularly on market access."

### B. RATIONALE

Aid for Trade is about assisting developing countries to increase exports of goods and services, to integrate into the multilateral trading system, and to benefit from liberalized trade and increased market access. Effective Aid for Trade will enhance growth prospects and reduce poverty in developing countries, as well as complement multilateral trade reforms and distribute the global benefits more equitably across and within developing countries.

### C. FINANCING

Additional, predictable, sustainable and effective financing is fundamental for fulfilling the Aid-for-Trade mandate. The effectiveness of the following recommendations for operationalizing Aid for Trade requires substantial additional targeted resources for trade-related programmes and projects as pledged at the WTO's Hong Kong Ministerial Conference, 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 as part of his mandate to consult on "appropriate mechanisms to secure additional financial resources for Aid for Trade".<sup>34</sup> 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 fulfill his mandate.

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<sup>33</sup> Available as WT/AFT/1, July 27, 2006 on the WTO's website ([www.wto.org](http://www.wto.org)).

<sup>34</sup> In Hong Kong, Japan announced development assistance spending on trade, production and distribution infrastructure of \$10 billion over three years, the US announced Aid-for-Trade grants of \$2.7 billion a year by 2010, and the EU and its member States announced trade-related development assistance spending of €2 billion per year by 2010.

#### D. SCOPE

The scope of Aid for Trade should be defined in a way that is both broad enough to reflect the diverse trade needs identified by countries, and clear enough to establish a border between Aid for Trade and other development assistance of which it is a part. Projects and programmes should be considered as Aid for Trade if these activities have been identified as trade-related development priorities in the recipient country's national development strategies. In this regard, it should be pointed out that while the PRSPs<sup>35</sup> reflect national development priorities for some countries, other development strategies are equally important and will need Aid-for-Trade financing. At the same time, clear and agreed benchmarks are necessary for reliable global monitoring of Aid-for-Trade efforts to assure accurate accounting and to assess additionality. The following categories, building upon the definitions used in the Joint WTO/OECD Database, have been identified:

*(a) Trade policy and regulations, including:*

Training of trade officials, analysis of proposals and positions and their impact, support for national stakeholders to articulate commercial interest and identify trade-offs, dispute issues, institutional and technical support to facilitate implementation of trade agreements and to adapt to and comply with rules and standards.

*(b) Trade development, including:*

Investment promotion, analysis and institutional support for trade in services, business support services and institutions, public-private sector networking, e-commerce, trade finance, trade promotion, market analysis and development.

*(c) Trade-related infrastructure, including:*

Physical infrastructure

*(d) Building productive capacity*

*(e) Trade-related adjustment, including:*

Supporting developing countries to put in place accompanying measures that assist them to benefit from liberalized trade.

*(f) Other trade-related needs*

Reporting on categories (a) and (b) should follow the definitions in the Joint WTO/OECD Database. The activities that fall outside of the current Joint WTO/OECD Trade Capacity

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<sup>35</sup> Poverty Reduction Strategy Papers (PRSPs) describe the macroeconomic, structural and social policies and programmes that a low income country will pursue over several years to promote broad-based growth and reduce poverty, as well as external financing needs and the associated sources of financing. They are country-led, country-written documents prepared by governments through a participatory process involving domestic stakeholders and external development partners, including the World Bank and the IMF.

Building Database definition, i.e. category (c), (d) (e) and (f) should be reported as Aid for Trade when these activities have been explicitly identified as trade-related priorities in the recipient country's national development strategies, such as the PRSP.

#### E. CHALLENGES/GAPS

Since the start of the DDA in 2001, donors have stepped up their commitments on trade-related assistance. More developing countries are also integrating trade into their development strategies. But major challenges remain. These can include:

- Low attention to trade as a tool of development in recipient countries and in donor agencies.
- Insufficient trade mainstreaming in national development strategies and PRSPs.
- Lack of private-sector involvement in identifying trade needs.
- Limited absorptive capacity in recipient countries.
- Inadequate linking mechanisms and lack of predictability in donor response to trade priorities identified at the national and regional levels.
- Lack of coordination and coherence in donors' trade-related response.
- Slow, duplicative and bureaucratic processes in the assessment and delivery of trade assistance, including burdensome parallel structures within recipient countries.
- Lack of data on, and analysis of, trade policies and their impact on development, lack of easily-available information on existing Aid-for-Trade instruments.
- Ineffective monitoring of trade-related country policies and donor activities; absence of rigorous, independent project and programme evaluation and impact assessment.
- Limited support for regional, sub-regional and cross-border trade-related programmes and projects.
- Inadequate support to address the adjustment costs of trade liberalization.
- Insufficient resources for infrastructure and productive capacity building.
- Uneven country coverage.

#### F. OPERATIONALIZING AID FOR TRADE

##### F.1 Objectives

- To enable developing countries, particularly LDCs, to use trade more effectively to promote growth, development and poverty reduction and to achieve their development objectives, including the Millennium Development Goals (MDGs).
- To help developing countries, particularly LDCs, to build supply-side capacity and trade-related infrastructure in order to facilitate their access to markets and to export more.
- To help facilitate, implement, and adjust to trade reform and liberalization.
- To assist regional integration.
- To assist smooth integration into the world trading system
- To assist in implementation of trade agreements.

## **F.2 Guiding principles**

Aid for Trade should be guided by the Paris Declaration on Aid Effectiveness, applicable to all parties involved (donors, agencies and beneficiaries), including key principles such as country ownership, mutual accountability, aligning aid to national development strategies, effective donor coordination, harmonization of donor procedures, use of programme-based aid modalities, managing for result, transparency, and predictable and multi-year commitments, which should be built into all programming. Aid for Trade should be rendered in a coherent manner taking full account, *inter alia*, of the gender perspective and of the overall goal of sustainable development. Administrative costs associated with the delivery of Aid for Trade should be minimized to ensure that the resources go to the actual implementation of identified priority projects and programmes. The competence and skills of the human resources available at national and regional levels should be used in an optimal way.

## **F.3 Strengthening the "demand side"**

A commitment to country ownership and country-driven approaches—as well as a commitment of governments to fully mainstream trade into their development strategies—is key to the effectiveness of Aid for Trade. In some countries, the processes for mainstreaming trade into national development strategies, for formulating trade strategies, and for proposing priority trade projects for donor financing, need to be strengthened through technical assistance and capacity building to help developing countries put in place effective and sustainable trade policy frameworks and processes. Where consultative mechanisms already exist, they can be used – or improved upon. Value-chain analysis could be one valuable tool to identify trade needs.

*The Enhanced Integrated Framework (IF) for LDCs.* The purpose of the IF is to strengthen the LDCs' trade capacity, including the ability to identify their trade needs and to propose priorities to be supported by development partners. The recommendations on an enhanced IF, as agreed by the Integrated Framework Steering Committee (IFSC), will be an essential foundation for strengthening the demand-side of Aid for Trade in LDCs.

*Non-LDCs.* Many other developing countries also need support to mainstream trade into national strategies, to establish broad-based consultation processes involving the private sector, civil society organizations and relevant government agencies to formulate trade strategies, to develop action matrices, and to formulate priority project proposals.

*Regional needs.* Some of the constraints facing developing countries are regional, sub-regional or cross-border in nature. These needs should be identified and properly addressed. Regional organizations, including regional banks, regional integration organizations and regional economic communities, may play a role in assisting countries to identify such needs.

#### Recommendations:

- Implement the recommendations for an enhanced Integrated Framework.
- Establish effective national coordination, involving all relevant stakeholders, including the private sector, with a view to identifying the strengths and weaknesses of economies as a whole, and the particular challenges facing the trade sector.
- Explore the necessity of establishing a similar, but separately funded, in-country-process for non-LDCs "International Development Assistance (IDA)-only" countries, if such mechanisms do not already exist or can be improved upon.
- Urge agencies, donors and governments in other developing countries to work together to establish similar processes if they do not already exist. These processes should be modeled to the specific circumstances and needs of the country concerned, building on what already exists where possible and appropriate.
- Urge donors and agencies, together with regional banks and organizations, to step up their efforts to identify regional, sub-regional and cross-border needs, including those related to regional integration.
- Establish a system of data collection and analysis at country level.

#### **F.4 Strengthening donor "response"**

*Donor policies.* Donors should give more attention to trade issues in their aid programming and strengthen their trade expertise both in the field and at headquarters. There is a need for improved coordination of staff working across sectors and for greater trade mainstreaming in aid agencies' programmes.

*Donor coordination.* Greater donor and agency coordination and harmonization of procedures—at both the local and global level—is critical. Trade-related programmes and projects should be more coherent, both in terms of operations and policy.

*Donor response.* In allocating resources for Aid for Trade, donors and agencies should be guided by priority projects and programmes identified by developing countries, as well as by their potential merit in relation to the objectives for Aid for Trade. These priorities should be mirrored by donor and agency support. Each agency would need to determine how to deploy or reorient its financial and technical assistance to support either capacity building or accompanying measures related to trade liberalization.

### Recommendations:

Donors and agencies should:

- integrate trade and growth issues more effectively in their aid programming;
- further strengthen their trade expertise both in the field and in capitals;
- use needs assessment processes (where available), and their results, as a basis for their programming;
- move towards a programme/sector/budget approach, if country owned, if mainstreamed in national development strategies and if a robust system of financial accountability is in place;
- make targeted funds available for building infrastructure and removing supply-side constraints—over and above capacity building and technical assistance—perhaps as co-financing with multilateral development banks; and
- consider channeling Aid-for-Trade Funds multilaterally, when appropriate.

## **F.5 Strengthening the bridge between "demand" and "response"**

### F.5.1 Country level

*Matching.* Strengthened in-country structures, with improved links to donor financing, are needed to help move from trade-related diagnostics to implementation, and to maximize access to multilateral and bilateral resources. The task of matching demand for Aid-for-Trade projects with response could be addressed by strengthening national coordination

through a "National Aid-for- Trade Committee", which would include recipient countries, donors, and other relevant stakeholders, such as the private sector, under the leadership of relevant ministries. This committee should complement – not replace – existing PRSPs and other coordination mechanisms. If needed, this process could be supported by agencies that could serve as a clearing house.

*Mainstreaming trade.* Effectiveness in implementing Aid for Trade will depend on many actors working together in a coherent way. It will involve, for example, the World Bank, the IMF, regional development banks, UN agencies and donors at the national as well as the international level, and trade, agriculture, development and finance ministries at the national level. It is the responsibility of donors, agencies and recipients to do their part in reforming how those entities integrate trade into development and national strategies.

*South-South cooperation.* Technical cooperation among developing countries is a valuable tool to deliver effective results because of their common experience and understanding of the challenges they face. The valuable technical expertise of the South could be used to implement projects through triangular schemes of cooperation.

*Private sector.* As actors in the field, private enterprises are well placed to identify trade-related problems and bottlenecks. An increased dialogue between the public sector and private entrepreneurs would improve effectiveness in assessing Aid-for-Trade needs, in diagnostics, and in implementation, as well as in evaluating effectiveness in implementation.

#### Recommendations:

- Recipient countries should mainstream trade into national strategies, such as PRSPs, formulate trade strategies, and propose priority trade projects for donor financing.
- The division of responsibility for funding and implementing Aid-for-Trade projects and programmes should be addressed through country-based processes such as PRSPs or Consultative Groups, if necessary complemented with a partner conference focusing specifically on trade-related support, convened once countries have integrated trade into their national strategies.
- A National Aid-for-Trade Committee could be established, where necessary, to ensure trade mainstreaming in national development strategies, determine country needs, set priorities, assist in matching "demand" and "response", and help in evaluation. Tasks could include identifying co-financing or leveraging funds from other larger funds, as well as assessing adjustment needs and brokering financing for such programmes. Recipient countries could request agencies to perform a coordinating role.
- Partners should commit to contributing to the implementation of trade strategies and identified priority projects and programmes. The resulting plan should incorporate a results-based management framework resting on—and reinforcing—mutual accountability. Indicators of progress should be agreed.

Promote the involvement of local, regional and private-sector actors, as well as South-South cooperation through triangular schemes.

#### F.5.2 Regional level

Many countries require cross-border infrastructure and regional policy cooperation to trade more effectively. The ability to identify cross-border and regional needs should be strengthened at the country, regional and multilateral level. Once needs have been identified, donors and agencies must improve their ability to respond. In particular, assistance in formulating and financing accompanying measures could help to make regional integration an effective building block for the multilateral trading system. At the forthcoming September Development Committee Meeting, strengthening support for regional, sub-regional and cross-border needs will be discussed.

#### Recommendations:

- Strengthen the following functions in relation to regional, sub-regional and cross-border issues:
  - diagnosis of needs;
  - costing of projects;
  - preparation of project proposals; and
  - the coordination of donor response, including brokering and co-financing of needs that at present are difficult to finance through country-based processes, (e.g., cross-border infrastructure and policy-integration projects).
- Assign responsibility for these functions. In doing so, priority should be given to improving and strengthening existing mechanisms, including those at the multilateral and regional level, before considering a new mechanism. In exploring the most efficient solution, the conclusions from the discussions at the forthcoming Development Committee should be taken into account. Any solution should involve all relevant stakeholders and give priority to existing regional integration programmes that lack funding.
- Explore the merits of establishing a Regional Aid-for-Trade Committee, comprising sub-regional and regional organizations and financial institutions, to oversee the implementation of the sub-regional and regional dimensions of Aid for Trade, to report on needs, responses and impacts, and to oversee monitoring and evaluation.

#### F.5.3 Global level

A number of tasks in relation to Aid for Trade are best performed at the global level. These include:

*Data collection.* Lack of empirical data has made it difficult to examine the relationship between policies related to trade and development performance. Better data and statistics are

a precondition for better understanding the process of globalization and its impact, and for determining priorities for development cooperation.

*Knowledge creation and sharing.* Dissemination of Aid-for-Trade evaluation results, development of best practices and guidelines, and facilitation of information sharing, involving all relevant actors, needs to be improved at the global level, in order to assure efficient use of Aid-for-Trade funds.

*Channeling donor funding.* Some donors might wish to direct Aid-for Trade funds through multilateral channels, which would allow them to support Aid for Trade without having to build their own institutional capacity in this area and without getting involved at country level. This could include providing support for processes similar to the IF for non-LDC IDA-only countries.

*Matching.* While a clearing-house function should in most cases be performed at the country and the regional level, sessions dedicated to specific themes and groups of countries could be periodically organized to provide a platform for donors and developing countries to discuss specific gaps which may occur in the implementation of Aid for Trade. One important function could be to connect outstanding Trade-Related Assistance (TRA) needs to donors willing to contribute to their fulfillment.

#### Recommendations:

- Strengthen the following functions in relation to global issues:
  - the collection and analysis of data on trade policies and their impact, the facilitation of knowledge sharing, and the development of guidelines. Funding for such activities needs to be secured;
  - provision of information on existing Aid-for-Trade instruments and expertise; and
  - matching and brokering unfunded TRA-needs and available donor funding for such projects and programmes.
- Assign responsibility for these functions. In doing so, priority should be given to improving and strengthening existing mechanisms before considering the establishment of a new clearing house at the global level.

#### **F.6 Strengthening monitoring and evaluation**

Monitoring and evaluating progress is essential in building confidence that increased Aid for Trade will be delivered and effectively used. It will also provide strong incentives to both donors and recipients to advance the Aid-for-Trade agenda. It is important to emphasize the need for concrete and visible results on the ground. All the providers of Aid for Trade and the recipient countries have the responsibility to report on progress and results.

*Monitoring.* In recipient countries, monitoring should cover trade mainstreaming in national strategies, such as PRSPs, the identification of priority needs, donor responses, progress in implementing trade-related projects and programmes as well as the impact of these efforts. Donors who have made commitments to Aid for Trade should report on the content of such commitments as well as on how they plan to meet the targets for Aid for Trade that they have announced.

*Evaluation.* Rigorous Aid-for-Trade programme evaluation is particularly important because projected significant increases in Aid for Trade may stretch the delivery capacity of donors and the absorptive capacity of recipients. In-depth country-impact evaluations of Aid-for-Trade programmes should be undertaken to build knowledge and facilitate a results-based approach to delivery. Evaluation of in-country processes should focus, *inter alia*, on progress in mainstreaming trade in national development plans. Evaluations should adopt a results-based approach in order to ensure effectiveness of Aid-for-Trade programmes in relation to the objectives.

Recommendations:

- A global periodic review of Aid for Trade should be convened by a monitoring body in the WTO, based on reports from several different sources, to be published if feasible on the WTO web page:
  - from the country level;
  - from donors;
  - from the regional level;
  - from relevant multilateral agencies; and
  - from the private sector.
- Mechanisms to facilitate reporting to the global monitoring body should be enhanced, including the possibility of a notification process for WTO Members.
- The global periodic reviews should be followed by an annual debate on Aid for Trade convened in the WTO General Council to give political guidance on Aid for Trade.
- Recipient countries should report on the trade mainstreaming in national development strategies, such as the PRSPs, the formulation of trade strategies, Aid-for-Trade needs, donor responses, and implementation and impact. The primary responsibility for reporting to the global monitoring body would lie with the National Aid-for-Trade Committee.
- Donors should report on funds dedicated for Aid for Trade, how they intend to meet their announced Aid-for-Trade targets, the Aid-for-Trade categories covered, and their progress in mainstreaming trade into their aid programming.
- Multilateral and regional actors should be encouraged to report regularly on their Aid-for-Trade activities, progress and impact. When appropriate these actors –

including the OECD/DAC – should be asked to assist in providing input and in the organization of the periodic Aid-for-Trade review in the WTO.

- The private-sector should be provided an opportunity to report on their Aid for Trade contributions.
- An assessment of Aid for Trade – either as a donor or as a recipient – should be included in the WTO Trade Policy Reviews.
- Evaluation of country-needs identification, trade mainstreaming in national strategies and PRSPs, donor response and impact on the ground in relation to stated objectives, should be promoted and funded.
- The scope of the Joint WTO/OECD Database should be reviewed in light of the Task Force's definition of Aid for Trade. It should also be updated based on more accurate identification of needs (and the responses) by both providers and recipients of Aid for Trade.

#### G. HOW AID FOR TRADE CAN CONTRIBUTE TO THE DEVELOPMENT DIMENSION OF THE DOHA-ROUND

Aid for Trade is important in its own right. It should assist developing countries to benefit from increased trade opportunities multilaterally (both from previous rounds and from the anticipated results of the DDA), regionally, bilaterally and unilaterally. The Task Force therefore recommends that Aid for Trade must be operationalized as soon as possible. At the same time, the Task Force affirms that Aid for Trade is a complement, not a substitute, for a successful Doha Round. Increasing trade opportunities for developing countries, in particular the least-developed among them, remains the most important contribution that the WTO can make to development. A successful conclusion of the Round will increase the need for assistance to implement new agreements (e.g., Trade Facilitation), to ease adjustment costs, and to make use of new market access. Aid for Trade is a complement to the Doha Round, but it is not conditional upon its success.

#### H. NEXT STEPS

These recommendations are directed to many different actors. The Task Force suggests the following next steps:

- urges Members to expeditiously implement the recommendations of the Task Force.
- urges the Director-General to use these recommendations in pursuing his mandate to consult on "appropriate mechanisms to secure additional financial resources for Aid for Trade" so that the joint mandate in Paragraph 57 of the Hong Kong Declaration can be implemented in a holistic manner.
- invites the Director-General to communicate these recommendations to relevant agencies and organizations and to urge Ministers at the upcoming Development Committee Meeting in Singapore to give consideration to these recommendations and

to encourage the Bank and the Fund to ensure adequate follow-up and to report on the results at the 2007 Annual meeting.

- invites the Director-General to continue, under his coherence mandate, a dialogue on how recommendations targeted at the agencies could be implemented, including where responsibility for implementation should lie.
- invites the Director-General to establish an ad hoc consultative group to take forward the practical follow-up of these recommendations.
- invites the Director-General to begin examining how to implement the recommendations regarding WTO monitoring of Aid for Trade.
- invites the Director-General to convene, at an appropriate time, an initial review of Aid for Trade, with the participation of all relevant stakeholders.
- suggests, after the completion of the DDA, that the Secretariat conduct an assessment of associated Aid-for-Trade needs in developing countries, particularly those most affected, including LDCs, and of how Aid for Trade can contribute to the development dimension of the DDA.