

Term of Reference for the Integrated Framework Studies

Integration studies will typically have five components. **First**, a review and analysis of the country's economic and export performance. This would include real per capita growth, poverty trends, and integration performance in a historical and international perspective. Particular attention will be paid to indicators of per capita income, trade and integration performance vis-à-vis those of comparator countries. Analysis will focus inter alia on trends in export and import to GDP ratios, FDI as a share of GDP ratio, type of FDI (by sector), the speed and extent of export diversification (across products and markets), intra-industry trade trends (horizontal and vertical; role of global production sharing and processing trade), the composition of imports (share of capital goods, intermediates), international telecommunications traffic, composition of employment, dependence on agricultural production, etc, as well as sources of foreign exchange earnings by sector (including services). The analysis of these indicators will be forward as well as backward looking.

Second, a description and assessment of the macroeconomic environment and the country's investment climate. Particular emphasis will be placed on the adequacy of policies (both macro and microeconomic, e.g. transport or port monopolies, not only their infrastructure) and the business environment (property rights, rule of law). Trade and related policy developments and the behavior of the real exchange rate will be reviewed. The objective here is to assess the incentive regime that confronts (potential) investors, both in tradables and nontradables. Areas to be addressed/assessed include customs clearance (existence and functioning of temporary admission and drawback mechanisms and exemptions, the structure and effective incidence of tariffs and related 'red tape' costs), access to and cost of pre-shipment finance and working capital, as well as barriers to investment (regulations, negative lists, equity restrictions and nationality requirements, role of state-owned enterprises, including status of privatization programs, transfers from the budget, capital controls).

Research has identified the behavior of the real exchange rate to be a key determinant of the supply response to liberalization episodes. Appreciation and high volatility of real exchange rates lead to import surges and reduces the profitability of export and import substitution activities. More important, by increasing uncertainty about future profitability, high real exchange volatility lowers investment in tradable activities. In this section, the areas that can be covered are:

- historical behaviour of real exchange rates and its impact on the supply response, especially on the key activities and subsectors;
- institutional arrangements for exchange rate management, especially whether they are designed to be flexible, and reflect the underlying productivity of the real economy; and,
- the structure and constraints in efficient operation of the foreign exchange markets, and whether they can be improved to yield more competitive and stable real exchange rates.

The major objective of this dimension of the study will be to assess the relative importance of domestic policies in accounting for observed trends. The real exchange

rate is not a policy instrument itself; it is the result of the various macroeconomic policies that are pursued by the government. What matters therefore is to identify whether past and prevailing policies have resulted in a misaligned real exchange rate.

The first and second parts of the study will be summarized through a benchmarking exercise, in which the country is compared both in terms of policy reforms and performance (economic, social) vis-à-vis other developing countries in the relevant region and other parts of the world.

Third, focus on the international policy environment and specific constraints that exports from each country face in international markets. In many countries, policy recommendations aiming at export promotion have been made without paying attention to prevailing trade restrictions in the importing countries. This section will have three dimensions.

- Document the specific set of trade restrictions (and preferential trade arrangements) that exist in industrial country markets for the existing and potential export products. This will allow the LDCs to have reliable information to argue for greater market access in the global forums, as well as adjust their policy interventions so as not to be penalized by the restrictions in the world markets.
- Determine the impact of membership in regional economic integration arrangements on the prevailing policy stance by explicitly considering the benefits and costs of such agreements in terms of policy freedom and investment incentives.
- Analyze the implications of greater market access for the existing and potential export commodities, including services, both regionally and globally.¹

Fourth, focus on a small number of key labor-intensive sectors, including in agriculture (e.g. horticulture), where the private sector perceives a potential to exist for a significant expansion in output and exports, and a good a priori case can be made that the poor stand to benefit either in terms of employment and/or lower prices. For each sector/product, the team will analyze the internal constraints that entrepreneurs face in expanding production and exporting to the rest of the world. These analyses will be targeted on a set of priority subsectors, to be determined after consultations with stakeholders in the country, in line with the broad priorities that are being incorporated into the Poverty Reduction Strategy Papers. While these constraints will vary among countries, there are a series of common constraints that prevail in many countries. These include:

- transaction costs: trade facilitation, duty free access to intermediate inputs, availability of export credit and availability and cost of communications and energy are all important in determining the competitiveness of products from LDCs;
- transportation: explicit attention will be devoted to determining the adequacy of transportation infrastructure and regulation as a factor affecting the competitiveness of industries;

¹ While the implications of trade liberalization for developing countries have been made on an aggregate and regional basis, there are very few country specific analyses of the constraints and benefits each country face in the industrial country markets.

- the regulatory environment: this will focus restrictions on entry and exit, inspections, and other regulations that constrain the ability of firms to adjust in key sectors; and,
- global, regional rules and disciplines: analysis of constraints and opportunities will review such areas as product and other standards, market standards, intellectual property protection requirements, rules of origin, etc.

Finally, each study will conclude with a pro-poor trade integration strategy. This will comprise of a proposed set of policy reform priorities and several action plans at the sectoral level that include project proposals to capitalise on major opportunities identified in the strategy. These policy proposals will target the key bottlenecks and constraints that emerge from the analysis as priority areas for action, and corollary actions by donors and development partners. The sector-specific analyses will result in recommended action plans that identify key priorities and bottlenecks that must be addressed so as to mobilise investment and exports. Each study will also include an assessment of technical assistance and capacity building priorities to support the trade strategy, as well as recommended actions that should be taken by high-income and regional partner countries to improve access to their markets. The recommendations will take into account the likely impact of proposed actions on the level and structure of poverty to ensure that the strategy has the desired positive impact on the poor. Analyses of gainers and losers from the policy changes will be undertaken and specific policies to minimise any possible detrimental impact on the poor must be identified.