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On the  
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**DOHA DEVELOPMENT AGENDA AND AID FOR TRADE**

Attached for the September 25, 2005, Development Committee Meeting is a paper entitled "Doha Development Agenda and Aid for Trade," prepared by the staff of the IMF and the World Bank, and to be considered under Item II of the Provisional Agenda.

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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 World Bank

September 9, 2005

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## Acronyms and Abbreviations

APEC	Asia-Pacific Economic Cooperation forum
BOP	Balance of Payments
CAS	Country Assistance Strategy
CG	Consultative Group
DDA	Doha Development Agenda
DTIS	Diagnostic Trade Integration Study
EC	European Commission
EU	European Union
FAO	United Nations Food and Agriculture Organization
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GI	Geographical Indication
IDA	International Development Association
IF	Integrated Framework for Trade-related Technical Assistance
IFI	International Financial Institutions
IMFC	International Monetary and Finance Committee
ITC	International Trade Centre
LDC	Least Developed Country
MDB	Multilateral Development Bank
MDG	Millennium Development Goals
MFN	Most Favored Nation
NAMA	Non-agricultural Market Access
NIB	National IF Implementation Body
OECD/DAC	Organization for Economic Cooperation/ Development Assistance Committee
PRS(P)	Poverty Reduction Strategy (Paper)
RT	Round Table
RTA	Regional Trade Agreement
SDT	Special and Differential Treatment
TIM	Trade Integration Mechanism
TRIPS	Trade Related Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
WTO	World Trade Organization

1. This Trade Progress Report updates the Board on progress in the WTO negotiations under the Doha Development Agenda in the run-up to the Hong Kong SAR Ministerial in December, and presents proposals on aid for trade to be submitted to the Development Committee and International Monetary and Finance Committee in September as requested during the spring meetings.

2. The discussion of the Doha Development Agenda below represents the views of the staffs of the Bank and the Fund, based on their ongoing research and analysis of trade issues from a development perspective, and does not purport to represent those of Ministers at the Development Committee, nor of the Development Committee as a whole.

### **I. THE DOHA DEVELOPMENT AGENDA (DDA): STATE OF PLAY**

3. 2005 is a critical year for the Doha Round. After the failure of the WTO Ministerial in Cancun, Mexico, in September 2003, the August 1, 2004 WTO General Council decisions—the “July Framework Agreement”—helped to put the DDA back on track. The negotiating framework on agriculture, which included a provision to eliminate export subsidies by a date certain as an outcome of the negotiations, plus the decision on the Singapore Issues (i.e., to take up only trade facilitation and drop investment, competition, and transparency in government procurement from the negotiating agenda) were important steps in the right direction. Since then, however, progress has been limited and considerable work remains to be done if the DDA is to deliver on the promise of its name in a timely fashion.

4. At the WTO Ministerial meeting to be held in Hong Kong SAR on December 13–18, 2005, WTO members will need to reach agreement on negotiating modalities (i.e., reduction formulas and liberalization targets) for agriculture and manufactured products, and to make concrete progress on negotiations on services, rules, trade facilitation and on the development dimension of the round. To this end, “first approximations” of the modalities in the key areas of agriculture and non-agricultural market access (NAMA) were expected by the end of July 2005.

5. At the WTO General Council meeting of July 27 and 29, 2005, however, negotiators recognized that no consensus had been reached on first approximations. Moreover, several other targets (e.g., with respect to services and special and differential treatment) were also missed, further endangering the prospects for substantive results in Hong Kong SAR. Progress at the 6th WTO Ministerial, however, remains critical if the round is to be completed by the end of 2006.

6. Achieving an ambitious outcome from the Doha Round thus requires a renewed commitment and sense of urgency from all WTO members. The state-of-play in the main areas of negotiations is briefly reviewed in what follows.

## A. Agriculture

7. A round that does not begin to remove barriers in agriculture will not be a development round. While it is important to make progress on all three pillars of the agricultural negotiations, including market access, domestic support and export competition, empirical studies suggest that improved market access would offer by far the largest development pay-off.

8. There has been some progress on market access, with negotiators reaching agreement on the threshold technical issue of the tariff base on which to negotiate tariff reductions in May.<sup>1</sup> However, the difficulty in resolving this technical issue suggests that agreement on negotiating modalities for Hong Kong SAR will be a significant challenge. With average bound tariff rates (the basis for WTO negotiations) often well above currently applied rates—around double in developed (27 percent versus 14 percent) and developing countries (48 percent versus 21 percent), and six times higher (78 percent versus 13 percent) in least-developed countries (LDCs)—meaningful increases in market access will require large cuts in bound rates.

9. The key points of contention at this stage are the formula for tariff cuts and the flexibilities allowed, particularly with respect to the treatment of sensitive and special products.<sup>2</sup> Most recently, discussions have concentrated on the proposal on market access presented by the G20 at the recent informal Ministerial meeting in Dalian, China (July 12–13, 2005).<sup>3</sup> Although seen by many as an important step toward achieving consensus in this pillar, important points of contention remain with respect to the approach for tariff cuts proposed by the G20, the treatment of sensitive products and the adoption of tariff caps.

10. Wide gaps between bound and applied levels of domestic support also mean that large cuts in currently bound levels are needed to generate reductions in actual support. The extent of this gap is illustrated by Bank research indicating that even a cut as large as 75 percent would reduce domestic support in only four economies (including the United States and the European Union). More-modest cuts would have little impact in terms of expanding markets for developing countries that are competitive agricultural exporters. Disciplines on the Blue Box<sup>4</sup> also need to be clarified if this box is going to serve the purpose of facilitating

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<sup>1</sup> The issue in this instance was how best to calculate ad valorem equivalents of specific duties.

<sup>2</sup> Bank research has explored the impact of 2 percent of bound agricultural tariff lines covering the most protected heavily traded products being deemed “sensitive” and subject to smaller cuts of around 15 percent. The study concluded that this would sharply reduce the benefits of the package and that, unless the agreed list of exceptions were quite limited and the cuts in tariffs or expansion in their tariff rate quotas substantial, the new opportunities provided by the round would be minimal.

<sup>3</sup> The G-20 encompasses 21 members: Argentina, Bolivia, Brazil, Chile, China, Cuba, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Philippines, South Africa, Thailand, Tanzania, Uruguay, Venezuela, and Zimbabwe.

<sup>4</sup> The Blue Box covers payments based on fixed area and yields, number of head for livestock and base level of production. Blue Box support is aimed at constraining production and was not subject to reduction commitments in the Uruguay Round.

movement by countries away from more distorting practices, rather than resulting in box-shifting without significant liberalization effects.

11. While export subsidies are the smallest component of protection in dollar terms, they are highly distorting and the decision in the July Framework Agreement to eliminate them within an agreed timeframe as a part of the outcome of the Doha Round is welcome. The actual development impact of this decision will depend critically on the transition period for the elimination of the subsidies and other details still to be negotiated over the coming months. Issues of parallelism (i.e., the treatment of export credits, exporting state trading enterprises, and food aid) are also important and further elaboration appears necessary for the deal on the pillar of export competition to be completed. Of particular interest from a developmental perspective will be the debate on how to define where genuine food aid ends and commercial displacement begins.

12. Finally, any successful outcome of the agriculture negotiations is seen to require a substantive outcome on the trade aspects of cotton, which the July Framework Agreement confirmed should be dealt with “ambitiously, expeditiously, and specifically” in the context of the negotiations on agriculture.<sup>5</sup> African countries are expressing a growing frustration at what they perceive as a lack of response from trade partners to their proposals in this area. The EU has indicated its willingness to “front load” cotton-reforms in the context of an eventual agricultural deal and the United States, in turn, is underscoring actions taken to comply with a recent WTO ruling that required reform of its subsidies and credit programs for cotton. Still, cotton may become a major point of friction at the Hong Kong SAR Ministerial. The World Bank and IMF will continue to work with others to address the development dimensions of this topic.

### **B. Non-Agricultural Market Access (NAMA)**

13. Work on negotiating modalities for NAMA, covering both tariff cuts according to a nonlinear formula (i.e., which cuts higher tariffs more)<sup>6</sup> and the reduction or elimination of nontariff barriers, also failed to result in a first approximation of negotiating modalities by the end of July. The announcement (June 3, 2005) that the APEC Trade Ministers had endorsed a Swiss formula approach for NAMA was considered a positive development for the negotiations, but major divisions on the details of the formula remain amongst WTO members.<sup>7</sup> This matters, as the choice of formula can result in significantly varying levels of liberalization. Moreover, many developing country WTO members feel that progress in the NAMA negotiations will require substantive movement on agriculture.

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<sup>5</sup> The cotton initiative, launched in the context of the DDA by Benin, Burkina Faso, Chad, and Mali in 2003, stresses the damage caused to cotton-producing developing economies by OECD subsidies and seeks the establishment of a compensation fund.

<sup>6</sup> Cutting higher tariffs more addresses both tariff peaks and tariff escalation (where the tariff level increases with the degree of processing).

<sup>7</sup> A Swiss formula cuts higher tariffs by more and sets a limit on the highest post-liberalization tariff.

14. Another major issue in the negotiations is the degree of flexibility to be granted to developing countries, including in terms of their participation in sectoral negotiations (for example, on chemicals, wood products, fish, pharmaceuticals, jewels, electronics and environmental goods). LDCs are only expected to increase the proportion of their tariff lines that are bound (at present, that proportion stands at 48.8 percent, versus 85.5 percent for developing countries as a whole, and 98.8 percent for industrial countries),<sup>8</sup> however, they (and other small, poor countries) remain concerned about the erosion of their preferential access to other markets from MFN tariff liberalization. Bank and Fund staff research indicates that preference erosion is likely to affect significantly only a small number of developing countries in selected sectors, notably sugar, bananas, tobacco, garments. Further, preference erosion raises both bilateral and multilateral issues.

15. A meaningful Doha package on manufactures will require action by *all* WTO members: protection in high-income countries, while relatively low on average, is highest in the labor-intensive products (such as textiles and clothing), that developing countries export, preferential access for LDCs notwithstanding.<sup>9</sup> Protection in developing countries, on the other hand, is some four times higher than in high income countries. While developed countries should remove their discrimination against developing country exports, developing countries should be prepared to lower—and bind—their NAMA tariffs, not only in their own economic interests but in the interests of their developing and least developed country trading partners. South-South trade now constitutes some one quarter of developing country exports (around 40 percent if the WTO definition of developing countries is applied), and just under 40 percent of exports from least developed countries (LDCs) go to other low and middle income countries. With this trade growing 50 percent faster than world trade in general, exempting it from further liberalization would undercut the development objectives of the round.

### C. Services

16. The services negotiations could deliver some of the greatest gains from the round, but progress so far has been disappointingly slow. By the end of July, 68 initial offers (representing 92 WTO Members, since the EC offer covers 25 member states), and 24 revised offers (representing 48 WTO Members), had been received. Notwithstanding the difficulty of establishing clear targets for a successful outcome, given the qualitative rather than quantitative nature of services barriers, the general perception is that the overall level of

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<sup>8</sup> Calculations based on 2005 WTO figures. LDC figures refer only to the 32 LDCs that are WTO members; developing country figures include economies in transition, Mexico, Republic of Korea and Israel. All are simple averages of the percentage of tariff bindings (binding coverage is calculated as the number of HS 6-digit subheadings containing at least one bound tariff line divided by the respective total number of HS 6-digit subheadings of the corresponding version of the HS nomenclature). These average figures mask wide disparities amongst countries in terms of percentage of tariff lines bound, most particularly for LDCs.

<sup>9</sup> When agriculture is also taken into account, the pattern of protection against developing country exports is even more marked.

ambition in these offers is low. In the vast majority of instances, the offers bind liberalization at levels that are already exceeded by actual practice.

17. The General Agreement on Trade in Services (GATS) introduced as part of the Uruguay Round provided an important new framework of rules for trade in services. However, the GATS has, by and large, and except for countries undertaking commitments under WTO accession, generated little new actual liberalization to date. Yet, further market opening in services, in particular in key sectors in developing countries such as financial and telecommunications services, has the potential to remove important brakes on development. Given the importance of efficient and high quality services across the whole economy, as well as their importance for the competitiveness of exports of goods and other services, a meaningful Doha outcome should achieve tangible market opening in this sector, in line with the regulatory capacities of WTO members. Equally, further liberalization of the movement of natural persons as service suppliers (under GATS Mode 4) would entail large and ongoing gains for both developing and developed countries.

18. Parallel negotiations on services rules covering subsidies, government procurement, domestic regulation and an emergency safeguard mechanism (to enable suspension of commitments where imports threaten to harm local industry) are also proceeding slowly. Most of the focus is on the last of these, where there is a wide gulf among those that believe that such a mechanism is fundamental and others that dispute the feasibility and desirability of a safeguard for services. Domestic regulation has also received considerable attention, but the complexity and sensitive nature of this issue has resulted in limited progress.

#### **D. Trade Facilitation and Other Topics**

19. Improvements in trade facilitation are essential to enable countries to harness trade for development. WTO negotiations on trade facilitation are focused on expediting the movement, release and clearance of goods, including goods in transit, with commitments by developing countries linked to implementation capacity and availability of technical assistance. The negotiations are proceeding well. The World Bank, along with a number of other international organizations, has been active in support of these negotiations, through the creation of regional networks of experts in developing countries to advise on negotiating proposals and issues.

20. Negotiations on rules (including topics as antidumping, subsidy disciplines and regional trade agreements, RTAs), in turn, have achieved limited progress to date—the exception being the work on new mechanisms to promote transparency of RTAs. There are concerns that the debate on anti-dumping rules may become a major point of contention in the final phase of the DDA. In the same vein, the extension of higher protection for geographical indications (GIs) for products other than wines and spirits and the amendment of the WTO Agreement on Trade Related Intellectual Property Rights (TRIPS) to accommodate the waiver vis-à-vis compulsory licensing of pharmaceutical products may add to the complexity of the ongoing negotiations.

#### **E. Development Issues and Aid for Trade**

21. Since the negotiations started, 88 agreement specific proposals on operationalizing *special and differential treatment* (SDT) have been made, of which 28 have been, in principle, accepted by WTO members. Concrete recommendations on the remaining proposals were expected by July 31 2005. SDT proposals cover requests for greater flexibility in terms of “policy space” for developing countries (i.e., greater flexibility on the application of WTO disciplines, for example, related to subsidies), preferential market access, support for institution and capacity building, and improved capacity of developing countries to benefit from dispute-settlement procedures. There are substantial differences of view on the appropriate scope and recipients of SDT, including an ongoing debate on the need for greater “differentiation” amongst developing countries and the desirability of characterizing some developing countries (e.g., small and vulnerable economies) as a distinct group. Reflecting these differences, the Committee on Trade and Development was not in a position to make specific recommendations to the July 29 General Council meeting.

22. It may be timely to think again about what kind of SDT makes sense from a development perspective. Maintaining exemptions and high barriers is not in the long-term interest of developing countries, nor in the interests of their developing country trading partners. Liberalization in the Doha Round is a matter of self-interest: present a supportive investment climate, trade openness contributes to higher productivity and faster technological adoption and thus to growth. Openness to trade has been a central element of successful growth strategies: in all countries that have sustained growth the share of trade in GDP has increased and trade barriers have been reduced. Rather than pushing exclusively for “policy space,” developing countries could use the opportunity of the Doha Round to lower the barriers that sap the productivity of their economies, taking advantage of special treatment provisions that allow for longer implementation periods when necessitated by fiscal, capacity, and other constraints. This strategy may also induce industrial countries to act more vigorously on trade policies that harm developing countries, most obviously in agriculture and labor intensive manufactures.

23. But while there are real gains for developing countries from active participation in the Doha Round, gains will not necessarily be automatic, and some countries may experience transitional adjustment costs. Increased international assistance is required to help countries to overcome supply-side constraints in order to take advantage of new trade opportunities from the Doha Round, or to address transitional adjustment costs from liberalization. This “aid for trade” is an essential element of a successful, pro-development Doha package.

## **F. Conclusion**

24. In sum, from a development perspective, a “good” outcome from the Doha Round would have 3 main elements:

- (i) *developed country action on agriculture*: developed countries must adopt the same ambitious market openings in agriculture that they long ago adopted in manufactures by eliminating export subsidies and substantially reducing applied tariffs and trade-distorting domestic support; market access is particularly important;

- (ii) *participation by all countries*: middle income countries, and poor countries more selectively, contribute with offers to open services markets, bring down high tariffs in manufactures, and reduce barriers in heavily protected agricultural markets, while expressing willingness to trade away “special and differential treatment” for increased market access in agriculture and elsewhere to spur their own development; and
- (iii) “*aid for trade*”: provision of assistance by the international community to help countries address supply-side constraints to their participation in international markets and to cope with transitional adjustment costs from liberalization.

25. The 2005 Hong Kong SAR Ministerial will be a key test of the ultimate ambitions of the “development” round. If all countries stick to minimalist positions, there is little chance that the Doha Round will make a significant contribution to reducing global poverty. And an investment in a successful Doha Round is an investment in the future of a strong and effective multilateral trading system. To this end, the World Bank and IMF are intensifying their efforts in support of an ambitious outcome from the Doha Round. In addition to support for the trade facilitation negotiations (see paragraph 19), and increased lending for trade (see paragraph 34 below), the Bank has conducted an extensive program of research, seminars and outreach, including in Geneva, to help inform key issues in the negotiations. This work has focused on the impact of agricultural trade reform on all WTO members, including the poorest; preference erosion; services liberalization and the GATS; and trade liberalization and poverty. The IMF has introduced the Trade Integration Mechanism (TIM) (see paragraph 34 below), to provide financial assistance to members facing balance of payments pressures resulting from multilateral trade reforms by other countries, and is examining the use of floating tranches under Fund arrangements aimed at mitigating the balance of payments impact of own trade reforms. The Fund has also sharpened its surveillance of countries with trade-related vulnerabilities and is providing trade-related technical assistance for customs and tax reform.

## II. AID FOR TRADE

26. At their meeting of February 5, 2005 G7 Finance Ministers called on the IFIs to develop proposals for additional assistance to countries to ease adjustment to trade liberalization and to increase their capacity to take advantage of more open markets. In response, a joint paper from the Bank and IMF was tabled at the 2005 Spring meetings.<sup>10</sup>

27. At the Spring meetings, the Development Committee and the International Monetary and Financial Committee (IMFC) called on the Bank and Fund to work with others to develop more detailed proposals to help developing countries adjust to and take advantage of the round, for consideration at the Annual Meetings. These requests were echoed by the G8 in Gleneagles in July 2005.

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<sup>10</sup> “Aid for Trade: Competitiveness and Adjustment,” DC 2005-0006, dated April 12 2005.

28. In response to these requests, the Bank and Fund organized a consultation process with key stakeholders in Geneva, ably chaired at our request by the Ambassadors of Rwanda and Sweden. The outcome of those consultations is reflected in the cover letter and paper forwarded to us by the Ambassadors at Annex I.<sup>11</sup>

29. In line with the above request from the Development Committee and the IMFC, this note outlines proposals by IMF and World Bank staff to help developing countries adjust to and take advantage of the Doha Round, for consideration at the Annual Meetings.

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

30. To reach the MDGs, growth must be accelerated in many countries. Trade can be an important engine of growth, but many poor countries lack the basic infrastructure to trade and face considerable supply-side constraints in participating in global markets. These difficulties can be compounded by own trade policy settings that create disincentives to enter international markets, such as maintenance of high unbound tariffs.

31. There may be too little trade reform not only because the benefits of unilateral liberalization may be poorly understood by the general public, but also in part because MFN (non-discriminatory) trade reform has some of the characteristics of a global public good and is not adequately internalized in country processes. Trade policy reforms (such as lowering of tariffs) and investments in trade machinery (such as customs reform and ports) can have significant externalities. All countries benefit from one country's trade reforms and trade-related investments, and benefits are increased when undertaken by a number of countries concurrently. However, the full benefits of reform are not captured by the country itself, leading potentially to "under-investment" in reform.

32. In the current Doha Round, aid for trade<sup>12</sup> can help to encourage an ambitious outcome in which all countries participate. Indeed, both the Doha declaration and the July Framework Agreement<sup>13</sup> contain multiple references to the need for technical assistance and capacity building for poor countries to undertake commitments and benefit from the round. Many poor countries see limited benefits from the round unless their supply-side capacity constraints are addressed. Others fear that they only stand to lose from preference erosion under multilateral liberalization, and that they would have to forego scarce fiscal revenue or suffer other adjustment costs. Addressing these concerns is an important part of ensuring overall success of the Doha Round and a strong and effective multilateral trading system—

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<sup>11</sup> Bank staff contributed to the drafting of this paper in a personal capacity.

<sup>12</sup> "Aid for trade" comprises: technical assistance; capacity building; institutional reform; investments in trade-related infrastructure; and assistance to offset adjustment costs, such as fiscal support to help countries make the transition from tariffs to other sources of revenue.

<sup>13</sup> See WTO, Ministerial Conference, Fourth Session, Doha, November 9–14, 2001, "Ministerial Declaration: Adopted on November 14" WT/MIN(01)/DEC/1, dated November 20, 2001 and WTO, "Doha Work Program: Decision Adopted by the General Council on 1 August 2004," WT/L/579, dated August 2, 2004.

both of which are very much in the interests of poor countries as well as of the global trade community as a whole.<sup>14</sup>

33. While aid for trade may be a key complement to ambitious liberalization under the Doha Round, and is important in its own right, it is not a substitute. Put more starkly, the majority of developing countries will gain more from a successful Doha Round that opens markets and reduces subsidies than from any aid for trade package.

### **B. Progress to Date on Aid for Trade**

34. Some progress has already been made on aid for trade:

- The OECD DAC/WTO database indicates that resources devoted to trade-related capacity building and technical assistance increased significantly in 2003, after being static between 2001 and 2002. Commitments for trade policy and regulations increased from about US\$660 million per year in 2001–2002 to almost US\$1 billion in 2003. Commitments for trade development activities increased from US\$1.35 billion per year in 2001–2002 to US\$1.8 billion in 2003.<sup>15</sup>
- The World Bank has scaled up its activities, with lending for trade increasing from US\$0.8 billion in FY98–00, to US\$1.4 billion in FY01–03, to a projected US\$3 billion in FY04–06. Trade facilitation is a significant component of this, accounting for US\$1 billion in FY04–06.<sup>16</sup>
- The IMF has introduced the Trade Integration Mechanism (TIM), designed to assist member countries to meet balance of payments difficulties that might result from trade liberalization by other countries. Two countries have taken advantage of the TIM to date—Bangladesh (US\$78.03 million, equivalent to 10 percent of their IMF quota) and the Dominican Republic (US\$32.03 million, equivalent to 10 percent of their IMF quota).
- The Integrated Framework of Trade-related Technical Assistance (IF), which brings together multilateral agencies (the IMF, International Trade Centre (ITC), UNCTAD,

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<sup>14</sup> Goal 8 of the MDGs (a global partnership for development) includes as one of its targets the further development of an open, rules-based predictable, nondiscriminatory trading system. “Trade and Development”, the Report of the UN Millennium Project Task Force on Trade, underlines both the importance of an ambitious outcome from the Doha Round and significantly increased aid for trade. UNCTAD has also called for major increases in aid for trade (see “Towards a New Trade “Marshall Plan” for Least Developed Countries” UNCTAD/DITC/TAB/POV/2005/1).

<sup>15</sup> The 2004 Joint Report on Trade-Related Capacity Building and Technical Assistance (TRTA/CB) cautions that these amounts cannot be summed to give an overall value for TRTA/CB. See p. 8 of: <http://www.oecd.org/dataoecd/27/4/11422694.pdf>.

<sup>16</sup> Trade-related lending refers to the trade theme component of loans (i.e., those components with a significant impact on trade).

UNDP, WTO and World Bank) and bilateral and multilateral donors to assist least-developed countries (LDCs), has been re-vamped and is now operating in 28 countries, with another 9 in the offing.

35. But while things have improved, much remains to be done for the trade and competitiveness vision to be shared and articulated at the highest levels of government, and fully reflected in national development strategies. While the IF was designed to spur this process, as a vehicle to mainstream trade in the Poverty Reduction Strategy (PRS) process, and to promote donor coordination in trade-related assistance, follow-up has often been incomplete and donor response slow. It is clear that more needs to be done, and there is a window of opportunity to move forward:

- Annual development aid is expected to increase by US\$50 billion between now and 2010. Scrutiny of the extent to which the increased aid results in sustained growth outcomes is bound to increase. Furthermore, dealing with the likely real exchange rate appreciation (“Dutch Disease”) effects of increased aid will require that greater attention be paid to trade liberalization, facilitation and to international competitiveness more generally.
- The critical juncture of the Doha Round provides a political focus for aid for trade.
- The current work program of the IF runs through to the end of 2005. This provides an opportunity to look again at how the IF can work to promote an agenda of trade, competitiveness and growth in poor countries.<sup>17</sup>

### **C. Ways Forward on Aid for Trade**

36. It is against this background that the World Bank and the IMF were asked by the Development Committee and the IMFC to develop proposals on aid for trade. The Geneva consultation process undertaken pursuant to that mandate identified a number of non-mutually exclusive approaches for increasing aid for trade (Annex I):

- An enhanced IF, including significantly strengthened machinery for in-country follow up, as well as increased, multi-year resources, to strengthen basic trade capacity building and promote mainstreaming of trade in the PRS.
- A multilateral fund to provide a predictable source of follow up financing for priorities identified in the country-level Diagnostic Trade Integration Studies (DTIS) conducted under the IF.

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<sup>17</sup> Provision of technical assistance is also included in the mandate for WTO negotiations on trade facilitation under the DDA (see Part I). WTO members may wish to consider the implications of this mandate for the broader aid for trade agenda.

- A multilateral fund to address adjustment concerns from multilateral liberalization under the Doha Round.

37. Based on the input and feedback received via this process, the following section outlines those areas that the Bank and Fund staffs feel represent the most effective response. In sum:

- The staffs of the Bank and Fund support a significantly enhanced IF, with the design and resources to function as an effective platform for integrating the growth and competitiveness agenda into the national development strategies of poor countries.
- The staffs of the Bank and Fund have, however, doubts about the value of a general, multilateral fund to follow up on priorities identified in the DTIS. Such a fund may not be necessary with full and faithful implementation of the enhanced IF. That said, Bank and Fund staff see merit in examining *regional or cross-country* aid for trade needs that are frequently insufficiently addressed under the country-based PRS process. The staffs propose to explore the adequacy of existing mechanisms to address regional and cross-country aid for trade and, in cooperation with other stakeholders, examine (i) the opportunities offered by the enhanced IF; (ii) extension of existing Bank instruments; and (iii) a dedicated multilateral fund.
- The staffs of the Bank and Fund see value in strengthening the assessment of adjustment needs to enable existing assistance mechanisms to be better utilized, and, in cases where adjustment effects are particularly severe, in having the IFs coordinate with other donors to provide a package of additional assistance in the form of grants or loans as appropriate. However, the staffs have serious misgivings about the desirability and effectiveness of a separate fund to address adjustment, given the availability of existing mechanisms and the need to consider adjustment as part of an overall package of domestic policy reforms and economic planning.

### **Enhancing the IF**

38. The IF is a potentially powerful instrument to help countries generate and embed a trade and competitiveness agenda in their national development strategies. As a mechanism for mainstreaming trade into the PRS, with country priorities identified on the basis of sound diagnostics (DTIS), it provides the most effective channel for trade to tap into existing and additional aid flows. The IF has two central objectives: (i) to mainstream trade into the PRS of LDCs for both policy coherence and proper financing of trade-related projects; and (ii) to assist in the coordinated delivery of trade-related technical assistance in response to needs identified in the LDCs. The key principles upon which the IF is built are country ownership, coherence and partnership.

39. Much has been achieved under the IF to date:

- By the end 2005, DTIS and national validation workshops will be completed in 21 countries. A further 7 LDCs have started the process and 9 more have applied to join.
- As of end of May 2005, 22 Window II projects<sup>18</sup> had been approved in 12 countries, amounting to US\$8 million, covering diverse areas, from trade negotiation capacity building (Cambodia, Madagascar, Ethiopia), export-related information gathering and dissemination (Yemen) to sector-specific institutional and technical support (e.g., Burundi, Ethiopia, Senegal).
- As of end of April 2005, 17 IF donors, including the Bank, had pledged a total of US\$30.2 million to the IF Trust Fund. While a sound basis of diagnostics has been established, overall funding, in particular for follow up technical assistance and capacity building projects, has remained modest.

40. The IF enjoys strong support amongst donors and LDCs.<sup>19</sup> In LDCs where it has been implemented, the IF has contributed to increased knowledge of trade issues, facilitated intra-governmental dialogue on trade and growth, and raised awareness of the wide array of complementary reforms needed for trade integration. Donors have found the IF to be a useful common framework for, and knowledge base for the design of, trade-related assistance. Overall, the IF has enabled a more fluid dialogue on trade amongst LDCs, stakeholders within LDCs, donors and trade-related agencies.

41. That said, the IF faces considerable challenges in mainstreaming trade into the PRS process and translating diagnostics into implementation. Such challenges include: weak in-country capacity; lack of systematic follow up at the country level; insufficient and uncertain financing; and variable donor response to priorities in the DTIS (a more detailed description of the achievements and identified shortcomings of the IF as currently implemented is in Annex II). The enhanced IF could meet these challenges in several ways: (i) by supporting the creation of strong in-country leadership on trade; (ii) promoting the development of a coherent strategy for trade and competitiveness; (iii) sustaining this trade push via a multiyear, rolling program of capacity building, and; (iv) promoting increased donor coordination on aid for trade, via both multilateral and bilateral channels.

42. To this end, the enhanced IF would fund two main types of activities:

- ***Multi-year programs of technical assistance and capacity building*** related to, for example, trade policy and strategy, strengthening of core trade-related institutions and functions, certain administrative/regulatory reforms, intra-governmental

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<sup>18</sup> Window II of the IF is a bridging mechanism designed to finance small, priority technical assistance and capacity building projects prior to the incorporation of the DTIS findings in the PRS and subsequent donor funding. Window II currently provides a maximum of US\$1 million for each country. See Annex II.

<sup>19</sup> The Doha Declaration endorsed the IF as a viable model for LDCs' trade development and urged development partners to significantly increase contributions to the IF Trust Fund. Op cit. paragraph 43.

coordination, and private sector capacities/initiatives. This would encompass a wide range of activities, including the existing range of activities from Windows I and II<sup>20</sup> from the current IF and smaller projects to address supply-side issues.<sup>21</sup>

- ***Project preparation:*** The enhanced IF would strengthen the link between identified large-scale needs in the DTIS (e.g., key trade-related infrastructure), and donor funding by financing project preparation in areas of priority. Completed project proposals could then be presented to donors for appropriate response.

43. The enhanced IF would require *predictable, multi-year financing*, with resources increased to a sum in the order of \$200–\$400 million, disbursed over an initial 5 year period.<sup>22</sup> Financing would continue to take the form of grants, not loans. *Strengthened in-country structures* would also be required to move from diagnostics to implementation (Box 1), along with *improved links to donor processes* to maximize both multilateral and bilateral resources for aid for trade. For example, to assist mainstreaming into country programs, the IF Secretariat could work with countries to follow up pro-actively with donors where necessary. Linkages between the enhanced IF and World Bank country programs would also be strengthened, building upon the growing emphasis on the trade and growth agenda in Bank programs (see, for example, the Africa Action Plan). IF *engagement with the private sector and civil society* at the country level would also be enhanced (Box 1).

44. Improved *monitoring and administration* is an essential component of the enhanced IF. The IF should be placed on a sustainable, fully-funded footing, with adequate resources to ensure its professional operation. Clearly, with this scaling up, it is important that careful attention be paid to the necessary reforms to the IF governance structure at the global level. The enhanced IF could be reviewed after 3 years, any necessary adjustments made and the possibility of scaling up explored.

45. Operation of the current IF is the prerogative of the IF Steering Committee and more detailed consideration of necessary reforms will need to be undertaken in consultation with IF stakeholders. However, in view of concerns expressed by some donors, and structural

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<sup>20</sup> Window I of the IF trust fund is used primarily to provide financial resources up to US\$300,000 to the IF diagnostic studies (DTISs) for eligible countries. Window II is explained in footnote 17 above.

<sup>21</sup> Projects would depend upon country needs and priorities, but could include: trade policy capacity (training, funding for staff or external experts); customs (valuation, computerization, risk management); standards (training, upgrading legislation, surveillance and international accreditation), development of export and investment promotion agencies or private sector industry associations; sectoral support (product development, policy analysis, supply chain upgrading); and development of regulatory and institutional frameworks to support services liberalization or export processing zones. The enhanced IF could incorporate the current Window II funding or, for existing Window II countries, could be implemented sequentially.

<sup>22</sup> This number is based on an assessment of technical assistance and capacity building (but not investment) needs in selected DTISs and is intended to provide a broad indication of the dimensions of scaling up envisaged. While based on an estimated 40 active clients under the program, the exact amounts per country would vary according to needs and circumstances and the effectiveness of the country in implementing the IF.

issues identified in previous evaluations of the IF (Annex II), Box 1 sets out some initial thinking on a possible approach to improving the operation of, and outcomes from, the IF at the country level.

Box 1. A Possible Model for In-Country Institutional Strengthening of the IF

A key first step would be the establishment, with assistance from the IF, of a national IF implementation body (NIB), with trade and operational expertise. The Trade Ministry would continue to play a key role, but consideration could be given to housing the NIB within, or otherwise linking it to, a core economic ministry (e.g., Ministry of Finance, or Planning). It will be critical to ensure the effectiveness of the NIB.

The first major task of the NIB would be to develop an overall 5 year implementation plan, translating the DTIS matrix into priority themes and time slices for capacity building. Next, in consultation with donors (e.g., at DTIS follow up conferences), the NIB would identify gaps where existing or planned activities were not meeting needs. Two key gaps are likely to be in capacity building and project preparation, both of which would be financed from the IF Trust Fund. The NIB would then solicit and screen project proposals on these priority topics.

The NIB would also monitor implementation and advocate trade in PRS/economic planning. Additional oversight and assistance would be provided by an intra-governmental policy committee, and private sector and civil society advisory groups.

Projects could be provided by a range of suppliers, including the private sector and NGOs, and would be approved by the Trust Fund administrator, who would manage disbursements and arrange for periodic independent reviews of portfolios of projects and operation of the NIB in individual IF countries. Allocation of resources for subsequent tranches of projects would be based, in part, upon satisfactory performance.

Overall oversight would be provided by the IF Steering Committee. The IF Secretariat would manage regional coordinators to support country NIBs and a roster of experts to advise on particular proposals, and coordinate with the country NIBs and the Trust Fund administrator.

***Eligibility***

46. Appropriate eligibility criteria would need to be developed and could include governance, absorptive capacity and a demonstrated commitment to an integrated trade agenda. Ongoing allocations would also be subject to performance review (Box 1), promoting mutual learning and demonstration effects amongst IF countries.

47. While the IF has traditionally been a program for LDCs only, from a development perspective, consideration should be given to extending the IF beyond LDCs to other low income countries, for example to other IDA-only eligible countries (Annex III). However, LDCs have expressed considerable concern about possible extension of the IF (Annex I), and the possible dilution of benefits. One possibility to address these concerns would be for a separate window to be created to fund non-LDCs.

### ***Inclusion of a Regional/Cross-Country Window***

48. A further enhancement to the IF could be the creation of a separate window to finance diagnostics of regional, or cross-country, impediments to trade development (e.g., regional transport corridors, standards, disease or pest issues). A regional diagnostics window under the DTIS could also examine the feasibility and desirability of regional solutions to trade capacity problems, such as regional standards bodies, infrastructure, or regulatory frameworks. Requests for regional DTIS, making a *prima facie* case, would require the support of all countries concerned, but would be funded from a separate window and not included in the allocation of the individual countries. Regional DTIS would need to involve at least one LDC, but would not be limited to LDCs.

### ***Resources for Implementation***

49. In addition to \$200–400 million for IF countries (see paragraph 43 above), an essential corollary for the enhanced IF will be increased donor willingness to fund aid for trade via the PRS process. (This maintains the existing structure of the IF whereby donors can contribute to the IF trust fund and/or fund aid for trade needs via the PRS). Additionally, increased resources will also be required for more effective IF implementation at both the country and global levels. Under the scenario in Box 1, for example, the IF trust fund would finance operation of the country NIB, the roster of experts, regional advisers, and costs of the trust fund administrator. The enhanced IF will also have resource implications for the major IF implementing agencies (WTO, UNDP, ITC, World Bank) that would need to be addressed in order to substantially scale up IF efforts.

### **Cross-Country and Regional Aid for Trade**

50. With thorough and meaningful implementation, the enhanced IF should address most aid for trade needs through countries' increased capacity to bring trade needs to the PRS process, and donors' increased willingness to make funds available for aid for trade, including as part of the growth agenda, in the context of PRS.

51. However, the country-focused PRS process may not be adequate to ensure follow up to regional issues, including but not limited to those identified in the regional DTIS above. Regional or cross-country projects might be particularly important for small, very poor, or landlocked countries dependent on action by a neighbor for whom the issue may not be a high priority. For example, the roads that Rwanda requires to have access to the ports of Mombasa or Dar es Salaam require the cooperation of Kenya, Uganda, and Tanzania—but for these countries, roads in the hinterland may be a low priority. Small, very poor, or landlocked countries are also likely to face numerous competing demands for existing donor resources within their PRS process and may benefit from cost-effective regional machinery for trade, such as regional laboratories for conformity assessment or, potentially, regional infrastructure or regulatory frameworks to support liberalization in services such as electricity or telecommunications.

52. Against this background, the staffs of the Bank and Fund see merit in further exploring the adequacy of existing mechanisms to address regional or cross-country aid for trade. As part of this exploration, the staffs would, in cooperation with other stakeholders, examine (i) the opportunities offered by the enhanced IF; (ii) extension of existing Bank instruments; and (iii) a dedicated multilateral fund to provide co-financing for regional projects.<sup>23</sup> The staffs would report back to the Development Committee and the IMFC at the 2006 Spring Meetings.

53. Exploration of the desirability and feasibility of a fund would be without prejudice to a final decision and would be guided by the following principles:

- The fund should provide co-financing in the form of grants to support projects clearly linked to trade, in close coordination with MDBs, regional development banks and other relevant agencies.
- The fund should complement, but not duplicate, existing mechanisms.
- The fund would provide for the widest possible range of implementing agencies. Involvement of the private sector would be encouraged.
- The management structure would be light but accountable, leveraging existing expertise and systems to the extent possible, with all costs fully met by the fund.

### **Addressing Adjustment Costs**

54. Trade liberalization creates adjustment problems for some countries; and in some cases, these can be relatively large. Countries suffering adjustment shocks from trade liberalization, including—but not only—via the Doha Round, should be assured of transitional support from the international community. The key is (i) ready and objective identification of these countries and (ii) ensuring that they are given assistance under existing mechanisms.

55. To address these concerns the staffs of the IMF and World Bank propose to work closely with our member countries to:

- assess the nature and magnitude of any adjustment need;

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<sup>23</sup> A dedicated fund could encourage regional solutions to problems and assist in promoting regional integration amongst poor countries. Grant co-financing from a possible fund could cover, for example, project preparation; training and technical assistance (e.g., training of the private sector or national standards bodies on newly adopted regional standards); capacity building; infrastructure (e.g., construction of a port access road); and project monitoring and evaluation. The support of all countries concerned could be required and priority could be given to proposals involving low income countries. Issues identified in country or regional DTISs could also be a priority for funding, although other issues would not be excluded.

- work with countries to design policies aimed at addressing key obstacles to trade expansion and at managing the impact on affected population groups,<sup>24</sup> and
- provide assistance under existing mechanisms (e.g. Bank and Fund lending, including, in the case of the IMF, the TIM) and, where a country is found to be suffering particularly severe adjustment costs, to coordinate with other donors to bring an additional package of assistance, in the form of grants or loans as appropriate.

56. Analyses of adjustment impacts could be undertaken in the context of regular staff work or could be done on a stand-alone request basis, in consultation with other relevant international organizations. It is not intended to conduct these analyses for every country, but only for countries with a prima facie case of significant adjustment shocks. Depending on the number of such countries, conduct of these analyses could have resource implications for both the World Bank and the IMF.

57. Analyses could examine the economic impacts of trade reform, undertaken multilaterally, unilaterally or as the result of regional agreements (indeed, the impacts can be difficult to separate).<sup>25</sup> Likely candidates for such analyses could include (but are not limited to) countries negatively affected by the end of textile quotas, countries affected by preference erosion, net food importing countries,<sup>26</sup> and countries undertaking major programs of trade reform, including significant reductions in applied tariffs.<sup>27</sup> Analyses would not be limited to LDCs, given that the purpose is to identify those countries that are suffering the largest adjustment shocks. Analyses would also not be limited to macro impacts, but could also potentially draw upon World Bank Poverty and Social Impact

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<sup>24</sup> This would be consistent with the joint letter of the heads of the IMF and World Bank to the WTO before the Cancun Ministerial (“IMF and World Bank Announce Plans to Support Developing Countries with Trade-Related Adjustment Needs in WTO Round,” Press Release No. 03/140, August 21, 2003. Available at: <http://www.imf.org/external/np/sec/pr/2003/pr03140.htm>).

<sup>25</sup> Analysis of adjustment shocks might also consider, for example: the extent to which adjustment shocks from regional liberalization might be offset by gains from multilateral liberalization; the scope for improved revenue collection from lower tariffs and customs reform; the likely timeframe for adjustment; utilization rates of preferential access (including due to strict rules of origin); the extent of liberalization for products subject to preferences; and regional, social, gender or other characteristics of affected industries/groups.

<sup>26</sup> Without disputing that gains from the removal of export subsidies outweigh losses from the standpoint of poor countries, the negative income effects can precede in time the efficiency gains and some affected countries may thus require transitional income support.

<sup>27</sup> Fund staff have already sharpened surveillance of countries with trade-related vulnerabilities (as noted in Annex IV), as well as surveillance of the spillover effects from trade policies of large industrial and middle-income countries.

Analyses as tools to capture impacts upon the poor, and to propose ways of mitigating them.<sup>28</sup>

58. Analyses would estimate the scale of adjustment challenges and identify appropriate policy responses and necessary assistance from the international community. These could serve as the basis to ensure that the needs of the countries are appropriately addressed under existing Bank—and Fund—supported programs (Annex IV) and for recommendations for increased assistance from bilateral donors in the context of the PRS/Consultative Group process.<sup>29</sup> Where a country was found to be suffering particularly severe adjustment shocks, there may be a case for additional assistance beyond that already available. In such cases, the IFIs could coordinate with other donors to bring an additional package of assistance, making additional funds available in the form of grants or loans, as appropriate. These analyses would also be widely disseminated within the World Bank and IMF to ensure that their findings were fully reflected in all country operations.

59. A further possibility proposed in the Geneva consultation process is the creation of a dedicated fund to address problems arising for some countries from multilateral liberalization under the Doha Round, to be targeted at preference erosion and, perhaps, loss of government revenue from tariff reductions and terms-of-trade impacts on net food importers. Proponents of this dedicated fund argue that it is necessary to help build support for ambitious liberalization under the Doha Round.

60. However, the staffs of the Bank and Fund do not believe that a dedicated adjustment fund would be a desirable use of additional aid for trade resources. There are a number of drawbacks to such a fund, beyond the risk of politicization, and few benefits:

- Adjustment needs should not be considered in isolation, but as part of an overall package of domestic policy reforms and economic planning.
- Multiple channels already exist to provide adjustment assistance, including in the context of an overall economic assessment—e.g., IMF TIM and World Bank structural adjustment lending (Annex IV).<sup>30</sup>

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<sup>28</sup> The Poverty and Social Impact Analysis (PSIA) approach analyses the distributional impact of policy reforms on the well-being or welfare of different stakeholder groups, with particular focus on the poor and vulnerable. PSIA has an important role in the elaboration and implementation of PRS in developing countries and has been used to analyze the poverty and social impacts of a variety of reforms in different sectors and regions.

<sup>29</sup> Some projects related to adjustment (e.g., worker retraining) could be financed under the enhanced IF, where prioritized by the country concerned.

<sup>30</sup> Fund staff are already experimenting with the floating tranche concept, mentioned in the Aid for Trade note sent to the Development Committee and the IMFC at the Spring Meetings.

- The evidence suggests that serious adjustment problems from preference erosion will be limited to relatively few countries. Further, preference erosion raises both bilateral and multilateral issues.
- The impact on government revenue from tariff reductions by low income countries in the context of the Doha Round will depend upon the degree of liberalization undertaken. The fiscal impacts of unilateral and DDA trade reforms can be addressed under existing IFI financing facilities.
- The cost of setting up a fund, which would duplicate existing mechanisms, could detract from availability of funds for other approaches to aid for trade, such as those outlined in this paper.

61. We believe that the above approach—improved diagnostics to enable the better utilization of existing mechanisms for assistance, with coordination for additional packages of assistance where adjustment effects are particularly severe—should be sufficient to ensure appropriate response, both by the IFIs and bilateral donors, to adjustment concerns.

#### **D. Conclusions and Recommendations**

62. The staffs of the Bank and Fund recommend that the Development Committee and IMFC:

- (a) Endorse the enhanced IF outlined above (paragraphs 41–49), including predictable, multi-year financing, of the order of \$200–\$400 million, over an initial 5 year period.*
- (b) Grant a mandate to the staffs of the Bank and Fund to explore the adequacy of existing mechanisms to address regional or cross-country aid for trade and, in cooperation with other stakeholders, examine (i) the opportunities offered by the enhanced IF; (ii) extension of existing Bank instruments; and (iii) a dedicated multilateral fund (on the basis of the principles set out in paragraph 53). The staffs of the Bank and Fund would report back to the Development Committee and IMFC at the 2006 Spring Meetings (paragraphs 50-53).*
- (c) Agree to a strengthened framework for assessing adjustment needs so that existing assistance mechanisms can be better utilized. Agree that, where a country was found to be suffering particularly severe adjustment costs, the IFIs would coordinate with other donors to bring an additional package of assistance, in the form of grants or loans as appropriate (paragraphs 54–58).*

**Cover Letter and Paper from Geneva Consultation Process**



PERMANENT MISSION OF SWEDEN

Geneva, 29 July 2005

PERMANENT MISSION OF RWANDA

Mr. John Panzer  
Sector Manager  
International Trade Department  
World Bank

Mr. Hans Peter Lankes  
Division Chief Trade Policy and Review  
Department  
International Monetary Fund

Dear Mr. Lankes and Mr. Panzer,

In your letter dated May 13, 2005 to us, you kindly asked us whether we would be willing to coordinate a Geneva based process on building understanding for proposals for IF and Aid for Trade. Such a process was called on by the IMF/World Bank Spring meetings in Washington in April 2005 where “the need for aid for trade” was stressed and the where the IFIs were called to work with others” to prepare proposals for “additional assistance to countries to develop their trade and ease adjustment in their economies” for consideration at the IMF/World Bank annual meetings in September, 2005.

We are now very pleased to be able to present you with the result of those consultations. The enclosed non-paper is the result of an intensive and extensive process in Geneva during the last two months. The first meeting of the group chaired by us took place on May 25<sup>th</sup>, 2005. The aim was to create a first opportunity for the participants to present and discuss the current proposals and invite others to contribute with new ideas. The group comprised of representatives from the multilateral agencies, donor countries, and LDCs and other African countries. A number of informal papers and proposals were submitted at that first meeting.

As Chairs, we requested a paper for discussion at the next meeting of the group that would synthesize the various options for enhanced support that have been proposed. A small drafting group was formed which held a number of meeting before the next meeting with the group on June 22<sup>nd</sup>. At that meeting a number of comments were made and it was decided we do a final attempt to synthesize the proposals made to date on an “Aid for Trade” initiative. A new informal drafting group was formed and the non-paper enclosed is the result of that work.

The current paper builds upon the interactions at the group meetings and preceding contributions but does not in any way represent an agreed text. It represents the best efforts of

the authors to capture the range of ideas raised in consultations to date and does not commit them or their organizations in any way.

To summarize, it tries to sets out some of the various reasons cited for trade support. It also identifies some key principles and criteria to ensure support is effectively delivered and also elaborates some details on possible ways forward, including a section on some governance issues that will need to be addressed in future work.

- i. In this process there are many persons we want to thank including all those that have contributed with both official and non-official papers and those who have spent time to draft and redraft the paper.

Although the paper is self-explanatory we would like to highlight a few important conclusions from the consultations. The case is made for increased support to poor countries that accept responsibility for their own development and that are committed to making trade a part of their development strategies. Various and differing reasons are cited. There is a common understanding that the poorest countries need increased assistance in their efforts to make use of international trade opportunities and to meet the challenges that trade reform may create. There is a clear message that any new initiative has to build on existing mechanisms for trade related support and that they should not compromise structures for development cooperation that are already in place. The Integrated Framework is the natural mechanism to build on for any "aid for trade" initiative. Any strengthening of the Integrated Framework has, however, to respect that the IF was created for Least Developed Countries and that the LDC:s will continue to be the first priority in an enhanced IF process. The paper gives rather concrete proposals at three ambition levels on what and how "aid for trade "support could be strengthened: One which is essentially a strengthened IF-process with some additional funding. A second, which builds on the first but envisages substantial commitments of resources to ensure better response to the needs identified in the IF process. A third level, that complements the two first levels with a fund to address adjustment costs arising from trade liberalisation.

We do believe and hope that the paper will provide the Bank and the Fund with constructive points and ideas for increased support for aid for trade initiatives as well as proposals on the way forward.

During our meeting on the 22 June, several participants noted the need to allow time for capitals to reflect and come up with their views. It is important that national governments now take the time to study the content of the non-paper in preparation for the discussions that are planned for the September meeting of the Bank and the Fund, but also in preparations for discussion of the issue in other fora.

Many, including ourselves, have noted the great interest for the issue in circles far outside the informal group that we have chaired. We have also received a number of additional comments on the non-paper. In order to allow for a widening of the discussions and a dialogue with more actors, the idea of an informal "out-reach" meeting on Aid for Trade in the fall of 2005 was well-received by the participants at our last meeting. Such an event would allow for further discussions on how to complement, and possibly implement, the outcome of the Bank and Fund process on "aid for trade". It would also allow for the

inclusion of more interested parties. Our plan is to try to arrange some sort of activity to this end this coming fall. We will come back with more information in due course.

Let us end by thanking you for giving us the possibility to chair the very important and constructive informal process on Aid for Trade in Geneva and we are very much looking forward to the outcome of your September meeting.

Yours sincerely,

*Ambassador Valentine Rugwabiza,  
Permanent Mission of Rwanda, Geneva*

*and*

*Ambassador Mia Horn of Rantzien,  
Permanent Representative to the WTO,  
Permanent Mission of Sweden, Geneva*

encl: "AID FOR TRADE" INITIATIVE – OPTIONS TO ENHANCE SUPPORT,  
Non-Paper: July 20, 2005

cc: WTO members in Geneva

**“AID FOR TRADE” INITIATIVE – OPTIONS TO ENHANCE SUPPORT**  
**Non-Paper: July 20, 2005**

**I. Introduction**

There is broad acceptance that improved trade integration of poor countries holds one of the keys for accelerating growth and poverty reduction. However, the poorest countries in general have had very limited success in penetrating global markets or in attracting investment.

The IMF/World Bank Spring meetings in Washington in April, and the G7 Finance Ministers meeting of June 11<sup>th</sup>, all “stressed the need for aid for trade” and “called on the IFIs to work with others” to prepare proposals for “additional assistance to countries to develop their trade and ease adjustment in their economies” for consideration at the IMF/World Bank annual meetings in September. The U.N. Secretary General’s Report of 21 March for the Millennium Review Summit also highlighted the importance of additional trade-related assistance and this is expected to be reflected in the Summit outcome. More recently, the LDC Ministerial in Livingstone called for increased resources and an effective delivery mechanism for trade capacity building to address supply-side constraints faced by LDCs. This included strengthening the effectiveness of the Integrated Framework, *inter alia*, by a significant resource increase, and an additional, substantial and predictable financial mechanism to strengthen supply-side and infrastructure capacity, diversification of trade in LDCs and address adjustment challenges and costs for their effective integration into the international trading system.<sup>1</sup> Finally, the G8 meeting in Gleneagles on 6-8 July repeated its earlier call for the IFIs to present proposals to the annual meetings, and also agreed to increase help to developing countries to building the physical, human and institutional capacity to trade, including trade facilitation measures. G8 members committed to granting additional support for trade capacity building to assist LDCs, particularly in Africa, to take advantage of the new opportunities to trade which will result from a positive conclusion of the DDA.

In light of the Spring meeting mandate, the IMF and World Bank requested the Ambassadors of Rwanda and Sweden to facilitate consultations on “Aid for Trade” in Geneva. A number of informal papers and proposals have been submitted.<sup>2</sup> This note attempts to synthesize proposals received to date on an “Aid for Trade” initiative.<sup>3</sup>

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<sup>1</sup> See the “Livingstone Declaration”, Fourth LDC Trade Ministers’ Meeting, Livingstone, Zambia, June 25-26 2005 [LDC/IV/2005/4].

<sup>2</sup> Papers received include those from Finland, Netherlands, Nielson and Panzer, Prowse, the United States, Van den Heuvel, and the World Bank/IMF.

<sup>3</sup> The first meeting of the group chaired by the Ambassadors of Rwanda and Sweden to discuss “Aid for Trade” took place May 25<sup>th</sup>, 2005. The group comprised of representatives from the multilateral agencies, donor countries, and LDCs and other African countries. The Chairs requested a paper for discussion at the next meeting of the group (June 22<sup>nd</sup>) that would synthesize the various options for enhanced support that have been proposed to date. The current paper builds upon these interactions and preceding contributions.

Section II sets out some of the various reasons cited for trade support. Section III identifies some key principles and criteria to ensure support is effectively delivered. Section IV elaborates details on possible ways forward. Section V highlights some governance issues that will need to be addressed in future work.

This paper has been prepared for discussion purposes only, with a view to assisting stakeholders to clarify their views on the possible ways forward. It represents the best efforts of the authors to capture the range of ideas raised in consultations to date and does not commit them or their organizations in any way.

## **II. The case for support**

Proposals received make a case for increased support to poor countries that accept responsibility for their own development and are committed to making trade a part of their development strategies. Various and differing reasons were cited and include some of the following:

- Trade development should be a core part of any growth strategy. The goal is integration, enhancing competitiveness and harnessing trade for development that will advance the Millennium Development Goals.
- Support for a successful Doha round, where both developed and developing countries pursue liberalization with ambition, would generate significant aggregate gains and therefore represents a powerful global public good. The poorest countries need support to realize benefits from membership to the WTO. Furthermore, WTO negotiations are very demanding for poor countries. There is a need for enhanced negotiating capacity and for bringing business advocacy into the process. Moreover, for some countries, implementing WTO agreements may require high up-front costs while benefits will occur only later. Supporting low-income countries is therefore important to bolster and safeguard the multilateral trading system.
- Increased and effective “Aid for Trade” (that is well targeted, harmonised, coming under a multi-year plan and within an effective multilateral delivery mechanism) will enable poor countries that are strongly committed to the multilateral trading system to operationalize their vision and commitment of trade as an engine for economic growth and sustainable poverty reduction. Increased and effective “Aid for Trade” is required for countries that will only derive benefits from a Doha agreement if additional investments are made in productivity, competitiveness and infrastructure. However, extra “Aid for Trade” is not a substitute for, but a complement to, an ambitious outcome from the Doha round resulting in effective liberalisation, including between developing countries.
- Taking advantage of improvements in market access will entail additional domestic policy reform to facilitate trade as well as trade-related supply-side

capacities. This can involve a range of issues specific to the country from national and sectoral export strategies, and institutional capacity building, through to enterprise competitiveness enhancement and trade-related infrastructure.

- The promotion of trade and investment in country development strategies has been weak. There is a strong case to strengthen in-country institutional capacity to enhance trade policy formulation, to improve coordination among donors and government for effective implementation.
- Sustained improvement in export performance fuelled by a diversified export base, a competitive foreign investment environment, an entrepreneurial and professionally managed business sector and effective trade support services contributes directly and increasingly to employment generation, rural development and the progressive alleviation of poverty.
- Support can help to facilitate adjustment in cases where MFN liberalization may affect some countries (for example, preferences, net food importing developing countries, fiscal revenue measures, and meeting social adjustment costs).
- More support for trade diversification and integration on an MFN basis will help reduce country dependence on preferences (and thereby improve aid effectiveness, efficiency and coherence).

### **III. Guiding criteria on effective aid delivery**

Papers presented stressed the fundamental importance of effective aid delivery demonstrated by concrete results on the ground. Various and differing reasons were cited and include some of the following:

- The delivery mechanism (“Aid for Trade”) should underpin the basic principle of a strong alignment with country policies and complementary donor efforts. Delivery of assistance should be linked to measurable results, and should ensure stakeholder participation.
- On “Aid for Trade”; no one assistance provider has the ability to respond to all the needs. Agency activities should reflect core competencies of assistance providers.
- There can be further improvements in trade assistance being delivered in a less fragmented manner, which would improve aid effectiveness.
- Aid resources are expected to increase by \$40 billion between now and 2010 (roughly a 50 percent increase). Increased aid flows must be effectively allocated to contribute to competitiveness and avoid Dutch Disease. Disbursement of resources should be linked to the macroeconomic framework, and to strategies to

increase productivity. Increasing “Aid for Trade” on the basis of the Integrated Framework (IF) approach meets this criteria (see below).

- The main purpose of the IF approach is to generate a broad-based trade development agenda within a country’s overall macroeconomic and development strategy and to prioritise capacity building needs to which bilateral and multilateral donors respond. This would allow for direct budget support where appropriate, strong ownership by the beneficiary country and coordination of donor efforts.
- The IF structure can link the regional and multilateral trade agendas and thereby derive multiple gains.
- The IF process promotes good practice in aid delivery. A consortium of development partners (both bilateral and multilateral), the IF links the IFIs with the UN system (trade development) and the WTO (trade rules).
- However, the IF approach has to be substantially improved to meet the goal of effective aid delivery. In practice, implementation beyond the diagnostic phase requires a substantial improvement with regard to ownership and implementation capacity by the government, simplification of the action list, integrating it into donor programming and concrete instruments for participation by dynamic private sector agents.

#### **IV. Ways forward to enhance support (See schematic table attached)**

From the papers presented and discussions to date three pillars for expanding support for trade can be identified. These are:

1. enhancing the in-country trade development agenda (in broadest sense) via the IF approach
2. creating a multilateral fund with the aim of providing more predictable and credible financing to respond to the prioritised trade-related needs assessment and
3. a separate “window” for specific adjustment issues affecting certain countries arising from MFN liberalisation (notably on preference erosion, but also other issues could be considered, including loss of fiscal revenues)

Assistance under all pillars is envisaged as taking more the form of grants and other forms of assistance, as opposed to loans, over a 10 year period.

These “pillars” are not mutually exclusive – indeed there is broad consensus that the first (an enhanced IF) is an essential foundation and a prerequisite for the other two. The first

pillar is a core element of increasing support for “Aid for Trade”; and the basis on which to build support for pillars two and three.

Each of the pillars represent different means by which the amount of aid devoted to the trade and growth agenda can be increased in the context of the forthcoming increase in overall aid. While each of the pillars proposes a possible multilateral way forward, it of course remains open to donors to step up aid for trade via their bilateral processes and programs. However, co-ordination of effort around a country’s prioritized needs assessments arising from trade diagnostics, which in turn have been assessed within the context of the country’s macroeconomic framework under the PRSP, would improve the delivery of these resources. Given the expected increase in aid resources over the coming years, aid allocation may be more effectively disbursed if it is undertaken within a multilateral framework.

The three pillars broadly reflect the proposals tabled to date, it should be noted that they appear to enjoy differing levels of support, with the broadest support so far expressed for the first pillar, and a number of concerns raised about the third pillar.

In terms of country coverage, the Integrated Framework is a programme for LDCs and this should remain the priority. However, it is recognised that non-LDC poor countries experience very similar difficulties to those of LDCs. Consideration should be given to widening support, for example to IDA only countries including from a separate funding window if necessary.

***1. Enhancing the in-country trade development agenda via an enhanced IF***

This would upgrade the Integrated Framework through practical enhancements by an increased commitment from all stakeholders, including greater engagement by recipient countries, donors, the private sector, and civil society. This does not represent a “business as usual” scenario but a firm and serious commitment to scale up and bring about visible results in the implementation of the IF with tangible benefits. The enhancements would include a multi-year program of technical assistance and capacity building to build the required capacity in-country to undertake policy formulation for trade development including formulation of budgeted projects and their implementation, as well as increased in-country donor programming responding in a timely manner to needs identified in the Diagnostic Trade Integration Study (DTIS). This would also include practical steps such as instruments to engage dynamic private sector agents and civil society, a simplified process, including increased and accelerated DTIS completion with a limited list of priority actions that can be implemented realistically in a short to medium time period, IF-specific donor conferences, and broadening of Trust Fund disbursements. Such an approach recognizes that there are many ways in which donors can contribute to trade capacity building. The IF works to maximize these contributions by not prescribing one way to contribute to this effort. This avoids stifling innovation, increases the likelihood of participation, and permits donors to seek improved effectiveness through flexibility. It would require increased contributions to the IF Trust Fund beyond those currently envisaged for the IF.

*Range of “aid for trade” activities covered*

Activities would boost a country’s capacity to formulate its trade development strategy, engage broad stakeholder interest and improve coordination among donors and within government for effective implementation. The focus would be on diagnostics and capacity building for trade development. Diagnostics would focus on the DTIS, which would include assessment of prioritized needs to address supply-side constraints to trade. It could also include assessment of adjustment needs.

Stakeholders would contribute to multi-year programs of technical assistance and capacity building for trade development, to improve trade policy capacity, improve intra-governmental coordination for a trade integration strategy, improve institutional capacity for export support and promotion, strengthen the role of the private sector and increase the coherence and effectiveness of aid. A major result of this initiative would be to help countries develop and implement (through the PRS process) sound trade development strategies, taking into account country-based, regional, and multilateral reforms.

The intensified IF activities could enable more of the identified aid for trade needs to be picked up within donor processes, for example, the Consultative Group and Round Table meetings and thereby make the follow-up bilateral response stronger. A donor conference could be convened once the DTIS is done – i.e. jump starting the CG process rather than wait for the regular cycle. Enhanced co-ordination of bilateral efforts around a country’s prioritized action matrices would also improve the delivery of these resources and in effect multilateralize the bilateral effort

Enhancements to the current IF could include specific steps such as:

- Definite timelines for completion and validation in a National Workshop of the DTIS for all current IF countries
- Steps to Accelerate DTIS completion and improve its usefulness
- Implementation of IF-specific donor conferences with definite timeline for such implementation
- More effective use of Window II disbursements
- Focus on bringing the private sector and civil society into supporting capacity building efforts by tapping their resources and expertise.
- Increased resources for prompt follow-up project assistance
- Improve demand-driven monitoring of IF follow-up

- Advisory services to non-IF countries
- Identification and dissemination of best practices for trade capacity building

### *Resources*

This pillar would require a commitment by donors to increase the current funding available to the IF. Based on examples of similar activities, the amount required could range from \$5-15 million per country, disbursed over a 10 year period.<sup>4</sup> Additionally, possible costs related to necessary governance changes (such as a fully-funded Secretariat) would need to be taken into account (see V below).

It should be recalled that this amount represents the additional financing required to enhance the IF – it does not include the additional support for trade-related projects that may come via the PRS process. In that sense, the \$5-15 million over 10 years in no way represents a total of the amount of additional assistance to be received under the first pillar.

## ***2. A multilateral fund to respond to prioritized trade-diagnostic needs assessments***

The aim of the first pillar is to build trade policy and institutional capacity, generate in-country a comprehensive trade development agenda, and develop, via the DTIS, a prioritized assessment of supply-side needs. However, the first pillar does not provide an assurance that these identified priorities will be met. Developing countries have frequently expressed concern that donor follow-up to the identified supply-side priorities has been insufficient. The overall low level of aid resources devoted to trade development (at just 4 percent of total) would tend to support this view. The intention under this pillar would be to establish a mechanism to provide a more predictable, credible and timely response to the needs identified in the DTIS.

The intention would be to create a multilateral fund to provide dedicated resources to scale up “aid for trade” and to improve the effectiveness of existing funding. The fund would not set up a parallel process, but would operate via the PRSP/CG/RT to ensure

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<sup>4</sup> A possible comparator is the trade-related technical assistance project, being implemented by the Inter-American Development Bank, which entails a cost in the order of \$3-5million per country (via loans, not grants). The program for Peru has a total budget of US\$6.2 million, of which US\$1.2 million is a contribution from Peru, and consists of: (1) Training for Staff (US\$1.5 million): on international negotiations, administration and norms of WTO and Customs Unions, commercial disputes and conflict resolution, management of information systems, establishment of databases and statistical analyses of trade data; training on export promotion. (2) Technical Studies (US\$1.2 million): consultants to carry out analytical work, modeling, trade policy options for decision makers, including on customs unions, rules of origin, custom procedures, competition policy, SPS and agriculture trade. (3) Information Systems for Trade (1.5 million): data, treaties and agreements, legal framework, paper work and administrative procedures for trade. (4) Export Promotion (1 million): capacity building for export support institutions. (5) Program for Consultations with Stakeholders, and Policy coordination in government (1 million).

coherence of policy and co-ordination of donor efforts, and allow issues related to the absorptive capacity to be taken into account. While donors would be encouraged to contribute resources to the fund, they of course remain free to disburse funds bilaterally. Donors with a strong field presence and that prefer to provide funding bilaterally could continue to fund projects using their own processes and funding mechanisms as they would under the first pillar. As noted in the first pillar, co-ordination of effort around a country's prioritized action matrices still has the benefit of improving the delivery of these resources.

Resources from the fund would be allocated on a project basis, or as budget support for trade-related programs with an overall maximum country allocation set in accordance with criteria to be agreed. It would be for the country to decide how the resources would be utilized according to the identified priorities arising from the trade diagnostics. For example if a country prioritizes standards or trade facilitation, resources could be made available from the fund via the PRSP/CG/RT. It would be for the country to decide an appropriate institutional partner with expertise in standards and trade facilitation. While the intention would be to use the existing IF partner agencies, it may be desirable to extend this to include other multilateral agencies (notably the regional banks, FAO, UNIDO) and also private sector partners. While involvement by one of the implementing agencies could be required for co-financing from the fund, broader partnerships particularly including the private sector, would be encouraged. A fund of this size undertaking projects of this nature would also raise a range of additional governance issues (some of which are flagged in V below).

#### *Range of "aid for trade" activities covered*

The aim of this pillar would be to provide additional, predictable and dedicated resources for activities identified in the DTIS to address supply-side constraints not being addressed by the IF Trust Fund or bilateral donors under pillar one.. It could, for example, co-finance projects by the six IF agencies or other approved bodies related to export diversification, trade facilitation and standards or provide budget support for trade-related programs. These could include, for example, projects related to customs (computerization, improvement of transit), ports (streamlining of port operations, increasing storage capacity, dredging); transport (improving rural road networks, corridor road maintenance, railway infrastructure, intermodal terminals), standards (equipment, surveillance and international accreditation), sectoral support (product development, supply chain upgrading, market infrastructure), energy (rural electrification), creation of national or regional regulatory authorities in liberalized sectors, finance (export finance and working capital facilities for smaller firms), and development of export processing zones.

It is unlikely, however, that the fund would be of a scale to undertake and fully-fund large-scale infrastructure projects. Where infrastructure needs were identified priorities, it could, however, contribute some co-financing (in the form of a grant) A grant from the aid for trade fund could, for example, be used to finance a specific component of a larger infrastructure project, or to reduce the amount of, or interest on, the relevant loan.

Resources could also co-finance projects associated with adjustment, such as specific worker re-training programs or capacity building for administrative/legal changes that may be needed to adjust to liberalization where they were prioritized by the country concerned.

### *Resources*

While needs – and associated costs – could vary considerably amongst countries, preliminary estimates suggest that assistance for trade capacity building and supply-side constraints could require a commitment of \$40-80 million per country over 10 years.<sup>5</sup> Additionally, costs related to associated governance costs would need to be taken into account. These resources would be additional to the funds necessary to deepen the in-country trade diagnostic work envisaged under pillar I.

### **3. *A fund to address specific adjustment costs arising from MFN liberalisation***

It may be considered desirable to earmark funding to address specific adjustment needs arising from the Doha round (notably for preference erosion but also for other adjustment issues arising including loss of fiscal revenue.

Providing dedicated resources to meet adjustment needs however, does not suggest that the mechanism and policy response should depart from the basic approach taken in the first two pillars. The policy response and effective support for adjustment should be provided within the context of the country's overall development strategy and macroeconomic framework. The inter-relationship between the trade policy agenda, the IF diagnostic work and the PRSP process remains relevant. Adjustment to trade reform is just one of many potential shocks and opportunities. Indeed, there are also a number of existing facilities operated by the IFIs that are designed to help countries overcome adjustment shocks. One possibility in this context would be to establish a mechanism

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<sup>5</sup> World Bank projects that address capacity building and supply side issues, but not major infrastructure, on trade have generally been in the range of US\$15 to US\$30 million, often disbursed over a number of years including via follow-up projects. For example, an export diversification project in Bangladesh (US\$32 million over 5 years); private sector competitiveness in Uganda (US\$12.3 million over 8 years); agricultural export promotion in Senegal (US\$8 million over 7 years); private sector development in Madagascar (US\$23.8 million over 6 years); enterprise development in Mozambique (US\$26 million since 2000); and trade gateway and investment in Ghana (US\$50 million since 1998). Additionally, a very preliminary "costing" of DTIS priorities coming out of the recent DTIS in Rwanda, Benin, and Tanzania suggests costs of at least US\$30 million per country over 5 years to address technical assistance and basic investments needs in areas such as standards, customs, transport logistics and facilitation and energy. As one illustration of additional costs once some co-financing for infrastructure is factored in, some examples of Bank lending for infrastructure projects with a significant trade component include: Nepal (multimodal transit, US\$23.5 million over 7 years); Benin (transport sector investment program (US\$40 million over 6 years); Lesotho (highlands water project (US\$45 million since 1998); Cameroon (transport sector project US\$60.7 million over 8 years); Cote d'Ivoire (railways rehabilitation, US\$20 million over 6 years); and Kenya (Nairobi Mombassa road, US\$50.5 million over 8 years).

whereby the IFIs in consultation with other IF partners including the WTO and bilateral donors examine situations where large adjustment costs are expected to occur and, based on the examination, recommend through the CG/PRSP processes that special adjustment assistance be provided.

However the political economy case for establishing a separate mechanism/window may be strong largely to enhance the negotiating dynamics of the Doha round. A separate window could be made available for certain adjustment needs (this might be particularly relevant in the case of preference erosion). Preference erosion is an economic issue for a number of countries (and not necessarily only for countries classified as LDCs or IDA-only but for weak and vulnerable countries). Hence a separate fund to meet these countries' concerns may be considered necessary. It is however a bilateral issue: the countries and trading blocs that reduce the value of past preferential access commitments would make resources available within this window, subject to an objective analysis of the impact of preference erosion.

If a separate fund is established, a mechanism will need to be developed to more specifically evaluate costs arising (e.g. likely loss of preferences) and to broker financing of these needs. In terms of the former, as noted in under the first pillar, one option is for an assessment of adjustment needs and necessary policy responses to be undertaken as part of the IF diagnostic work. For the latter, the brokering mechanism to be developed would need to take account of existing IFI programs.

#### *Range of "aid for trade" activities covered*

A key decision will be to identify which adjustment costs - for example, fiscal revenue losses, loss of terms of trade for net-food importers, social adjustment needs and costs associated with preference erosion - would be covered.

#### *Resources*

Available estimates of preference erosion vary widely, and the estimated costs for individual countries of the impact of preference erosion would need to be separately calculated. Several factors may influence these calculations. First, the impact of preference erosion on a particular country depends on the extent to which preferences are actually utilized - usage may be low due to competitiveness constraints or strict rules of origin, the latter in particular can significantly reduce the actual gains from preferences. Second, the nature and extent of adjustment costs will depend on the level of ambition in the outcome of the Doha round; modest liberalization or exemption of certain products from deeper cuts could lessen the adjustment impact. Third, as multilateral liberalization will bring benefits as well as costs - by opening markets for poor countries on an MFN basis - it is an open question whether the total amount of support for any individual country should also take into account any offsetting gains from multilateral liberalization. Finally, the value of preferences is reduced when adjusted to take into account existing reciprocal preferential agreements, and this might mitigate or in some cases even reverse the preference erosion losses from multilateral liberalization.

Equally, assessment of the potential adjustment costs for Net Food Importers would need to be undertaken on a country by country basis. However, most studies conclude that even very deep liberalization (beyond what is currently under consideration in the Doha round) would produce increases in the prices of basic foodstuffs, especially cereals, on the order of magnitude of 10- 15%. Furthermore, the secular trend of prices for these products has been - and is likely to continue to be – downward.

#### **V. Governance, administrative arrangements and eligibility**

**Governance:** While the priority is to identify how a mechanism for enhanced support will operate in practice and governance issues can be taken up subsequently, it may be worth flagging briefly some of the implications of each pillar for governance at this stage.

Enhancing support for “aid for trade” using the IF approach along the lines suggested under the first pillar will mean changes to the governance structure of the IF and it will be necessary to develop an appropriate structure and administrative support.

As previously mentioned, a number of organizational issues require consideration, including: how an enhanced IF would operate over a multi-year basis (e.g., whether donor conferences would be one-offs or be held regularly and how DTIS might be updated); the key issue of increasing country ownership, including how to strengthen governance at the country level (e.g., strengthening national steering committees, loans of professionals to Ministries to assist with implementation of the DTIS, increased resources to fund staffing by nationals), including to promote the greater involvement of the private sector; and ways that donor facilitator roles might be made more effective, and that the IF agencies might scale up their support at the country level.

The multilateral fund proposed under the second pillar poses additional challenges. For example, a fund Secretariat could disseminate information and manage and disburse funding to the implementing agencies. It could facilitate matching of priorities with appropriate funds, including for example by providing technical advice to the PRSP/CG/RT process on whether projects proposed to receive financing from the fund are in line with the priorities identified in the DTIS.

If a fund were to be created under the third pillar, this would also require increased attention to governance structures in terms of the mechanism to be developed to evaluate the extent of and costs arising from adjustment, and to broker and manage (e.g., in terms of eligibility and conditions) financing of these needs.

**Eligibility:** With additional resources being made available appropriate eligibility criteria would be necessary and could possibly include governance, poverty impact, absorptive capacity and a demonstrated commitment to an integrated trade agenda.

**Country Coverage:** The first priority will be completion of the enhanced IF process for LDCs that meet the IF eligibility criteria. Consideration should also be given to extension

of some or all of the options beyond LDCs, for example to other IDA-only eligible countries. Widening support could use an IF type approach yet a separate funding window.

**“AID FOR TRADE” – OPTIONS FOR ENHANCED SUPPORT**

OPTIONS FOR ENHANCED SUPPORT	INSTITUTIONAL ENHANCEMENTS	CONTRIBUTIONS			ELIGIBILITY	
		IF Trust Fund	Donor Conference (IF, CG, RT)*		Priority	To Be Considered
			Integration (incl. supply side)	Adjustment		
First Pillar	↑	↑	↑ Bilateral Programs	Diagnostic work	LDCs	IDA-only, LICs
Second Pillar	↑↑]	↑**	↑ Multilateral Fund ↑ [Bilateral Programs]***	Specific adjustment-related programs	LDCs	IDA-only, LICs
Third Pillar	↑↑	↑**		↑ Multilateral Fund ↑ Bilateral Programs	LDCs	IDA-only, LICs, Weak and Vulnerable

\* Increased resources could be made available for identified projects and/or budget support

\*\* Increased contributions to the IF Trust Fund are included under these pillars in recognition of the fact that the first pillar is an essential precondition for both the second and third pillars.

\*\*\* Bilateral programs are included in square brackets as they always remain an option for donors.

## **Integrated Framework: Current State of Affairs**

### **I. Objectives and Operational Mode of the Integrated Framework**

The Integrated Framework (IF) was first mandated at the 1996 WTO Singapore Ministerial Conference, as part of the WTO Action Plan for least developed countries (LDCs) to ensure more effective participation of LDCs to the world trading system. The six multilateral institutions participating are the World Bank, WTO, IMF, ITC, UNCTAD and UNDP. These institutions and other donors, with their distinct competence, agreed to join force and streamline the trade-related assistance delivered to 50 eligible LDCs.

The IF process was renewed in 2000 with improvements introduced to provide a sound diagnostic base to trade assistance strategies and to bring the IF within the new Poverty Reduction Strategy (PRS) structure. Under its new design, the IF has two central objectives: (i) to mainstream trade into the Poverty Reduction Strategies of LDCs for both policy coherence and proper financing of trade-related projects; and (ii) to assist in the coordinated delivery of trade-related technical assistance in response to needs identified in the LDC. The key principles upon which the IF is built are country ownership, coherence and partnership. These principles require an active engagement by the country and effective coordination across Ministries and among donors.

The operational mode of the revamped IF features two key elements:

- An improved governance structure with the establishment of two institutional bodies:
  - A board (the IF Steering Committee) and an appended executive branch (the IF Working Group) based in Geneva that provide strategic direction, supervision and enhanced coordination amongst donors, beneficiary LDCs and the agencies.
  - A focal point and a steering committee in the LDC to help coordinate and animate IF activities in the IF country;
- The establishment of an IF two-window Trust Fund (IFTF) managed by UNDP, which finances diagnostic work, usually led by the World Bank and high priority follow-up technical assistance activities:
  - The diagnostic work phase is led by the Bank. Following a formal request by a government to join the IF program, a technical review is conducted to assess the country's eligibility. Upon inclusion in the IF program, the Window I of the IFTF is used primarily to provide financial resources up to US\$300,000 for IF Diagnostic Trade Integration Studies (DTIS) for eligible countries.
  - The follow-up technical assistance phase is an "interim" implementation phase introduced to address capacity building needs identified in the DTIS' Action Matrix. Window II of the IFTF provides bridging finance up to a maximum of US\$1 million for each country. This bridging mechanism is designed to finance small priority projects prior to the

incorporation of the DTIS findings in the PRSPs and subsequent donor funding.

## II. What is the Current Status of the IF?

Table 1 provides a summary of the current status of the IF. By the end 2005, DTISs and national validation workshops will be completed in 21 countries. Fifteen national validation workshops have already been completed and six more are planned before the end of 2005. Further, seven new LDCs have either recently began the DTIS process or will start it in the fall of 2005. Finally, nine new applications will be technically reviewed for possible inclusion in the IF program by the end of the year 2005 (see Table 1).

**Table 1. Status of LDC Participation to the IF<sup>1</sup>**

DTIS and National Validation Workshop Completed by End of 2005	Scheduled to Start DTIS before End of 2005	Scheduled for Technical Review by End of 2005/ Early 2006
<p><b>**21 countries**</b></p> <p>Burundi Cambodia Djibouti Ethiopia Guinea Lesotho Madagascar Malawi Mali Mauritania Mozambique Nepal Senegal Yemen Zambia</p> <p><i>Benin</i> <i>Chad</i> <i>Lao P.D.R.</i> <i>Rwanda</i> <i>São Tomé &amp; Príncipe</i> <i>Tanzania</i></p>	<p><b>**7 countries**</b></p> <p>Angola Burkina Faso Maldives Niger Sierra Leone The Gambia Uganda</p>	<p><b>**9 countries**</b></p> <p>Afghanistan Central African Republic Comoros Democratic Republic of Congo Equatorial Guinea Haiti Liberia Sudan Vanuatu</p>

Note: Countries in italic are those where a national workshop is expected to be completed by the end of 2005.

In terms of implementation, LDCs have been quick at requesting and implementing TA projects under Window II, and the program has rapidly expanded. As of end of May

<sup>1</sup> The remaining LDCs that may participate in the IF at a later date include Bhutan, Cape Verde, Eritrea, Guinea-Bissau, Kiribati, Myanmar, Samoa, Solomon Islands, Somalia, Timor-Leste, Togo and Tuvalu. They are mostly small island economies or conflict countries. Bangladesh was an original participant in the first phase of the IF but chose not to participate in the re-vamped IF.

2005, 22 “Window II” projects have been approved in 12 countries, amounting to US\$8 million. The projects financed cover diverse areas, from trade negotiation capacity building (Cambodia, Madagascar, Ethiopia), export-related information gathering and dissemination (Yemen) to sector-specific institutional and technical support (e.g., Burundi, Ethiopia, Senegal). It should be noted that while the DTIS matrix identifies both technical assistance and investment needs to address trade integration, physical infrastructure projects in the DTIS matrices are excluded from funding under Window II. As of the end of May 2005, 17 IF donors, including the Bank, had pledged a total of US\$30.2 million (Table 2). It should however be noted that these projects address only a fraction of the needs identified in the DTIS (see Box 1).

**Table 2. Summary of IF Trust Fund Accounts – Aggregated Totals**  
(As of May 31 2005)

	Pledges		Transfers		Total	
	Window I	Window II	Window I	Window II	Pledges	Transfers*
<b>Totals</b>	US\$16.0m	US\$14.2m	US\$15.4m	US\$12.3m	US\$30.2m	US\$27.9m

\* includes adjustment for interest income retained of \$0.2 million  
Source: UNDP

**Box 1. What Have We Learned From DTISs?**

The DTISs include comprehensive analysis of both internal and external barriers to trade. They typically cover macroeconomic developments, trade policy and market access, transport and trade facilitation, product standards, investment climate, trade support institutions, trade and poverty and sector studies.

The findings from the studies completed point to internal barriers as the largest constraints to trade than external barriers. Most of LDCs enjoy preferential access to industrial country markets and face low MFN trade barriers on the bulk of what they currently export. The key challenges are to reduce constraints on supply response and competitiveness – costly transport, transit and border crossing services, customs delays and delivery uncertainties, weak trade support institutions, lack of marketing, standards and export skills, excessive business regulations, lack of access to finance, etc. Because most countries undertook significant trade policy liberalization during the late 1980s and 1990s, the tariff and tariff reform agenda is, in general, relatively modest. Few quantitative restrictions remain, and average tariff levels are relatively low. However, liberal trade policies in small countries are often undermined by protectionist policies maintained in large neighboring countries (e.g., Benin and Chad with respect to Nigeria; Nepal with respect to India). The policy gap creates incentives for smuggling and corruption.

**III. What Are the Major Achievements of the IF?**

The IF can be credited with having greatly contributed to increased knowledge of trade issues in the countries where it is implemented. The diagnostic phase of the IF has helped to raise in-country awareness of the wide array of complementary reforms needed for trade integration and have facilitated a dialogue on trade and growth across

Ministries. The knowledge generated provided a better basis for designing appropriate assistance. Many donors see the IF as a very useful common framework for interventions on trade-related areas. Finally, the IF has enabled a more fluid dialogue on trade among LDCs, donors, and trade-related agencies and stakeholders in LDCs. The overall concept of coherence and partnerships towards a common objective among LDCs, donors, and agencies has proven its merits.

#### **IV. What are the Major Shortcomings of the IF?**

A recent evaluation of the Bank's Operations Evaluation Department recognized the IF as a sound framework for trade capacity building and donor coordination but also highlighted some of shortcomings. From this document and Bank staff's observations, the main shortcomings can be summarized as follows:

- There is still a gap between available resources and the expectations of developing countries. Indeed, the DTIS matrixes identify many investment and capacity building needs to address trade integration (see Box 1), but these are often left unaddressed due to slow mainstreaming of trade in PRSPs (although some progress is being made, see Box 2) and the limited resources of Window II. Implementation actions remain largely short-term in nature.
- There is no systematic follow-up at the country level and therefore implementation is often delayed. Parts of the action matrixes were often not implemented due to lack of donor awareness, developing countries' action and inadequate implementation plans for the matrix.
- In-country capacity and ownership is still too weak. The IF is, in many cases, "owned" and led by the Ministry of Trade. However, the capacity of the latter is, in most cases, insufficient to play a leading role in successfully implementing the IF:
  - This limited capacity often explains the poor reflection of trade issues in PRSPs and government programs.
  - A more active engagement and support of the Ministry of Finance, which often leads the PRS process, and that of other relevant Ministries, is required to strengthen IF implementation.
  - Subsequently, donor response beyond Window II has been weak and financing of the DTIS Matrix uncertain.
- At the Bank level, despite recent improvements, the IF process needs to be more effectively linked to regular Bank's operations so that trade related assistance is reflected in CASS.

**Box 2. Status of Trade Integration in PRSP**

A recent Bank-Fund review of the trade content in PRSPs sheds some light on the status of mainstreaming trade in PRSPs, a crucial step in the implementation process in IF countries. This study shows that despite the relative large number of completed DTIS, many of these studies were quite recent so that only eight of the 20 IF countries reviewed had completed a DTIS validation workshop at the time of the publication of the PRSP. Of these eight countries, three (Cambodia, Mauritania and Nepal) had successfully incorporated the recommendations of the DTIS in the PRS documents. In two countries (Ethiopia and Guinea), it was noted that the government was working to implement/incorporate the recommendations of the DTIS into their next PRSPs/ PRSP Progress Reports. Finally the remaining three countries, Malawi, Lesotho and Senegal, failed to incorporate the findings of the DTIS in their respective PRSPs.

**V. Continuing Improvement of the IF**

The current work program of the IF ends in December 2005. The IF Working Group is currently discussing ways to improve it. In light of the shortcomings underlined above and the opportunity for the IF to play a more sustained catalytic role in building long-term trade capacity, the following key elements must be considered when attempting to improve it:

- Strengthen in-country institutional arrangements (stronger focal point and steering committee) for proper follow through;
- Strengthen the capacity of trade authorities and other relevant stakeholders to bring trade needs into the policy arena and see them fully reflected and prioritized in PRSPs;
- Focus more on results, outcomes and impacts. The IF is still too process-oriented. While generating and sharing trade knowledge widely is key, inserting it into country budgets and donor programs and effectively implement the resulting projects are crucial;
- Increase resources to facilitate greater buy-in from governments, agencies and donors;
- Increase the predictability of funding to allow for planning of multi-year projects;
- Further strengthen the collaboration between the Trade Department and the Regions at the Bank to strengthen the link between the IF and other Bank operations.
- Strengthen partnerships and maximize knowledge sharing amongst participating agencies to optimize resource use and avoid duplication.

The enhanced IF outlined in the body of this paper aims to capture and address these key elements (see paragraphs 41-49).

**Breakdown of LDCs and IDA only Countries by Region**

<b>Africa (39)</b>	<b>Category</b>	<b>East Asia (13)</b>	<b>Category</b>	<b>Europe and Central Asia (10)</b>	<b>Category</b>
Angola	LDC	Cambodia	LDC	Albania	IDA only
Benin	LDC	Kiribati	LDC	Armenia	IDA only
Burkina Faso	LDC	Lao, P.D.R.	LDC	Georgia	IDA only
Burundi	LDC	Mongolia	IDA only	Kyrgyz Republic	IDA only
Cape Verde	LDC	Myanmar	LDC	Moldova	IDA only
Cameroon	IDA only	Samoa	LDC	Tajikistan	IDA only
CAR	LDC	Solomon Islands	LDC		
Chad	LDC	Timor-Leste	LDC		
Comoros	LDC	Tonga	IDA only	<b>Middle East and North Africa (2)</b>	
Congo (Rep. of)	IDA only	Vanuatu	LDC	Djibouti	LDC
Congo (Democratic Rep of)	LDC	Vietnam	IDA only	Yemen, Rep. of	LDC
Cote d'Ivoire	IDA only				
Ethiopia	LDC	<b>Latin America and the Caribbean (9)</b>			
Eritrea	LDC				
The Gambia	LDC				
Ghana	IDA only				
Guinea	LDC	Guyana	IDA only		
Guinea-Bissau	LDC	Haiti	LDC		
Kenya	IDA only	Honduras	IDA only		
Lesotho	LDC	Nicaragua	IDA only		
Liberia	LDC				
Madagascar	LDC				
Malawi	LDC	<b>South Asia (8)</b>			
Mali	LDC				
Mauritania	LDC	Afghanistan	LDC		
Mozambique	LDC	Bangladesh	LDC		
Niger	LDC	Bhutan	LDC		
Rwanda	LDC	Maldives	LDC		
São Tomé and Príncipe	LDC	Nepal	LDC		
Senegal	LDC	Sri Lanka	IDA only		
Sierra Leone	LDC				
Somalia	LDC				
Sudan	LDC				
Tanzania	LDC				
Togo	LDC				
Uganda	LDC				
Zambia	LDC				

## **Examples of Existing Mechanisms to Address Adjustment**

### **The IMF Trade Integration Mechanism (TIM)**

The Trade Integration Mechanism (TIM) was introduced in April 2004 to assist member countries to meet balance of payments difficulties that might result from trade liberalization by other countries – for example from preference erosion, the removal of quotas under the ATC and cuts in agricultural subsidies in the OECD countries. The TIM aims to mitigate concerns - particularly in developing countries - about financing such balance of payments shortfalls. According to Fund research, these shortfalls are unlikely to be large for most countries, and would eventually be dominated by the positive impact of more open trade. Nevertheless, they could be significant in the short run for some countries.

The TIM is not a special facility that will provide new resources under special terms. Financial support for balance of payments difficulties arising from trade-related adjustments is already provided under the Fund's existing lending facilities. Rather, the TIM is a policy designed to increase the predictability of resources that are available under existing facilities if a country expects a net balance of payments shortfall as a result of measures implemented by other countries that lead to more open market access for goods and services.

The TIM is expected to create a modest increase in IMF financing, for two reasons. First, the explicit emphasis on trade adjustments will ensure that their impact is carefully estimated and incorporated into Fund-supported programs. Second, the TIM contains a "deviation feature" which provides countries with a greater degree of certainty that IMF financing will be available to assist with larger-than-anticipated adjustments.

#### ***How the TIM works***

A member country can request consideration under the TIM if it expects a net balance of payments shortfall as a result of measures implemented by other countries that lead to more open market access for goods and services. Such measures would typically be introduced either under a WTO agreement or in some other way that treats all countries on a non-discriminatory basis.<sup>1</sup>

The TIM details how the Fund would provide access to its resources to meet a balance of payments need associated with such trade-related adjustments. In particular, the IMF would:

- stand ready to discuss with countries facing such balance of payments shortfalls, new arrangements within its existing lending facilities (i.e., upper credit tranches, the

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<sup>1</sup> The TIM does not cover the implications of "own liberalization" measures – e.g., any deterioration in a country's balance of payments that results from a reduction in its own import tariffs. However, the Fund will continue to assist its members in anticipating and managing the implications of domestic reforms associated with Doha Round commitments, including through financing under the Fund's existing policies.

Extended Fund Facility (EFF), or the Poverty Reduction and Growth Facility (PRGF));

- take into account the anticipated impact of the trade adjustment on the member's balance of payments in determining the appropriate size of access under both new and existing arrangements (the "baseline feature"); and
- be prepared to augment arrangements under simplified procedures if the actual balance of payments effect turns out to be larger than anticipated (the "deviation feature").

Two countries have taken advantage of the TIM to date: Bangladesh and Dominican Republic. For Bangladesh, the amount approved under the TIM was SDR53.33 million (US\$78.03 million, equivalent to 10% of their IMF quota). For the Dominican Republic, the amount approved under the TIM was SDR21.89 million (US\$32.03 million, equivalent to 10% of their IMF quota).

Additionally, the IMF has sharpened its surveillance of countries with trade-related vulnerabilities and has continued to provide trade-related technical assistance for customs and tax reform.<sup>2</sup> Through technical assistance on tax policy and administration, the IMF assists countries to adjust to decreased revenue from tariff reforms.

### **World Bank development policy lending and adjustment**

The following provides some information on World Bank development policy lending programs in the field of agriculture as an example of the kinds of programs offered by the Bank to assist countries facing adjustment problems.<sup>3</sup>

In agriculture, World Bank lending projects and AAA (analytical and advisory/assistance activities) have been used to: help farmers switch out of formerly highly protected crops through technical assistance and financial support; assist governments to develop income support and safety net programs that help groups made worse off by liberalization; and develop retraining programs.

Bank support for agricultural policy reforms has a long history, mainly through policy-based lending, but has a very mixed record. A key lesson has been that government implementation capacity is important, and many development policy loans now incorporate conditions intended to augment this capacity or to set up or reform institutions that are important for

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<sup>2</sup> In fiscal year 2005, the Fund delivered 2.5 person-years of technical assistance in customs administration and a significant share of the technical assistance provided in revenue administration in general also included assistance in customs administration. Similarly, the technical assistance in balance of payments statistics included enhancing the quality of trade statistics.

<sup>3</sup> Examples of non-agricultural programs include an Economic Reform Support Credit for Ghana (US\$110 million, 2001-2003) and an Economic Recovery Adjustment Credit to Togo (US\$50 million, 1996-1998).

carrying out the reform program. Some have been accompanied by a technical assistance loan for this purpose.

One example is the Agricultural Implementation Reform Project undertaken in Turkey, under which the government and Bank agreed on an ambitious reform program of agricultural reform, including removal of subsidies and provision of direct income support. The project consists of both development policy and investment lending.

The four *investment components* provide \$400 million to: (1) Finance support to the Ministry of Agriculture and Rural Affairs and the Land Registration and Cadastre Office for the establishment of a National Registry of Farmers; (2) Partially compensate farmers of certain crops (those that were over-produced because of the previous artificially high support prices) for their costs in switching to alternative activities; (3) Assist in the implementation of the new Law on Agricultural Sales Cooperatives by financing labor retrenchment, institutional development of coops and capacity building for the government institution overseeing the process; and (4) Finance project support services, such as public information campaigns, advisory services, monitoring and evaluation, and management activities.

The *development policy portion* of the loan provides financing for \$200 million in 2 equal quick-disbursing tranches, conditional upon achievement of certain indicators of progress in the overall reform program. A key objective of this quick-disbursing component was to enable the Government to make up some of the anticipated shortfall in funds needed for the critical first and second rounds of DIS payments in a period of fiscal stringency.

*Net food importing developing countries (NFIDCs)*

The Bank also has mechanisms to assist NFIDCs with mitigate any shocks from structural changes in the global markets for food products as a result of the Doha Round. Through its stepped-up program to help countries meet new commitments made in the Doha Round and to resolve transition problems, the Bank can assist countries in addressing the shock through a full range of AAA work, development policy lending, and investment finance.

Development policy lending is appropriate in cases where countries face balance of payments crises from food price spikes and need policy reform. The AAA and investment finance is aimed at, for example:

- Improving agricultural production systems, so local farmers could take advantage of the higher world prices, thereby reducing reliance on imported food.
- Restructuring food marketing systems to reduce costs and keep down prices for consumers, while increasing the share of the final price captured by farmers.
- Reducing post-harvest losses, costs of storage, and transport costs by improving warehouse facilities and infrastructure.
- Restructuring and privatizing state-owned enterprises charged with food procurement and distribution and improving public sector food security stockpiling policies.

The World Bank is also a member of the monitoring committee established under the Uruguay Round “Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net-Food Importing Developing Countries”. The Committee has had before it for the last couple of years a proposal from the LDCs and NFIDCs for a guarantee facility that would assist private food importers in these countries to access additional trade credit when needed to pay for excess costs of importing food in response to spikes in world prices of these commodities.