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
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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 25th, 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 22nd. 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 af 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 11th, 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.[1] 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.[2] This note attempts to synthesize proposals received to date on an "Aid for Trade" initiative.[3] Section II sets out some of the

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[1] See the "Livingstone Declaration", Fourth LDC Trade Ministers' Meeting, Livingstone, Zambia, June 25-26 2005 [LDC/IV/2005/4].

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

[3] The first meeting of the group chaired by the Ambassadors of Rwanda and Sweden to discuss "Aid for Trade" took place May 25th, 2005. The group comprised of representatives from the multilateral agencies, donor

(continued…)

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

countries, and LDCs and other African countries. The Chairs requested a paper for discussion at the next meeting of the group (June 22nd) 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.

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. <u>Guiding criteria on effective aid delivery</u>

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. <u>Ways forward to enhance support (See schematic table attached)</u>

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.[4] 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.

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[4] 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).

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 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.[5] 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

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[5] 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 U$30 million, often disbursed over a number of years including via follow-up projects. For example, an export diversification project in Bangladesh ($US32 million over 5 years); private sector competitiveness in Uganda ($US12.3 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).

that are designed to help countries overcome adjustment shocks. One possibility in this context would be to establish a mechanism 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 (TA) 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 (TA) 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[1]

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
*****21 countries*****	*****7 countries*****	*****9 countries*****
Burundi	Angola	Afghanistan
Cambodia	Burkina Faso	Central African Republic
Djibouti	Maldives	Comoros
Ethiopia	Niger	Democratic Republic of Congo
Guinea	Sierra Leone	Equatorial Guinea
Lesotho	The Gambia	Haiti
Madagascar	Uganda	Liberia
Malawi		Sudan
Mali		Vanuatu
Mauritania		
Mozambique		
Nepal		
Senegal		
Yemen		
Zambia		
Benin		
Chad		
Lao P.D.R.		
Rwanda		
São Tomé & Príncipe		
Tanzania		

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 2005, 22 "Window II" projects have been approved in 12 countries, amounting to US$8 million. The

[1] The remaining LDCs that may participate to the IF at a later date include Bhutan, Cape Verde, Guinea-Bissau, Kiribati, Myanmar, Samoa, Solomon Islands, Somalia, Timor-Leste, Togo, Tuvalu and Vanuatu. They are mostly small island economies or conflict countries.

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 TA and investment needs to address trade integration, physical infrastructure projects in the DTIS matrices are excluded from funding under Window II. As of end of May 2005, 17 IF donors, including the Bank, have 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*
Totals	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 (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 mandate 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.

Breakdown of LDCs and IDA only Countries by Region

Africa (39)	**Category**	**East Asia (13)**	**Category**	**Europe and Central Asia (10)**	**Category**
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	**Middle East and North Africa (2)**	
Congo (Rep. of)	IDA only	Vanuatu	LDC		
Congo (Democratic Rep of)	LDC	Vietnam	IDA only	Djibouti	LDC
Cote d'Ivoire	IDA only			Yemen, Rep. of	LDC
Ethiopia	LDC	**Latin America and the Caribbean (9)**			
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	**South Asia (8)**			
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.[1]

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

[1] 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.

- 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.[2] Through technical assistance on tax policy and administration, the IMF assists countries to adjust to decreased revenue from tariff reforms.

World Bank lending and adjustment programs

The following provides some information on World Bank adjustment 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.[3]

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 adjustment lending, but has a very mixed record. A key lesson has been that government implementation capacity is important, and many adjustment loans now incorporate conditions intended to augment this capacity or to set up or reform institutions that are important for 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,.

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[2] 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.

[3] 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).

including removal of subsidies and provision of direct income support. The project consists of both adjustment 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 *adjustment* portion of the project 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, adjustment lending, and investment finance. Adjustment 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.