4

Aid, Debt Relief, and Trade: Making Commitments Work

Developed countries can help developing countries' progress toward the MDGs by delivering on commitments of more (and more effective) assistance and by improving market access for these countries. The chapter assesses donors' performance by monitoring recent trends in the overall volume, allocation, and delivery of aid; implementation of debt relief; and progress on global trade reform.

The expansion in global aid has stalled. After climbing to a record high in 2005, official development assistance (ODA) by members of the OECD's Development Assistance Committee (DAC) fell 5 percent in 2006. Most of the increase in ODA in 2005 reflected exceptional debt relief operations to two countries; less than a quarter represented net transfers of new resources. A winding down of debt relief operations and a decline in other forms of aid pulled ODA lower in 2006, and official assistance is projected to fall in 2007.

At the Group of Eight summit in 2005, DAC donors pledged to scale up their aid to Sub-Saharan Africa. Nearly two years later, there is little indication of actual increases. In fact, official assistance to the region—excluding Nigeria, one of the two recipients of exceptional debt relief—edged lower in 2005 and stagnated in 2006. Moreover, a survey of DAC members' planned future aid flows provides scant evidence of an intended scaling up of aid to Africa. DAC donors need to accelerate the provision of aid that they have promised, and provide reliable information on resource availability.

For scaling up, action is required of recipient countries as well. Although scale-up opportunities exist in a broad range of reforming countries, these countries face difficulties in developing sound, results-oriented development strategies. Scaling up requires strengthening development strategies; identifying and addressing absorptive capacity constraints; and establishing closer links between development strategies and policy making, planning, and budgeting processes. For their part, donors and international financial institutions need to be ready to support country efforts.

The Paris Declaration of March 2005 raised expectations and generated a momentum for change in aid delivery practices. The results of the 2006 Baseline Survey show that a number of challenges need to be addressed: ownership of the Declaration by operational staff; demonstration of tangible benefits from doing business differently; and deepening the harmonization and alignment of aid efforts at the country level. The rise of nontraditional donors, including private foundations,

and a profusion of global vertical funds also heighten the need for alignment and harmonization among a wider donor community.

The past year saw major progress in extending and deepening debt relief to the poorest countries. The Multilateral Debt Relief Initiative (MDRI) has provided debt relief of about $38 billion (in nominal terms) to 22 countries. The MDRI commits donors to providing additional resources to International Development Assocation (IDA) and the African Development Fund (AfDF) to cover the losses to these organizations stemming from debt forgiveness; the upcoming 15th replenishment of IDA will be an important test of donors' intentions regarding their support of the MDRI and of IDA.

As the pace of global integration increases, harnessing the new opportunities and managing the risks places a premium for all countries on a trade strategy of greater openness, coupled with behind-the-border reforms to dismantle remaining barriers to trade. Donors need to honor their commitment to increasing their support of trade liberalization in developing countries, or "aid for trade." Aid for trade needs to be focused on bringing practical solutions to countries' trade needs.

The Doha Round of multilateral trade negotiations continued to struggle in 2006. A small window of opportunity remains open for a deal to be reached in 2007, and flexibility will be required from all sides. Concluding the round remains an important step in efforts to achieve the Millennium Development Goals (MDGs) by the target date of 2015. Even as multilateral efforts faltered, preferential trade agreements continued to proliferate, raising concerns about their impact on countries left out.

Aid

Trends in Aid Volumes and Instruments

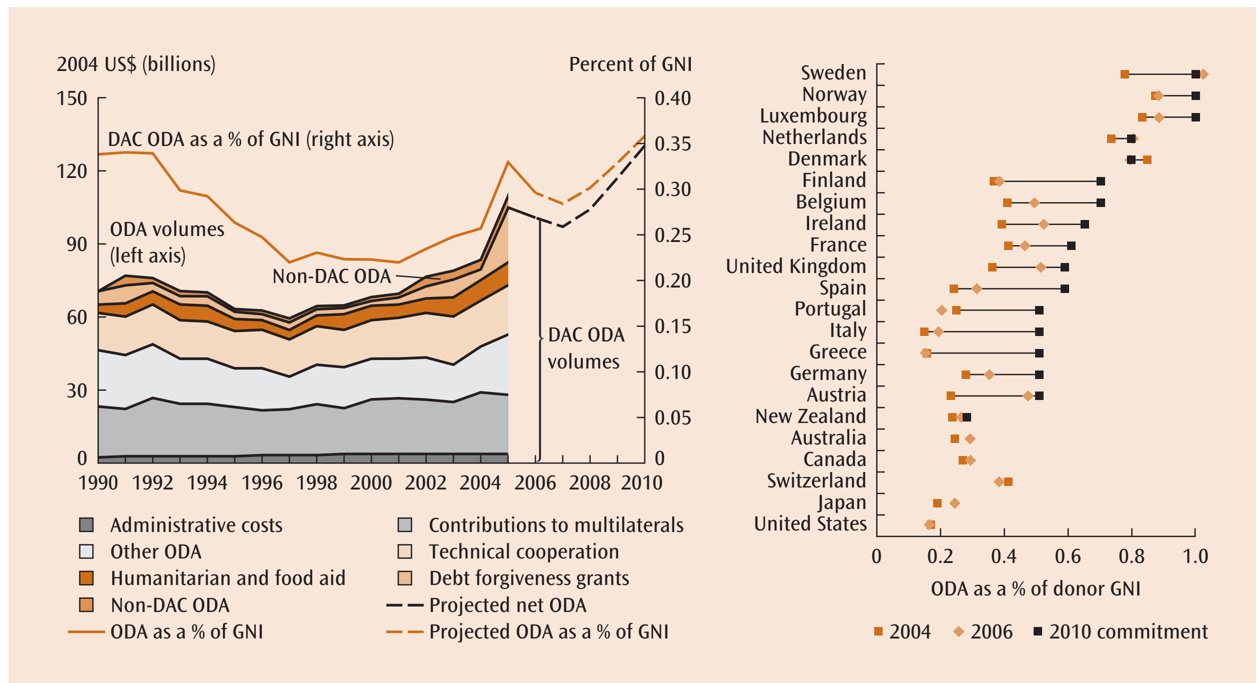
Higher aid flows amid a changing aid landscape. Aid worldwide continued on an upward trend in 2005 as DAC members, non-DAC traditional donors, and nontraditional donors all expanded their assistance to developing countries. Total aid then edged lower in 2006 and is expected to decline slightly in 2007. DAC members continue to be the largest source of official assistance, but so far much of the increase in their aid flows has added little to total aid as measured by net transfers or by the availability of new resources for development. Moreover, these donors have been slow to translate their aid commitments—in particular, a promised doubling of assistance to Africa—into increases in aid volume and tangible action plans.

After climbing to a record $106.8 billion in 2005, DAC members' ODA pulled back to $103.9 billion (preliminary) in 2006 (figure 4.1). The 5.1 percent decline in real terms was the first drop in ODA in real terms since 1997. Over 70 percent of the $25 billion real increase in net ODA in 2005 was due to higher amounts of debt relief ($18 billion) resulting from implementation of the Paris Club agreements for Iraq and Nigeria. (See box 4.1 for a discussion of debt forgiveness in DAC statistics.) By contrast, the expansion in other bilateral ODA—that is, ODA minus special-purpose grants such as debt relief, humanitarian aid, and technical cooperation—was a moderate $5.6 billion, or less than a fourth of the total increase. The reduction in ODA in 2006 resulted from the winding down of these debt relief operations; other forms of ODA also contracted by nearly 2 percent in real terms.

The latest numbers show that 17 of the 22 DAC members met their Monterrey commitments on 2006 ODA targets. At 0.43 percent, ODA relative to DAC-EU donors' average gross national income was above the 0.39 percent target set in 2002. These countries now account for close to 60 percent of DAC assistance. Overall, the share of ODA in donor GNI was 0.3 percent, below the level of the early 1990s.

2007 could see a noticeable fall in ODA as debt relief continues to decline. Other forms of aid will have to expand very rapidly in 2008–10 for donor promises of an additional $50 billion in annual aid (over 2004 levels) to be met by 2010. Based on announced commitments,

FIGURE 4.1 Evolution of aid: 1990–2006 and prospects



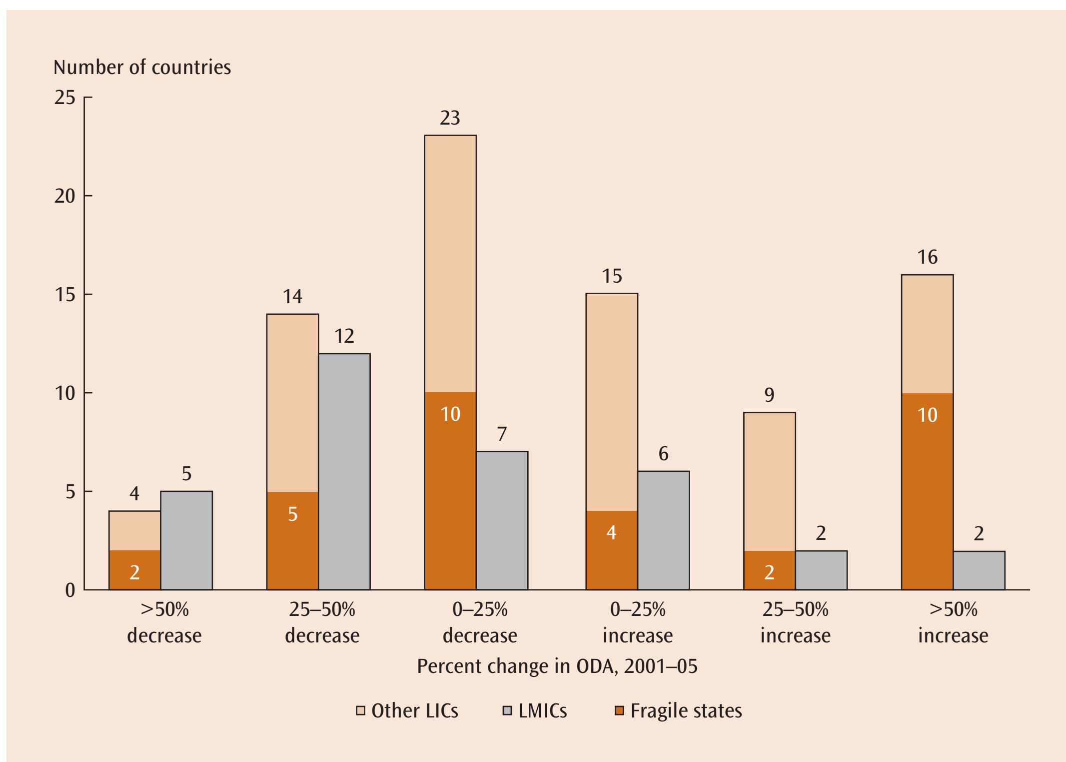
Source: OECD DAC Development Co-operation Report 2006 and DAC database.
Note: In the second panel, data for 2010 are shown only for DAC donors with announced ODA/GNI commitments. Prospects are for DAC donors only and are based on these donors' public announcements.

nearly a third of donors face an expansion in ODA/GNI of 50 percent or more (figure 4.1). This is prompting concerns that donors may fail to deliver on their commitments.

The continuing concentration of aid increases in a handful of recipient countries meant that aid to most countries rose very slowly, if at all. Despite a nearly 55 percent increase in real aid volumes in 2001–05, only 16 out of 81 IDA-eligible countries saw their ODA expand by 50 percent or more in this period (figure 4.2). The largest increases were in fragile states such as Afghanistan, Republic of Congo, Democratic Republic of Congo, Liberia, Nigeria, and Sudan. Indeed, 10 fragile states saw an expansion in ODA of over 50 percent. Just over half of low-income countries actually saw an outright decline in aid received during this period. Among lower-middle-income countries (that are not IDA-eligible), Iraq saw the largest gain and 70 percent (24 out of 34) saw a decline.

Contributions to multilateral institutions dipped in 2005, both absolutely and as a share of total ODA as bilateral aid surged through exceptional debt relief. The share of these contributions in DAC members' ODA has averaged about 30 percent in recent years, but in 2005 this share dropped precipitously to 23 percent. Within this group, the share of IDA and regional development banks was sharply lower as well (at 6.5 percent), which could undermine these financial institutions' role in supporting poverty reduction. Donors have promised to provide IDA and the African Development Fund with additional resources to compensate them for debt service forgone under the MDRI, and this should translate into higher future contributions. However, it is important that

FIGURE 4.2 Expansion in ODA is concentrated in a few countries



Source: OECD DAC database.
Note: Other LICs are IDA-eligible countries that are not fragile states; LMICs comprise lower-middle-income countries that are not IDA-eligible.

the pace of increase of contributions to these multilateral development banks not constrain the relative importance of these institutions in the future.

A wide range of other donors are increasing their aid to poor countries, and the amounts of this aid are set to rise. Non-DAC ODA was $5 billion in 2005, reflecting a threefold increase over 2001 amounts. Several non-DAC OECD countries—including the Republic of Korea, Mexico, and Turkey—have ambitious plans to scale up aid, as do some EU countries that are non-DAC members. ODA from these countries is likely to double by 2010, to over $2 billion (OECD 2007a). Other EU states that are not OECD members will also see their ODA increase because of EU commitments. Saudi Arabia (with an estimated $1 billion) and other Middle East countries provided nearly $2 billion in assistance in 2005, and indications are that these amounts will continue to expand.

With their growing global economic prominence, countries such as Brazil, China, India, the Russian Federation and South Africa are also becoming more important providers of official support to poor countries.[1] For example, China was the third-largest food aid donor in the world in 2005, and it is fast becoming a leading foreign creditor to Africa. The Export-Import Bank of China, now one of the world's largest export credit agencies, is playing an important role in facilitating trade between China and countries in that region, as well as providing economic support. It has recently expanded operations in Africa: over the past two years the agency committed around $8 billion in loans and credits to

BOX 4.1 Accounting for debt forgiveness in ODA statistics[a]

A surge in debt forgiveness grants beginning in 2002 has drawn attention to their treatment in ODA statistics. The table below shows the amount (in nominal terms) of debt forgiveness grants provided in recent years. These grants (measured in gross terms) have ballooned from a modest $2.5 billion in 2001 to $25 billion in 2005. Depetris Chauvin and Kraay (2006, 2005) argue that the standard data do not provide a reliable estimate of the value of debt relief—that is, in present value terms—and they have developed PV estimates of debt relief. Another problem with DAC debt relief statistics is that forgiveness of outstanding amounts, debt service flows, and arrears is treated in the same way, even though the cash flow implications for borrowers' budgets is quite different. Despite these methodological issues, DAC debt forgiveness statistics are widely used.

Debt relief from the donors' perspective (budget effort) can be quite different from that of the recipients' perspective (availability of resources). One question that arises is whether ODA debt forgiveness grants represent additional flows (cross-border flows) to recipients.

ODA Bilateral Debt forgiveness grants: 2001–05 (in US$ billions)

	Debt forgiveness grants (A)	Offsetting entries for debt relief (B)	Net debt forgiveness grants (A)–(B)
2001	2.51	0.54	1.97
2002	5.33	0.81	4.52
2003	8.44	1.58	6.86
2004	7.11	2.92	4.19
2005	24.96	2.43	22.53

DAC statistical guidelines allow debt cancellation to be reported as debt forgiveness when the action on debt occurs within the "framework of a bilateral agreement and is implemented for the purpose of promoting the development or welfare of the recipient."[b] Thus, forgiveness of ODA, other official flows (OOF), and private claims—principal, interest, and arrears—is captured in DAC statistics under "Debt forgiveness grants."[c] Appropriate offsetting items (or counter entries) for principal and interest of each type of claim are reported, but not all are ODA flows—only forgiven principal on ODA loans is included under "Offsetting entry for debt forgiveness" in ODA flows.[d]

Most of the debt forgiveness grants in DAC statistics represent forgiveness of OOF and private claims typically under the framework of the Paris Club. The counter entries are not ODA flows, so there is concern that recent debt actions assign a large amount of flows to recipients, that do not represent any new transfer of resources. This point is well illustrated by the 2002 Paris Club debt relief agreement for the Democratic Republic of Congo. The country had an unbearable debt burden and under reasonable conditions was clearly unable to meet its obligations to external creditors. The Paris Club agreement restructured $8.98 billion of debt—$8.49 billion in principal and interest arrears and $490 million of future payments.[e] Approximately $1.4 billion in outstanding claims were ODA loans. The country received Naples Terms—67 percent of commercial credits were cancelled and the remaining 33 percent were rescheduled; and ODA credits were rescheduled.[f] The resulting DAC data for ODA disbursements in 2003 (when the bulk of relief granted under the Paris Club agreement was reported in the DAC statistics) show debt forgiveness grants of $4.441 billion and offsetting entries for debt relief of only $4.9 million. Together, these two items account for $4.44 billion of net ODA flows. Yet, the country did not receive additional resources anywhere near to this amount. However, the country's debt burden was substantially reduced and it was able to normalize relations with the international community, improving its prospects for growth.

Although debt cancellation may not deliver additional flows to borrowers, it does reflect government budget effort. The extent of the current budget effort will depend upon the terms of government guarantees for export/commercial credits and on the timing of write-offs for official loans—some may have been already written down.[g]

continued

BOX 4.1 Accounting for debt forgiveness in ODA statistics[a] *(continued)*

Because of differences in practices across donors, the extent of the budget effort for a particular debt action varies across countries.

a. A whole host of debt actions are presented in DAC statistics. The focus here is on debt forgiveness.
b. OECD DAC "Handbook for Reporting Debt Reorganization on the DAC Questionnaire" and "DAC Statistical Reporting Directives."
c. Reorganization of OOF and private claims within the framework of the Paris Club often involves concessionality in the form of debt reduction, debt service reduction, and capitalization of moratorium interest. The cancellation of part of the claims (or the amount equivalent to the reduction in net present value) is treated as debt forgiveness in ODA with no offsetting items in ODA flows. Amounts of OOF and private claims that are rescheduled are not part of ODA and are included as "Rescheduling" loans under OOF flows.
d. Forgiven OOF principal is reported under "Offsetting entries for debt relief" in OOF flows and forgiven private principal is accounted in "Offsetting entry for debt relief" under private flows. There are no offsets to forgiven interest in ODA, OOF, or private flows. Instead, appropriate counter entries "Offsetting entry for forgiven interest" are to be noted in memo items—the data for which are usually incomplete. The result is that the treatment of debt cancellation in ODA statistics assigns a larger amount of net flows to recipients than amounts actually received.
e. Paris Club Press Release of September 13, 2002.
f. In November 2003 the country received Cologne Terms from Paris Club donors.
g. Also see the OECD's Development Cooperation Report 2006.

such countries as Angola, Ghana, Mozambique, and Nigeria (Moss and Rose 2006). India's export credit agency, Exim India, has also issued lines of credit totaling $558 million to West African countries to enhance its commercial relations with the region. Little is known about the size and composition of flows from emerging donors, and better information is needed to facilitate monitoring and donor coordination.

Financing by emerging donors is targeting productive sectors and physical infrastructure, areas that traditional donors have largely exited. Not all of this financing is in the form of aid; rather it represents a mix of concessional and nonconcessional funds. There is a concern that access to large amounts of funds from these newer donors may strain recipients' capacity to use additional resources effectively. Low-income countries that have only recently received major debt reductions through the Heavily Indebted Poor Countries (HIPC) Initiative and the MDRI may see yet another buildup of debt (see the section on debt relief below).[2] This reinforces the need for good practices in accounting, reporting, and transparency on the part of all donors and the need for borrowers to adhere to established international reporting standards. Creditor and borrowing countries alike are urged to use the joint Bank-Fund framework for assessing debt sustainability in low-income countries, to appropriately manage the associated risks.

Private flows to developing countries have shown strong growth in recent years, but most low-income countries remain heavily dependent on grants and concessional finance (see chapter 5). Private giving through foundations, charities, and other nongovernmental organizations is on the rise as well. Reported aid flows from private citizens more than doubled over 2001–05, reaching $14.7 billion. Private sources have a significant role in mobilizing resources and setting policies for certain activities, including humanitarian and disaster relief and research into vaccines and tropical diseases. For example, the Bill and Melinda Gates Foundation has contributed over $6.6 billion for global health programs, $2 billion of which is for fighting malaria, tuberculosis, and HIV/AIDS and other sexually transmitted diseases. The growing role of private donors calls for closer coordination and exploitation of possible synergies between official and

nonofficial donors.[3] [For a detailed discussion of private capital flows and remittances see *Global Development Finance 2007*.]

PROGRESS ON INNOVATIVE FINANCING
A number of innovative financing proposals for both the public and the private sector are being developed, and some are already in the pilot stage. Some of the proposed new mechanisms could contribute to expanding aid flows.

On the public sector side, new forms of taxation and securitized borrowing are being deployed. The International Finance Facility for Immunization (IFFIm) issued its first $1 billion bond last November, part of a plan to raise $4 billion over the next 10 years. The bond is backed by six donor countries—France, Italy, Norway, Spain, Sweden, and the United Kingdom—and will be repaid over 20 years. This new financing tool accelerates donor contributions to programs under the Global Alliance for Vaccines and Immunization, and it helps to lock in associated aid flows, which usually depend on annual budgets.

Air ticket levies could yield an estimated $1 billion to $1.5 billion a year, with France one of the largest contributors at $250 million a year. Views are mixed, however, on whether these levies add resources to what would otherwise have been provided. Meanwhile (in February) donors launched the first pilot Advance Market Commitment, to provide incentives for the development of vaccines of importance to developing countries.[4] Canada, Italy, Norway, Russia, the United Kingdom, and the Gates Foundation provided $1.5 billion in commitments to the pilot. Although AMCs do not increase aid flows to poor countries (especially not in the short run), by supporting the development of vaccines they could prove helpful in meeting the MDGs.

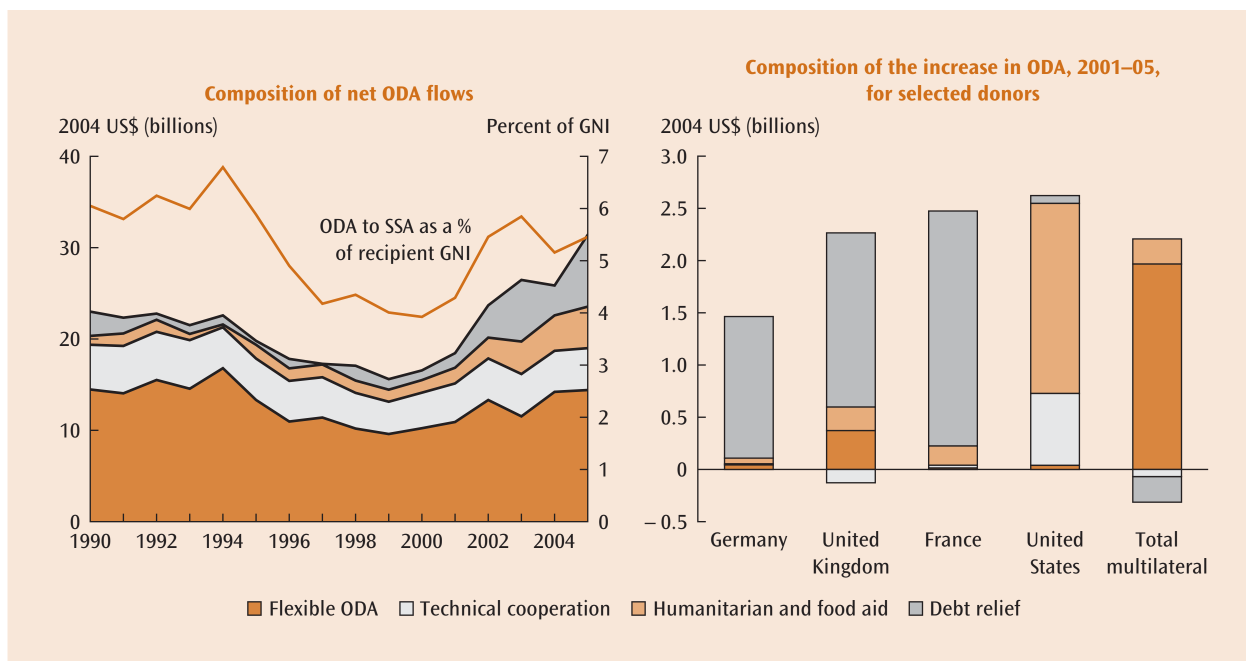
Blending, or the use of a combination of financing mechanisms toward a common objective, is seen as a way to augment MDB and donor resources aimed at accelerating progress on poverty and on social goals in middle-income countries. The World Bank is working with other MDBs to develop a menu of blending arrangements that would deploy part of current and future bilateral aid to middle-income countries so as to leverage the MDBs' nonconcessional lending.

Various private entities, meanwhile, have proposed a wide range of innovative financing measures. These include electronic billing-based fundraising; global development bonds, which would use financial engineering techniques to reduce the risk of developing-country investments; and results-based sequencing of funds, in which a country would receive additional funds only after specified targets have been met (de Ferranti 2006). Together these mechanisms are mobilizing new contributors to development finance in both the private and the public sector. Although this is surely a welcome development, it also heightens the need for stronger cooperation and collaboration among all actors so as to deliver resources more efficiently and effectively.

Progress on Scaling Up Aid to Africa: Actions Lag Commitments

At the 2005 Gleneagles summit, the Group of Eight leaders promised to double aid to Sub-Saharan Africa by 2010. Nearly two years later, that promise is not translating into actual increases: Sub-Saharan Africa is seeing little new aid beyond debt relief and certain special initiatives (figure 4.3). Indeed, DAC members' ODA to Sub-Saharan Africa—excluding Nigeria, the recipient of exceptional debt relief—actually declined by about 1 percent in real terms in 2005; preliminary data show that these flows stagnated in 2006. The prominence of debt relief in aid flows is evident during 2001–05: bilateral ODA to the region more than doubled over this period and the share of ODA allocated to Sub-Saharan Africa increased, but close to 70 percent of the expansion represented debt relief. The Bank's Africa Action Plan progress report aptly notes that "A typical 'well performing' African country has seen little or no increase in the resources available to support

FIGURE 4.3 Evolution of Net ODA to SSA, 1990–2005



Source: OECD DAC database.

development projects and programs." ODA from several of the largest bilateral donors to the region shows a similar pattern—the exception is the United States where humanitarian assistance and technical cooperation account for the bulk of the expansion in ODA. Moreover, a partial survey of DAC members' planned future aid flows by country and region provides scant evidence of any substantial scaling up of aid on the horizon. Without concrete action to further boost aid, the Gleneagles promise risks going unfulfilled.

Action is needed on both sides of the aid relationship. Scaling up requires recipient countries to strengthen nationally owned poverty reduction strategies (PRSs), building upon the solid progress of recent years. Particular attention must be on enhancing analytic capacity to identify and assess absorptive capacity constraints—macroeconomic, sectoral, and institutional—and develop appropriate interventions to alleviate them. Previous Global Monitoring Reports have addressed some of these issues and highlighted the importance of sequencing interventions across the range of constraints and of aligning public investments with these priorities.[5] As well, there is a need to establish closer links between the PRS and decision making processes in order to strengthen accountability to domestic stakeholders. One way of achieving this is by integrating the PRS and the budget process, thereby strengthening results orientation and domestic accountability.[6]

A range of reforming countries is well positioned to absorb scaled-up aid. The Bank teamed up with the OECD-DAC and UNDP to focus on six well-performing low-income countries in Africa which, because of their improved economic performance and better-developed aid alignment and harmonization mechanisms, were readier for scaled-up donor support. Within these countries, selected sector programs were costed to demonstrate that 15–30 percent of additional aid could be

absorbed in these countries. Another recent World Bank study (2007b) draws on 12 country case studies to identify a variety of fiscal constraints to growth and to assess the financing options to achieve higher growth. Among countries with high aid access, such as Madagascar, Rwanda, and Uganda, the study finds that physical public infrastructure is both a critical constraint to growth and to achievement of the MDGs. Because of structural constraints (small size of the formal sector, high dependency ratios, etc.) the study assesses the scope for generating additional domestic revenue to be modest. Given the need to restrain new borrowing, and relatively limited scope to capture efficiency gains, these countries will have to rely substantially on scaled-up aid to finance growth-enhancing expenditure. The study finds that the situation is quite different in some other countries—Kenya could undertake limited borrowing for key investments but will need to address governance concerns to access greater aid flows; Tajikistan will need to improve the regulatory and governance environment to attract private investment and to access more aid. In other cases, such as India, increased revenue effort and changes in the composition of expenditure will be needed to address constraints to growth.

The challenge is to establish an effective mechanism for scaling up. Donors have come to see results and resources (R&R) processes as important to facilitating the scaling up of aid within the country-based development model. The R&R process builds and improves on the consultative group meetings that are the existing mechanism for donor coordination. It proposes linking funds to ambitious country-owned strategies and development results in a framework of mutual accountability. Although the underlying principles are common to the countries involved, the specific modalities may vary from country to country. Several African countries are in the process of preparing well-defined and well-costed-out programs for using the additional aid. The example of Ghana illustrates how one country is implementing the results and resources agenda (box 4.2).

The Africa Catalytic Growth Fund (ACGF) is also a possible vehicle for scaling up. The ACGF is a new mechanism to provide targeted support to help countries scale up to achieve economic growth and hard-to-reach MDGs. Within a country-based framework, the ACGF identifies opportunities where resources from multiple sources can fill funding gaps.[7]

Donor Support for Gender Equality: Toward a More Realistic Agenda

At the 1995 Beijing Women's Conference, donors made commitments to focus actions and resources on promoting gender equality in the developing world through mainstreaming of gender issues and women's empowerment. Gender inequalities in the areas of education and health were of particular concern. Efforts to redress this situation are apparent in the pattern of aid allocations for 2001–05: nearly three-fourths of aid with a gender equality focus is directed to the social sectors (figure 4.4). A quarter of all bilateral ODA allocated by sector—$5 billion out of $20 billion in average annual commitments—is focused on gender equality. Because aid for activities with no explicit gender equality focus, such as infrastructure, can also have a beneficial impact on girls and women, it is hard to say what the appropriate amount of financing for gender equality should be. What can be said is that the share allocated to gender equality is increasing.[8,9]

Despite donors' strong policy commitments to gender equality, implementation has been disappointing. Self-evaluations of nine donor agencies' performance reflect a gap between words and deeds.[10] One reason for the shortfall has been an unfortunate diffusion of responsibility, the result of initial decisions to spread responsibility for gender mainstreaming across all staff, with little accountability. Agency staff found themselves suddenly tasked with mainstreaming gender issues in the project portfolio, yet nobody was held specifically responsible for making it happen. A second reason was the broad, ambitious scope of the gender mainstreaming mandate itself, which

BOX 4.2 Country-based scaling up: The case of Ghana

Within the results and resources framework, work on the scaling-up agenda is now under way in the initial focus countries, with several R&R meetings planned in 2007. The first such meeting for Ghana took place in June 2006. Although the specific modalities of the R&R process will vary from country to country, the Ghana experience provides a good illustration of the key elements. Country ownership and leadership have been at the center of the process in Ghana. The R&R meeting was organized under the leadership of the Ghanaian government, closely assisted by the World Bank. An ambitious, country-led Growth and Poverty Reduction Strategy II (GPRS II), covering the period 2006–09, provided the strategic framework. The strategy is focused on raising economic growth from its recent 5 to 6 percent a year to between 8 and 8.5 percent, and it sets out clear development goals and identifies policies and programs to achieve them.

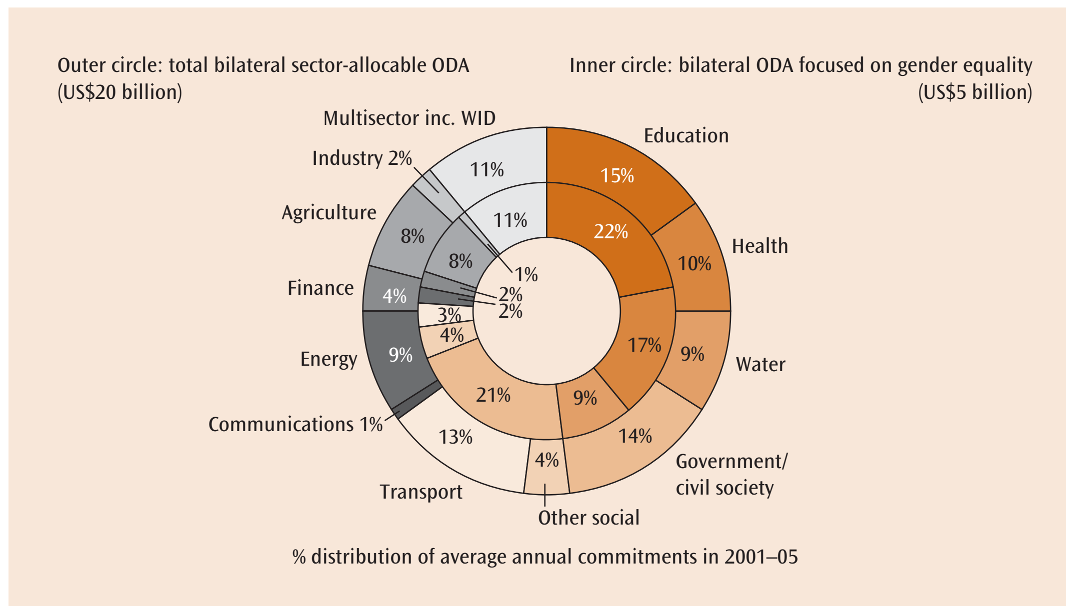
GPRS II encompasses an initial costing of the country's whole development strategy, linking development goals to an investment plan and a medium-term expenditure framework. This is complemented by a resource assessment, evaluating the macroeconomic and fiscal space for the scaled-up development strategy and outlining the planned mobilization of domestic resources and the amount and composition of resources to be raised externally. GPRS II also included an assessment of, and articulated a plan for strengthening, the country's institutional absorptive capacity, with particular attention to public resource management and the monitoring and evaluation system, to ensure value-for-money and efficiency of expenditure. GPRS II was supplemented by several key documents prepared specifically for the R&R meeting: these included a synthesis paper setting out Ghana's enhanced growth strategy, the macroeconomic context, and specific scale-up opportunities; a results matrix linking expected outcomes, resources, and indicators for monitoring progress; a financing matrix detailing recent and projected donor support; and a matrix on Ghana's Harmonization and Aid Effectiveness Action Plan. The World Bank worked closely with the government and with other development partners in preparing these documents.

Ghana's strategy for scaled-up development, with its emphasis on stronger economic growth, was well received by donors at the R&R meeting. Donors confirmed significantly increased and more predictable financial assistance, including $5 billion in new disbursements ($800 million more than had been projected six months earlier at a consultative group meeting) and $1.3 billion in debt relief under the HIPC Initiative and the MDRI, for a total of $6.3 billion in identified partner support for the four-year GPRS II period. The government noted that additional financing of about $2 billion ($500 million a year, or about 4 percent of the country's GDP) would be needed to fully fund the scaled-up investment plan, especially its infrastructure components, to achieve the GPRS II targets for accelerated growth. Donors committed to a full review of the financing requirements of GPRS II, based on further work to flesh out and assess the government's enhanced growth strategy and the associated investment plan. This work is now in progress, and the World Bank is contributing through a country economic report focused on the agenda for accelerated growth. In keeping with the Aid Effectiveness Action Plan, Ghana's development partners, including the Bank, have prepared a Joint Assistance Strategy that establishes a framework for support of GPRS II. The next R&R meeting on Ghana, scheduled for June 2007, will assess program implementation over the past year against the agreed results and progress indicators. It will also consider the financing requirements that remain unmet. Future R&R meetings are envisaged on an annual basis.

sought to encompass all actions throughout a given agency. This only reinforced inaction when the mandate was not translated into concrete priorities. Compounding these problems were inconsistent or limited support from senior management levels, and difficulty in tracking financial resources not specifically dedicated to or earmarked for gender equality objectives.

The evaluations did find some successes in mainstreaming gender issues in operations, although few projects systematically measured

FIGURE 4.4 Gender equality focus of bilateral ODA by sector (2001–05)



Source: OECD DAC.
Note: Not all donors report the gender focus of their bilateral aid.

the results and impacts. Examples include the embedding of gender issues in country dialogues and Poverty Reduction Strategy Papers (PRSPs) as well as in specific development projects, especially those where an enabling environment supported the gender equality agenda. In Tanzania, for instance, the United Kingdom through its development agency the Department for International Development supported the development of gender indicators in the poverty monitoring system. As a result, progress in gender equality is now systematically measured as part of Tanzania's overall poverty reduction performance assessment. In Nicaragua, the Swedish International Development Cooperation Agency and other donors were instrumental in helping mainstream gender issues in health sector projects.

These evaluation exercises, together with a more favorable political climate, have helped reenergize the commitment of donors to gender equality and women's empowerment. Several donors are in the process of fine-tuning or revamping their approaches, recognizing the importance of both gender mainstreaming and specific actions to reduce gender inequalities and empower women. Proposed changes include the following: much greater selectivity in targeting efforts at gender mainstreaming; adoption of a results orientation and strengthening of monitoring and accountability frameworks; stronger organizational arrangements for gender mainstreaming; and exploitation of synergies with the aid effectiveness agenda. This last change links gender equality instrumentally to the effectiveness of aid. It builds gender dimensions into the results and country ownership frameworks defined by the Paris Declaration, while recognizing the challenge of mainstreaming gender issues into programs and budgets.

Within this more realistic agenda, there is wide agreement that high-level leadership, technical expertise, and financial resources will be key to ensuring that donor agencies' gender policies are implemented. Financial resources, in particular, are needed up front, to enhance the capacity of donor and implementation agencies to mainstream gender issues. Beyond these internal challenges, success in

implementing gender equality policies will depend largely on recipient countries' interest and institutional capacity.

Despite the challenge of estimating the financial resources needed to achieve gender equity goals, a few countries, such as Ethiopia, Gabon, Kenya, Mauritania, Niger, Senegal, Tajikistan, Togo, and Yemen have drafted a variety of innovative gender intervention proposals with corresponding cost estimates.[11] These countries' proposed gender mainstream interventions cover both traditional gender sectors such as health and education and nontraditional sectors such as energy and infrastructure.[12]

Gender mainstream intervention proposals vary across countries contingent on national needs, priorities, and sectoral development of gender action. For example, Kenya calculates $2.41 per capita per year to provide energy subsidies to female-headed households to facilitate income generation through biomass and renewable energy, petroleum, and electricity. In Niger, an intervention proposes providing vocational and skills training to facilitate secondary school female graduate entry into the workforce with a projected annual cost of $2.13 per capita. The Dominican Republic proposes transferring subsidies to mothers of children in pre-primary, primary, and secondary education at an annual per capita cost of $1.78. Outlining financial requirements is an important first step in targeting gender action priorities and costs to which national governments and donor agencies may respond. [See box 3.5 for progress on gender budgeting.]

Selectivity in Aid Allocations

A SHARPER FOCUS ON POLICY

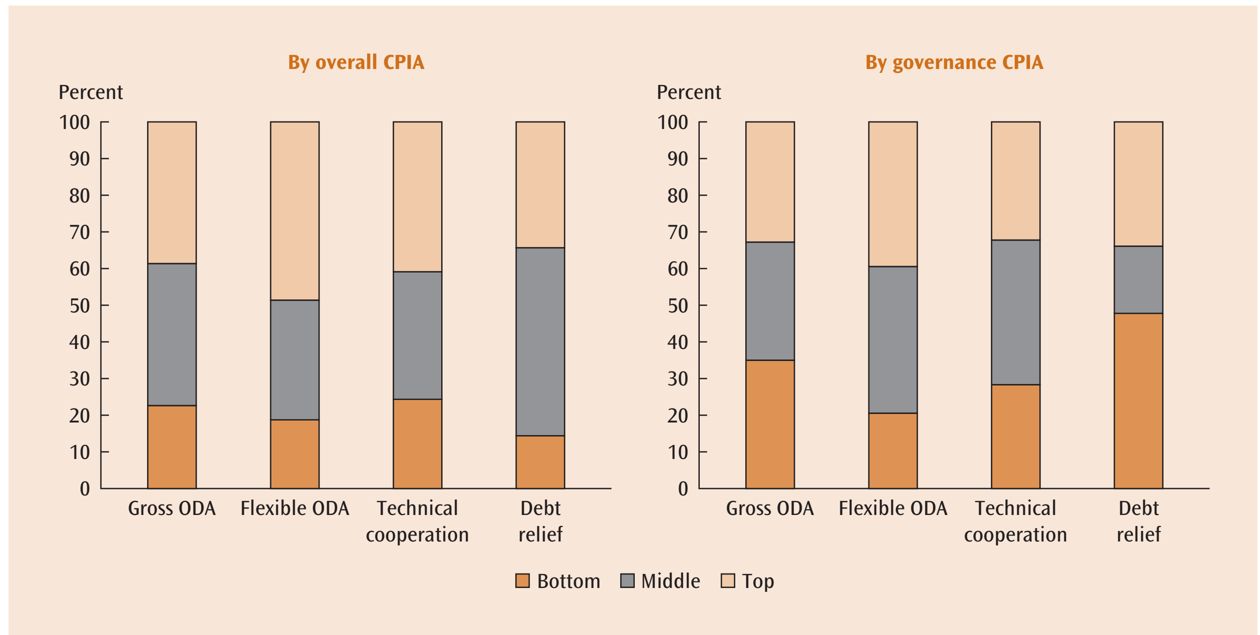
Although aid is allocated on the basis of several criteria, donors are becoming more focused on policy performance. For example, the distribution of DAC bilateral aid by the quality of countries' policies and institutions (CPIA) shows that the best-performing third of recipients receive a modest 40 percent of all aid, while the worst-performing third receive only a little over a fifth (figure 4.5).[13] The analysis excludes Afghanistan because CPIA data are not available for the country and Iraq because it is not in the group of 81 IDA-eligible countries. Including these two countries could alter the results. There is some variation in the distribution by type of aid: nearly half of flexible ODA (ODA not in the form of special-purpose grants) is directed to the top third of recipients, whereas debt relief is concentrated in the middle third. Donors also focus on recipient-country governance, and here the data exhibit a somewhat similar pattern: flexible ODA tends to be allocated to countries with relatively better quality of governance, and debt relief to those with relatively weaker governance.

Where the relationship between aid allocation and policy performance and poverty has been studied empirically, bilateral donors are found to be increasingly focused on these criteria. Both policy and poverty selectivity indexes exhibit an improving trend over 2001–05 (figure 4.6). This is true for each of the various types of aid as well. The policy selectivity index in 2005 for non-humanitarian ODA shows that, on average, a 1 percent increase in a country's policy and institutional quality (CPIA) score is associated with a more than 1.5 percent increase in ODA (with bilateral donors showing less selectivity than multilateral ones; see chapter 5). Studies of the responsiveness of aid flows to improved governance report fairly similar results: a 1 percent improvement in the quality of governance is associated with about a 1.4 percent increase in aid. The results for disaggregated aid show that flexible ODA is the most selective, and technical cooperation the least selective, with respect to policy performance (and no significant relationship is found between CPIA scores and debt relief). The results for poverty selectivity are similar: flexible ODA is again the most selective with respect to poverty, and technical cooperation the least selective.

AID TO FRAGILE STATES: ADDRESSING THE CHALLENGES

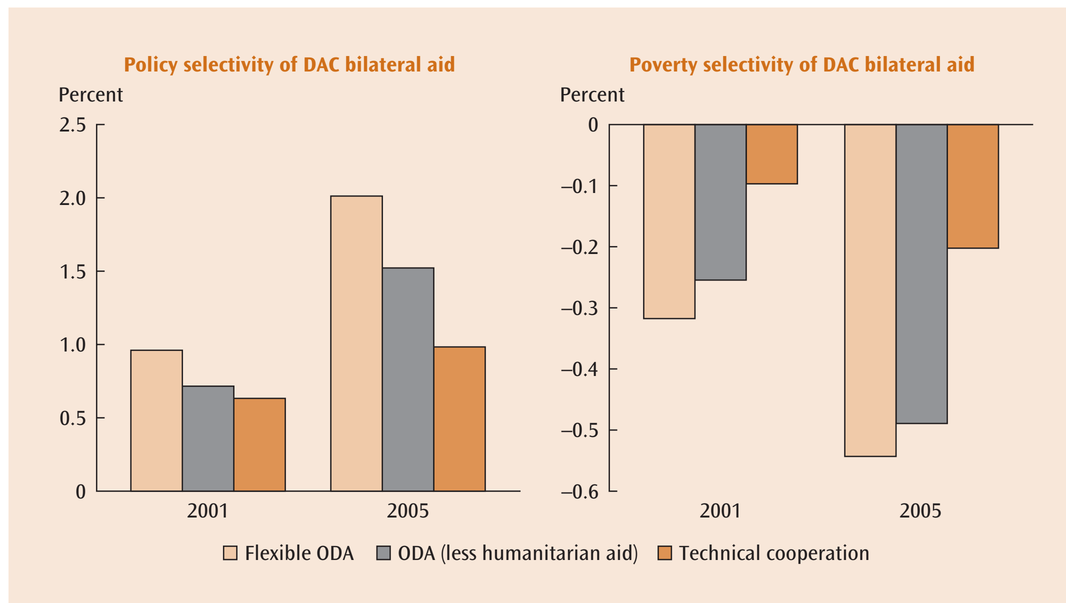
The world's fragile states with their multitude of chronic problems pose a particular

FIGURE 4.5 Quality of policy matters: Distribution of 2004–05 DAC bilateral ODA



Source: ODA data from OECD DAC database; CPIA data from World Bank.
Note: IDA-eligible countries are divided into three groups—bottom, middle, and top—using the 33.3 and 66.7 percentiles of overall CPIA or governance-CPIA (quality of public sector management and institutions). Afghanistan is not included in the above charts because CPIA data are not available for the country; Iraq is not in the group of IDA-eligible and is not included.

FIGURE 4.6 Sharper donor focus on policy and need



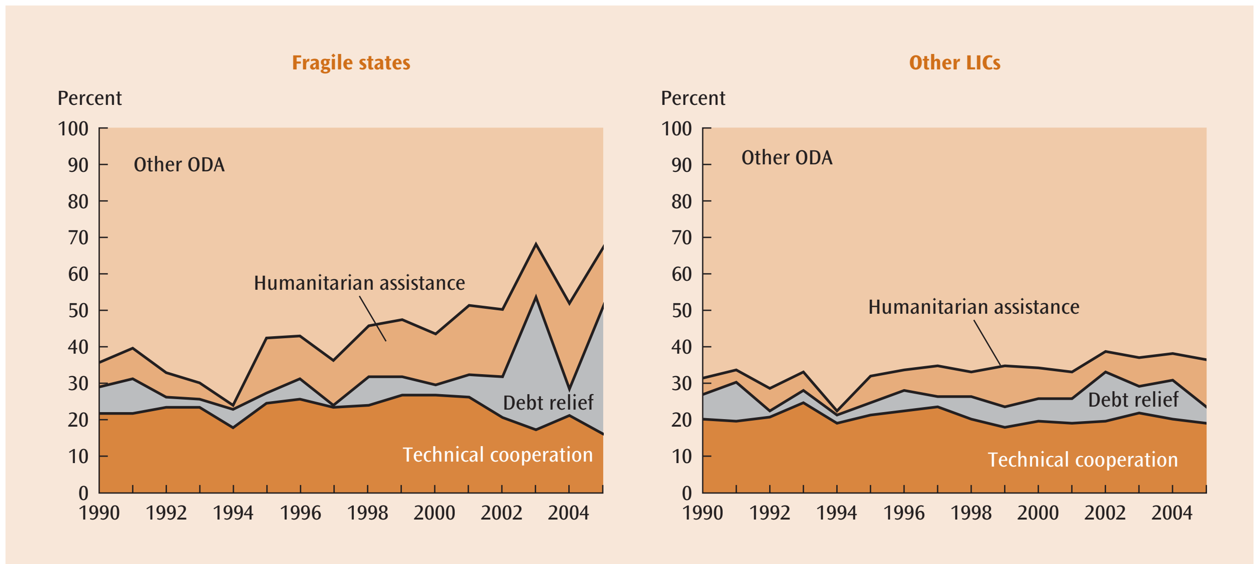
Source: Staff estimates, based on Dollar and Levin (2004).
Note: The quality of policies and institutions is measured by the overall CPIA. Policy selectivity shows the policy selectivity index, which measures the elasticity of aid with respect to the CPIA. Poverty selectivity shows the poverty elasticity index, which measures the elasticity of aid with respect to recipients' per capita income. The selectivity results do not include Afghanistan and Iraq because data on CPIA are not available.

challenge to the international community, but progress has been made in understanding and responding to these situations. In 2005 donors endorsed 12 principles for engagement in fragile states. Since then these principles have been piloted in nine countries, and their experiences have been fed back to allow the principles to be refined further (OECD DAC 2006b). The 12 principles emphasize the need to distinguish between country situations and to customize the mix and sequence of aid instruments accordingly. The central focus of international engagement in these countries should be on state building: supporting the legitimacy and accountability of the state and its capacity to foster development. The interdependence among political, security, and development objectives requires that donors devise coherent policies to deal with the multidimensional challenges these countries face. Where possible, donors should align their assistance with the recipient government's own priorities, and avoid actions that undermine long-term capacity building. The principles call for coordination among donors in making assessments, designing strategies, and assigning tasks. They also call on donors to act flexibly, to be prepared to engage over a longer horizon than they do with other low-income countries, and, specifically, to address the problem of aid orphans—those countries that for whatever reason get less assistance than their development indicators warrant.

Much remains to be done to improve development effectiveness of aid in fragile states. For one thing, application of the recently agreed principles needs to be extended beyond the few pilot programs to all fragile states. The principles also need to be mainstreamed with efforts to implement the Paris Declaration. International actors need to adopt "whole of government" approaches, fostering close collaboration across the economic, development, diplomatic, and security fields. The support provided by the international community to the creation of the United Nations Peace-Building Commission demonstrates the importance of this nexus, and work is now under way to consider how to make the hoped-for collaboration a reality. The principles also have organizational implications for donor agencies; for example, donors will have to create internal capacity to respond quickly to changing environments, build an appropriate local presence in fragile states, and attract skilled staff to work in these countries. Finally, appropriate performance indicators are needed so that progress can be monitored against the objective of building lasting peace among a more robust family of nations.

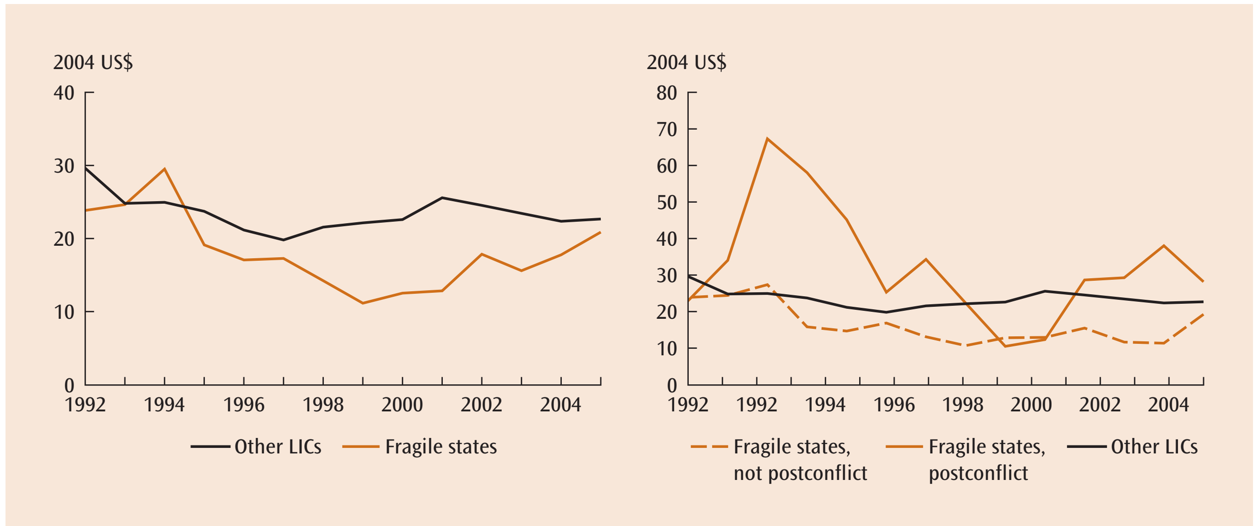
The focus on fragile states is beginning to translate into increased assistance, although aid flows to this group continue to be volatile. Overall aid to fragile states rose by more than two-thirds in 2005 alone, to nearly $20 billion (in 2004 dollars), and by 167 percent over 2001–05, just over half of which consisted of debt relief (figure 4.7). When debt relief and humanitarian assistance are excluded, aid to fragile states was around $10 billion in 2005.[14] Fragile states are also seeing an improving trend in aid received per capita. Although this group continues to receive less aid (excluding debt relief and humanitarian assistance) than the group of other low-income countries, the gap is narrowing (figure 4.8). Large increases in aid to Afghanistan, Sudan, and the Democratic Republic of Congo are behind this narrowing trend. Meanwhile, more than half of fragile states actually saw a decline in aid from 2001 to 2005 (figure 4.2). Aggregate trends mask the wide variation across different types of fragile states: those emerging from violent conflict typically receive much more aid than other fragile states, and more than other low-income countries. The DAC is therefore monitoring annual resource flows to fragile states to help identify those where international engagement seems imbalanced. The monitoring exercise conducted in June 2006 identified eight countries that appear to be underfunded and another three where aid is volatile and, on balance, falling (OECD DAC 2006c). The aim of the monitoring exercise is to use the findings on marginalized states to inform the consultative group meetings for these countries

FIGURE 4.7 Fragile states receive more of their aid in the form of debt relief and humanitarian assistance



Source: OECD DAC database.
Note: Other LICs are IDA-eligible countries that are not fragile states.

FIGURE 4.8 Aid per capita to fragile states



Source: OECD DAC database and staff estimates.
Note: Data exclude India. Aid is net ODA less humanitarian aid and debt relief.

and address the local bottlenecks to greater engagement by donors.

Despite an overall increase in aid flows, empirical evidence shows that fragile states as a group continue to be underfunded compared to other countries with similar policy and poverty characteristics. However, the extent of underfunding (as measured by

the coefficient on the fragile states dummy) appears to be declining in recent periods.[15] Evidence of underfunding is stronger for certain types of aid, especially flexible ODA. More important, the role of other factors such as regional and global spillovers and vulnerability has yet to be carefully examined in assessing the allocation of aid to this group of countries (Amprou, Guilliaumont, and Guilliaumont Jeanneney 2006).

Focus on Aid Effectiveness and Results

PROGRESS ON HARMONIZATION, ALIGNMENT, AND RESULTS

This section provides an update on the implementation of the harmonization and alignment actions at the global and country level in light of mutual commitments made by donors and partner countries in the Paris Declaration to improve aid effectiveness (actions by bilateral donors are reviewed here, while chapter 5 discusses implementation status of MDBs). Based on qualitative reviews and the Baseline Monitoring Survey of partner countries and donors,[16] it is evident that the international aid community is taking tangible actions toward meeting the Paris commitments but that results to date are modest. The Paris Declaration has raised expectations and generated a momentum for change in aid practices, but a number of challenges still need to be addressed by partners and donors if the targets of the Paris Declaration are to be met.

Following the adoption of the Paris framework in 2005, donors have taken a broad range of actions to disseminate the agreed commitments. Two-thirds of DAC donors have included the Paris Declaration as a strategic priority in official statements, indicating political ownership.[17] Many donors have also developed action plans for implementing the Paris framework. As of November 2006, 16 DAC members had adopted an action plan on implementing the Paris Declaration. An additional three members have adopted the principles of harmonization, alignment, and results in their aid strategies and policies, and four others have intentions of having an action plan. Along with the broad dissemination within donor agencies, a majority of DAC members have provided training courses on the commitments under the Paris Declaration to staff; some agencies have advanced training in budget support, sectorwide approaches, and public financial management. Donors have also collaborated with partner countries to disseminate Paris principles through regional workshops.

But implementing the Declaration involves a broad and complex process of change. In terms of organizing to strengthen internal processes, half of the donor agencies are focusing on mainstreaming responsibility for implementing the aid effectiveness agenda while the other half are relying on specialized units to promote implementation. Progress on decentralization is slower, however, with less than a third of DAC members reporting that field representatives are taking responsibility for advancing the Paris agenda on the ground.

At the country level, a growing number of partner countries are collaborating with donors on harmonization and alignment actions. Six countries—Burkina Faso, Ghana, Mozambique, Tanzania, Uganda, and Vietnam—are taking actions and making substantive progress across a broad range of areas.[18,19] An additional 13 countries are taking action and are making good progress. In the other countries, efforts are under way to implement harmonization and alignment actions but this progress is not as broad as in the more advanced countries.

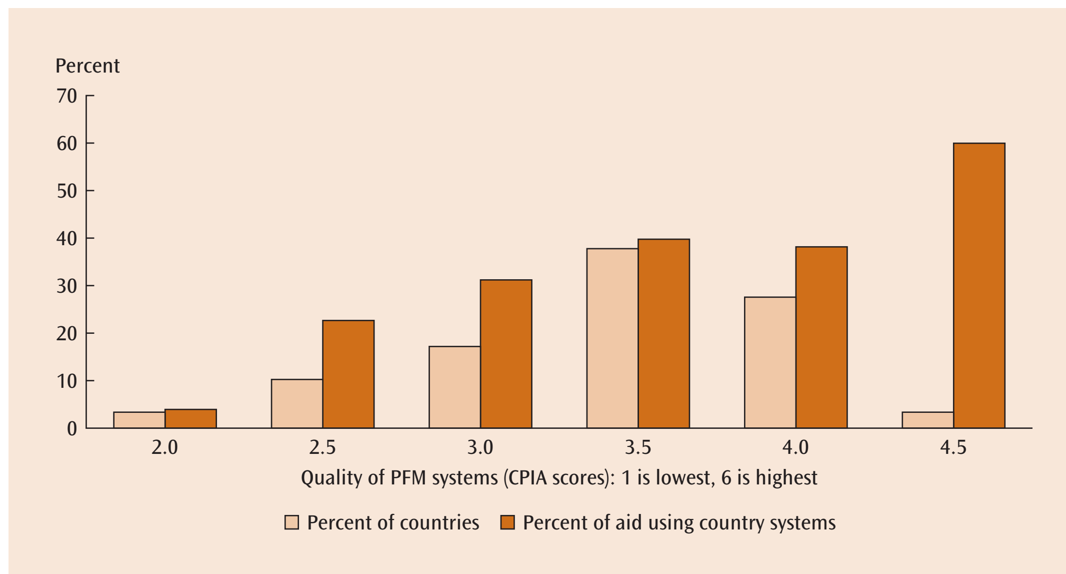
Although the findings are preliminary, the qualitative and quantitative monitoring of the Paris Declaration[20] provides a useful assessment of the state of play on the basic trends in implementation of the commitments. The qualitative part of the 2006 baseline review finds that progress on ownership by partnership countries is uneven. While countries increasingly have developed comprehensive national strategies and improved the links to operational frameworks, as well as enhanced the functioning of country systems, there is significant room for improvement, even in the better-performing countries. According

to the review, only 17 percent of the surveyed countries had developed operational national development strategies—strategies linked to fiscal policy and budget processes—that are considered "largely developed towards good practice," compared to a target of 75 percent of partner countries with largely or substantially developed strategies. Better use of the national budget to allocate resources in a more vigorous and consistent way to agreed policy priorities and activities is needed if countries are to close the gap on this target.

Furthermore, to align aid with country systems requires reliable country systems—for example those for public financial management (PFM) and public procurement systems. Nearly a third of countries have public financial systems that are moderately weak or worse—a CPIA-PFM quality score of 3 or less—and about a third have PFM systems that are moderately strong or better—a CPIA-PFM quality score of 4 or higher (figure 4.9). The Paris target for this indicator calls for half of the partner countries to move up at least half a point by 2010. Strengthening PFM and procurement systems is central to increasing utilization of country systems by donors. Sustained technical assistance from donors, when coupled with adequate country ownership of PFM reforms, has led to improvements in PFM systems—for example, reform efforts in Mozambique and Tanzania have been well coordinated and owned by the countries, and have resulted in significant improvements in their PFM systems. The survey also finds that very few countries have a mechanism for mutual review of implementation of aid effectiveness commitments (those in the Paris Declaration and in local agreements). As more countries develop and adopt harmonization action plans, this is expected to change.

According to the 2006 Baseline Survey, the status of implementation against the Paris indicators for which donors have primary responsibility is mixed; the breadth and depth of actions vary among donors. Donor effort to align aid with country policies and processes is measured by several indicators including use of country systems, less reliance on creating parallel project implementation units, disbursing on time and on budget, and coordinating support to strengthen capacity.

FIGURE 4.9 Quality of country public financial system and use of PFM system for aid to government sectors



Source: Preliminary results from the 2006 Survey on Monitoring the Paris Declaration, OECD/DAC (March 1, 2007); CPIA scores from World Bank.

Table 4.1 shows the results from the survey for bilateral donors and all donors for each of these indicators.

Among bilateral donors, 39 percent of their disbursements use the partner country's public financial management system and 42 percent of disbursements use the country's procurement system. Better quality of PFM systems (as measured by the CPIA) do tend to be associated with a higher use of these systems for aid that is provided to the public sector—correlation of quality with use is just over 0.4 (figure 4.9). Nevertheless, there is wide variation among bilateral donors (DAC members) on the use of PFM systems for delivering aid to government sectors—from a low of 10 percent to a high of 90 percent.

According to the survey, 67 percent of bilateral aid is reported to be disbursed during the fiscal year in which it is scheduled, though with considerable variation at the country level in the shortfall between planned and actual disbursements. (Also see box 4.3.) For another indicator, bilateral donors report that 48 percent of their capacity-building support is coordinated with other donors, as compared to the Paris target for 2010 of 50 percent. This is one area where the definition of "coordinated" needs to be reviewed to ensure greater consistency or the target for this indicator might be more ambitious.

The survey finds that the bilateral donors provide 40 percent of their aid through program-based approaches such as budget support and sectorwide approaches, relative to the Paris target of 66 percent; there appears to be an increasing trend for sectorwide approaches and other similar programmatic arrangements, although reliance on such programmatic approaches outside the social sectors is not widespread. An area where greater attention is needed is with respect to project implementation units (PIUs); in the 34 countries surveyed 1,005 parallel PIUs are relied upon to implement projects, with a Paris target to reduce this number to 335 by 2010. In addition, the extent to which bilateral donors conduct joint missions is low—the survey found that 24 percent of missions

TABLE 4.1 Indicators pertaining to bilateral donors' implementation of the Paris Declaration

Indicator	Bilateral Donors	All Donors	2010 Target
Strengthen capacity by coordinated support	48%	47%	50%
Percentage of aid that is disbrused using country public financial management systems	39%	39%	Reduction of aid not using country PFM systems by a third or more
Percentage of aid that is disbursed using country procurement systems	42%	39%	Target under development
Number of Parallel Implementation Units (PIUs)	1,005	1,767	Reduction by 2/3
Percentage of aid that is disbursed on time	67%	66%	Reduction by 50% of aid not disbursed on time
Percentage of aid that is disbursed through program-based approaches	40%	43%	66%
Percentage of missions that is done jointly with other donors	24%	24%	40%
Percentage of country analytic work that is done jointly with other donors and/or partner government	48%	54%	66%

Source: Preliminary results from the 2006 Survey on Monitoring the Paris Declaration, OECD/DAC (March 1, 2007).
Note: The data reflect implementation as of 2005 for donors that provided a total of more than $100 million for the government sector. The data are undergoing final review by the OECD/DAC.

BOX 4.3 Predictability of budget aid: Experience in eight African countries

Aid predictability has become a central issue in the quest for enhanced effectiveness, particularly in the discussion on how best to deliver untied budget aid. For countries whose budgetary spending depends heavily on disbursements of untied aid, volatile and unpredictable disbursements are seen as undermining the credibility and reliability of short- and medium-term budget planning, by rendering original allocations obsolete and forcing expenditure adjustments during execution.[a] These adjustments, in turn, can hamper the attainment of government objectives, most importantly by disrupting the implementation of poverty reduction strategies. Worse still, when significant adjustments are simply not feasible during a given budget year, the result can be deviations from macroeconomic targets, with potentially significant consequences for macroeconomic stability.

A recent study of the predictability of budget aid in eight African countries—Benin, Burkina Faso, Ghana, Mali, Mozambique, Senegal, Tanzania, and Uganda—finds that both negative and positive errors in the International Monetary Fund (IMF) aid projections are large, imposing burdens on budget management (Celasun and Walliser 2005). While weak donor reporting is an issue in aid predictability, another likely reason for aid shortfalls is the failure by recipients to meet disbursement triggers. Moreover, the delayed disbursements may be shifted to the following year, once the conditions are met, accounting for aid overruns. On average, the mean absolute error in projecting budget aid on a year-by-year basis was about 1 percent of recipient-country GDP during 1993–2004, or about 30 percent of actual aid received.[b] Errors have declined only slightly over time, from 1.13 percent of GDP during 1993–99 to 0.95 percent of GDP during 2000–04. Closer donor coordination and information sharing is needed to help improve the predictability of aid. Also, providing more donor financing through the budget would strengthen monitoring and forecasting.

The bulk of adjustments to these unforeseen variations in aid take the form of domestic bank financing of government, arrears, and changes in domestically financed investment expenditure. Little of the adjustment burden falls on recurrent expenditure, amortization, or other financing. It is also apparent that, for whatever reason, aid shortfalls tend to be accompanied by tax revenue shortfalls, and aid windfalls by tax windfalls (also see Bulir and Hamann 2003, 2006).[c] This, of course, only deepens the recipient country's predicament. Finally, the study also found that periods of excess aid and tax revenue are seldom used to accelerate domestically financed investment spending, to potentially catch up with previous shortfalls. This finding is important, since it signifies that aid volatility may have permanent costs in terms of lost output. The country examples point to potential gains from a greater emphasis on regular annual budget support and on strong donor coordination frameworks. Intrayear predictability remains an important issue for countries facing external financing constraints. It appears that coordinated budget support frameworks are likely to also improve intra-annual disbursement patterns and avoid the typical "year-end rush" of disbursements. Reaping these gains, however, is predicated on creating the environment for a reliable medium-term engagement of budget support donors.

a. Gelb and Eifert (2005) argue that although predictability poses a special challenge for budget support, there are practical ways to address this issue. They show that performance-based allocation rules that have a flexible precommitment rule can allow for precommitment of aid in a multiyear framework, while avoiding drawn-out periods of misallocations.
b. Although budget aid disbursements remain difficult to predict on a year-by-year basis and carry large prediction errors, the authors do not find evidence that, in the aggregate and over time, aid disbursements fall short of aid projections by large amounts.
c. This procyclicality of aid hurts investment and public debt management.

were undertaken jointly, while 48 percent of country analytic work was prepared jointly with another donor, relative to the 2010 Paris targets of 40 percent joint missions and 66 percent joint analytical work.

TOWARD A MORE EFFECTIVE AID ARCHITECTURE?

Even as the Paris Declaration is beginning to change aid delivery practices among traditional donors, the rise of new aid sources,

including new donors, private foundations, and a profusion of global vertical funds is increasing the complexity of the global "aid architecture." These changes increase total resources, but they also present the international community with the challenge of coherence—of forging an aid architecture with closer coordination of aid activities among a wider donor community, as well as greater harmonization, less fragmentation, and earmarking of aid toward specific applications. Such coherence is vital if aid is to be successfully scaled up to meet the MDGs.

Donor proliferation has seen a marked increase over time. The average number of official donors—bilateral and multilateral—per country has increased threefold since the 1960s; the number of countries with over 40 active bilateral and multilateral donors has ballooned from zero to over 30 since 1990 (World Bank 2007a). This has been accompanied more recently by an expansion in the number of emerging donors, many of which are gaining a substantial presence in the aid community. Non-DAC donors are a heterogeneous group; the degree to which DAC approaches and norms are applied varies from country to country. Insufficient data make it difficult to accurately assess aid volumes and prospects from these sources. The number of private foundations and charitable organizations has also mushroomed, as have global programs (which are discussed in the next section) and funds. Donor contributions to 20 major global programs have increased from almost zero in the mid-1970s to about $3 billion annually. The number of active trust funds administered by the World Bank alone in FY2006 was 929, up from 840 in the previous year (World Bank 2007f). At the same time, contributions to multilaterals, including to IDA and the major regional development banks, have dropped (see above). The proliferation of aid channels can overwhelm the often limited capacity of recipient countries to implement the recording, processing, auditing, monitoring, and assessment requirements of different donors. It can also complicate the management of aid, undermining its effectiveness.

Proliferation is particularly pronounced in the health sector, and the case of Rwanda, which is discussed in chapter 2, highlights many of the challenges that are faced by countries with weak capacity—the need for policy coherence at the sector level and for complementarity between national, regional, and global priorities and programs. The need for building country capacity to effectively handle scaled-up aid is abundantly clear as well. Indeed, countries with strong capacity—Tanzania and Uganda—have had some success in pulling together a myriad of health donors into coordinated sectorwide approaches. Nevertheless, the profusion of aid channels heightens the need for coordination, alignment, and harmonization among a wider donor community, particularly when engaging with poor countries that find it difficult to turn down offers of assistance.

The problem of a large number of aid channels is compounded by the trend toward the small average size of funded activities. Using the OECD's Creditor Reporting Database, World Bank (2007a) shows that between 1997 and 2004 the average size of aid activities (measured in 2004 prices) dropped by $1 million to about $1.5 million and the number of activities surged from 20,000 to 60,000. Moreover, countries with lower institutional capacity had higher aid fragmentation. Previous *Global Monitoring Reports* have noted the negative implications of higher fragmentation on aid quality, especially through higher transaction costs for recipients and donors and through a smaller donor stake in overall country outcomes. Excessive fragmentation is a serious problem and measures to reduce it, such as through donors limiting the number of countries in which they focus, providing a larger amount of funds through more efficient vehicles (including multilateral channels) and modalities, and committing to delegate authority to lead donors, could help to reduce transactions costs and to improve the effectiveness of aid.

Recent trends in proliferation and fragmentation are thus impacting the global aid architecture, and posing a challenge to the

quality and effectiveness of aid. Although the Paris Principles address some of these challenges, more is needed to achieve coherence in the aid architecture.

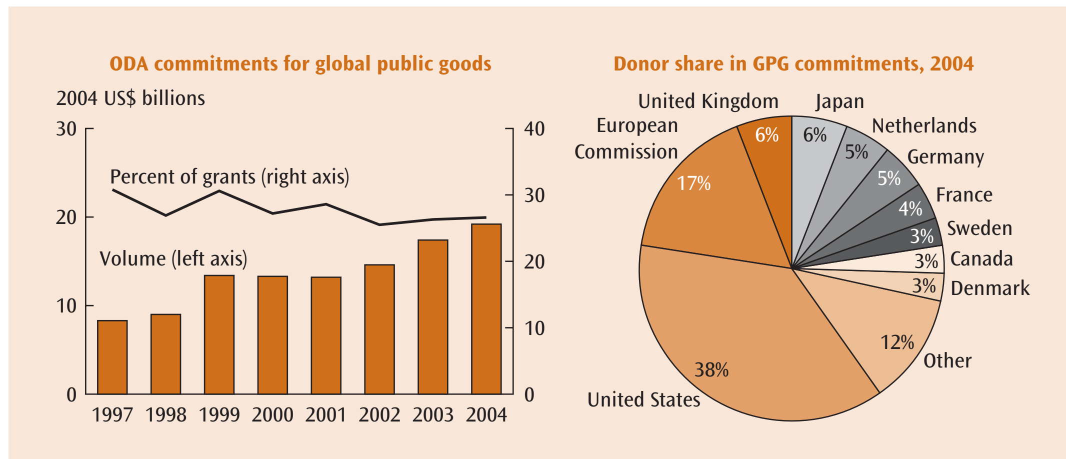
MAKING GLOBAL PROGRAMS MORE EFFECTIVE

Programs and partnerships of global scope have grown rapidly, reflecting the increasing influence of global issues over the development agenda. The international donor community—including both official and private donors—is already channeling substantial resources through these vehicles. Global programs typically focus on delivering either targeted key services such as primary education or HIV/AIDS treatment, or global public goods such as peace and security, control of infectious diseases, knowledge generation and dissemination, protection of the global commons, a free and open trading system, international financial stability, and protection from borderless crime. Global programs vary widely in terms of size, funding sources, financing arrangements, governance structures, and modalities. Their importance in delivering global public goods is revealed in the fact that nearly $20 billion in ODA grant commitments by DAC members—over a quarter of the total—is now allocated to such goods (figure 4.10). The United States is the largest source of funds for global public goods, financing nearly 40 percent of all DAC donors' ODA commitments of this type. Other important official contributors include the Germany, Japan, the Netherlands, the United Kingdom, and the European Union as a group.

Further evidence of the robust growth in global programs is seen in the activities of the various trust funds administered by the World Bank, many of which are global and regional in scope. Contributions to these trust funds have more than doubled in recent years, from $2.2 billion in 2001 to $5.2 billion in 2006. Contributions by bilateral donors and the European Commission accounted for nearly 90 percent of the 2006 figure, and those by private entities for 1 percent. Disbursements have shown remarkable growth as well, rising to a record high of $4.4 billion in 2006. Nearly half of all trust fund disbursements in 2005 were for global programs.

A key challenge for global programs is how best to integrate their mandates and priorities with country-based programs into coherent development strategies. Successful integration depends on aligning the objectives and design of the global program with

FIGURE 4.10 DAC members' and EC's ODA commitments forGPGs



Source: OECD DAC database and staff estimates.
Note: GPGs include both global and regional public goods.

conditions at the country level. A 2006 World Bank report evaluates the alignment of global programs at the country level for seven countries. Focusing on the larger programs, such as the Global Fund to Fight AIDS, Tuberculosis, and Malaria, the Global Environment Facility, the Global Alliance for Vaccines and Immunization, the Education for All Fast Track Initiative, and the Consultative Group on International Agricultural Research, the study finds considerable variation among them. The Education for All Fast Track Initiative was found to be well aligned, and the Global Environment Facility reasonably well aligned, while other global programs, especially in health, were struggling to improve their alignment.[21] The study also finds that alignment is easier when the benefits of the global public good to the individual country are perceived to be high. Shared objectives and strategies strengthen local ownership, and this helps promote success. Establishing ownership and alignment is more complicated in countries with limited institutional capacity and greater donor fragmentation.

One way to improve the alignment of global programs is to anchor them in the Paris Principles. Also central to success are predictability and sustainability of funds, especially for recurrent expenditures, at the local level. Evaluations suggest that only a few global programs provide truly global public goods; many so-called global programs actually provide national or local goods (see also chapter 2 of this report). This suggests the need for selectivity in establishing global programs to avoid their uncoordinated proliferation. Another concern is that the funds raised by global programs may crowd out other funds rather than provide net additional resources; they may also compete with country and local programs for scarce resources and staff. Clearly a balance has to be struck between country-owned priorities and global program objectives. The MDBs are well placed to help reinforce the centrality of country strategies and ensure that global programs complement rather than compete with them. The convening power of MDBs can also help reduce the costs of donor fragmentation that a welter of global programs might otherwise foster.

Debt Relief

Progress on Implementing the MDRI

The past year saw major progress in extending and deepening debt relief to the poorest countries. Following a 2005 proposal by the G-8, three multilateral institutions—the AfDF, IDA, and the IMF—implemented the new Multilateral Debt Relief Initiative (MDRI), and agreed to provide 100 percent debt relief on their eligible claims to countries that have reached, or will eventually reach, the completion point under the HIPC Initiative. The MDRI was implemented at the beginning of 2006 by the IMF, in mid-2006 by IDA, and early 2007 by the AfDF (for the latter, delivery of debt relief will be provided retroactively to the beginning of 2006). To date, 22 postcompletion-point HIPCs have benefited from debt relief under this new initiative, which amounts to about $38 billion (in nominal terms)—two non-HIPCs, Cambodia and Tajikistan, have also received MDRI relief from the Fund. The remaining HIPCs that have not yet reached the completion point will automatically qualify for the MDRI once they do so.

The full cost of the MDRI for the three institutions is expected to be around $50 billion. The MDRI commits donors to providing additional resources to ensure that the reflow losses associated with debt forgiveness do not undermine these institutions' overall financial integrity or ability to provide financial support to low-income countries.[22] Last year's GMR presented the baselines established by IDA and the AfDF on which additionality of donor financing is to be assessed. Monitoring donors' commitments on financing the MDRI is important to ensuring actual additionality of donor financing over time. Chapter 5 presents the progress on donor financing of the MDRI; as of end-2006, IDA donors had provided firm financing commitments of $3.8 billion over the four decades of MDRI implementation, against a volume of irrevocable debt relief provided by IDA under the MDRI of currently $28.3 bil-

lion.[23] The upcoming IDA-15 replenishment will be an important test of donors' intentions regarding their support of the MDRI.

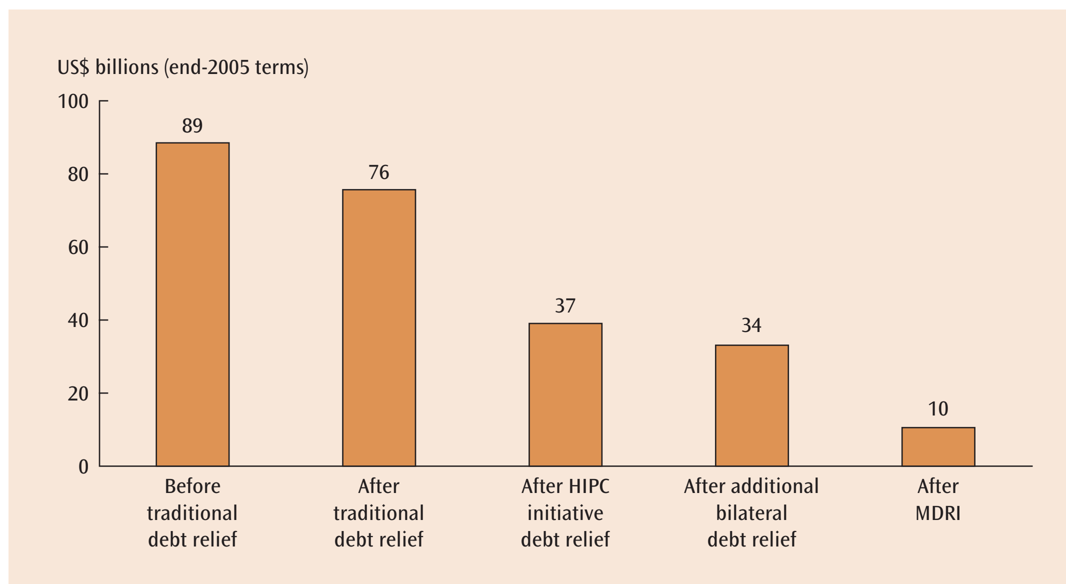
The proposal recently approved by the Inter-American Development Bank (IADB) to provide debt cancellation to postcompletion-point HIPCs (Guyana, Bolivia, Honduras, and Nicaragua) and to Haiti once it reaches completion point, in line with the MDRI, will provide debt relief of $4.4 billion—$3.4 billion in principal and $1 billion in interest—to these countries. Debt cancellation will be financed by the IADB out of internal sources, more specifically, from existing Funds for Special Operations (FSO). However, there is currently no consideration of an FSO replenishment linked to the above.

PROGRESS ON THE HIPC INITIATIVE

Overall, substantial progress has been made in the implementation of the HIPC Initiative. As of end-March 2007, 30 HIPCs have reached the decision point and are receiving debt relief. Progress toward reaching the completion point—when creditors provide the full amount of debt relief committed at the decision point on an irrevocable basis—continued in early 2007; four additional countries reached the completion point, bringing the total number of countries that have done so to 22. Several of the eight countries in the interim period between their decision point and completion point are on track with respect to their macroeconomic programs; others that experienced difficulties in program implementation are pursuing the necessary policy measures to bring their economic programs back on track (IMF-World Bank 2006b).[24]

Debt relief under the HIPC Initiative is projected to substantially lower debt and debt service ratios for most HIPCs that have reached the decision point. Net present value (NPV) of debt stocks in the 30 HIPCs that reached the decision point by end-March 2007 are projected to decline by about two-thirds once they reach their respective completion points, and by about 90 percent after the application of the MDRI (figure 4.11). The ratio of debt ser-

FIGURE 4.11 Reduction of debt stock (NPV terms) for the 30 decision-point countries



Sources: HIPC Initiative documents; IDA and IMF staff estimates.
Note: Based on decision-point debt stocks. (Updated compared to Progress Report to include Malawi, São Tomé and Principe, and Sierra Leone as completion-point countries and Haiti as interim country.)

vice to exports for these countries is estimated to have declined from an average of about 17 percent in 1998–99 to about 7 percent in 2005. These ratios are estimated to have declined further to about 4 percent in 2006.

For these 30 countries, poverty-reducing expenditures on average have risen from about 7 percent of GDP in 1999 to over 9 percent of GDP in 2005, a level more than five times that spent on debt service. In absolute terms, poverty-reducing spending is estimated to have increased from about $6 billion in 1999 to $15 billion in 2005, and is projected to have increased to $18 billion in 2006. Because of problems with cross-country consistency in the definition of poverty-related expenditures, it might be useful instead to review the trend in health and education expenditures (box 4.4).

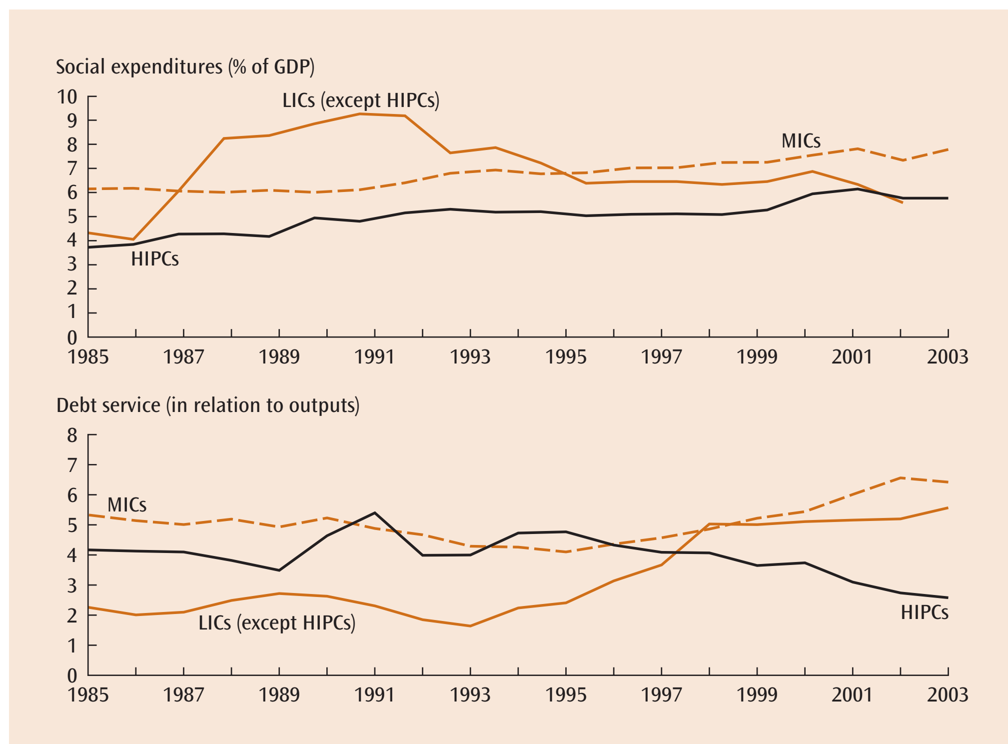
THE CHALLENGE OF KEEPING DEBT BURDENS SUSTAINABLE

The challenge for countries receiving MDRI debt relief is to ensure that financial resources freed up by debt reduction are used for

BOX 4.4 Debt service savings and social expenditures: Is there a link?

Recent data suggest a relationship between cuts in debt service costs and increases in social expenditures for HIPCs. Using data on health and education expenditures for 110 countries for 1985–2003/04, Thomas (2006) finds that social expenditures in relation to output have risen gradually over time in both HIPC (an approximately 2 percentage point increase) and middle-income countries, whereas the ratio has fluctuated more widely for other low-income countries.[a] Debt service

Trends in social expenditures and debt service



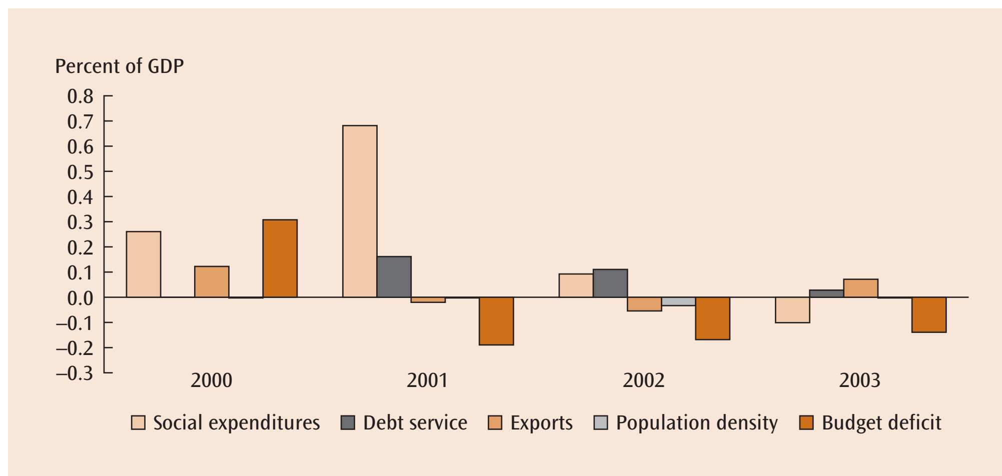
continued

BOX 4.4 Debt service savings and social expenditures: Is there a link? *(continued)*

in relation to output has declined continuously among HIPC countries since the introduction of the HIPC initiative in 1996 while debt service costs have risen for middle-income and other low-income countries over this period. Econometric estimates confirm that the HIPC relationship is significant at the 10 percent level of significance. Moreover, social expenditures are protected from expenditure cuts among low-income countries but are boosted by expansionary budgets.

Over 2000–02, the social expenditure ratio among HIPCs rose rapidly by almost 1 percentage point and has subsequently stabilized at this level. The main factors associated with these changes include an expansionary budget policy in 2000 and lower debt service payments since then. Exports also appear to have played a contributing role in 2000, possibly because strong export growth is an indicator of a strong-performing economy.

Contribution to the change in social expenditures



a. Some studies including Clements, Bhattacharya, and Nguyen (2003) find that the ratio of debt service to output is significantly negative relative to the public investment rate: with a coefficient of 0.2 they estimate that a decline in debt-service/GDP ratio from 10 percent to 5 percent would raise public investment/GDP by 1 percentage point. Kraay and Depetris Chauvin (2005) find that debt relief has not contributed to any significant change in health and education expenditures. One criticism is that they use imputed values of debt relief (PV terms). But one problem with using debt service is that debt service can change for reasons other than debt relief.

reaching the MDGs. Post debt relief, these countries are experiencing an increase in their perceived borrowing space as well as in the availability of financing from emerging official and private creditors and domestic sources. While these developments are welcome, they could raise new risks, if debt is built up too rapidly and abruptly. The debt sustainability framework for low-income countries, endorsed by the Boards of the IMF and IDA in 2005, can help countries design a financing strategy that will mitigate these risks without unnecessarily constraining access to resources for development.

The Boards of the IMF and IDA reviewed in late 2006 the application of this framework and have agreed to refinements aimed at improving the rigor and quality of the analyses in the post debt relief context. They concluded that ensuring long-term sustainability requires efforts by borrowers, lenders, and donors to promote prudent

borrowing and a suitable mix of concessional and other finance. To this end, the broader use of the debt sustainability framework by creditors would help disseminate information between borrowers and creditors, as well as among creditors, and better inform financing decisions.[25] In addition, the capacity of borrowing countries to manage and monitor their debt must be strengthened so countries can develop their own medium-term strategy to support national development objectives, while containing the associated risks of debt distress and macroeconomic vulnerability. Improving the quality and availability of debt data—external and domestic debt—will be important to support monitoring and assessment of debt and associated risks.

Trade

Major Developments in Global Trade

World trade in 2006 continued its strong growth trend of recent years. Worldwide exports of merchandise reached $12 trillion in 2006, growing 16 percent in value, well above the average growth of 8 percent recorded in 1995–2004. Reflecting increases in fuel prices, fuel-exporting countries experienced the highest export growth, at 23 percent, but global non-oil exports also grew 15 percent. At 22 percent, developing-country export growth continued to outpace the global average. Turning to individual regions, higher energy prices contributed to export growth of 22 percent in Middle Eastern and North African countries. China continued its strong recent export performance, with a 27 percent increase in 2006. Exports from Sub-Saharan Africa continued to benefit from the healthy global economy, recording a 23 percent increase overall, while least-developed countries experienced a remarkable 25 percent growth. Industrialized countries expanded their exports at a more modest 4 percent rate.

In addition to favorable cyclical factors, last year's global trade performance reflects continuing unilateral trade reforms. Average tariffs in developing countries have fallen from 16.3 percent in 1997 to 11 percent in 2006. As the pace of global integration increases, the challenge of harnessing the new opportunities while managing the risks places a premium on a strategy of greater openness to trade, coupled with behind-the-border reforms. For example, a number of countries have proved able to compete with China following the phase-out of textile and clothing quotas, but central to their success have been reform of their tariffs and investment climate and support from the international community to overcome infrastructure constraints (box 4.5).

BOX 4.5 Developing-country clothing exports in a postquota world

The clothing sector has been at the forefront of export diversification in many developing countries, and employment in the sector has been an important source of income for many women. But trade in this sector is undergoing a profound change, as the system of quantitative restrictions that managed the industrial countries' imports of textiles and clothing for 30 years was finally dismantled at the end of 2004 as part of WTO Uruguay Round agreement. This change engendered widespread fears that global markets for textiles and clothing would be swamped by Chinese products, with adverse implications for other developing countries. Does this sector still serve today's low-income countries as the first rung on the ladder to higher-value-added exports?

Early signs suggest that adjustments in production patterns and trade flows following the removal of quotas have been less drastic than anticipated. Although China's total exports soared by 29 percent between 2004 and 2005, its share of global clothing exports has increased at a slower rate.[a] The substantial growth in the world market for clothing has allowed exports from many other countries, including Colombia, Egypt, India, Madagascar, Peru, Sri Lanka, and Turkey, to increase.

continued

BOX 4.5 Developing-country clothing exports in a postquota world *(continued)*

In Bangladesh, where the loss of 1 million jobs had been predicted (Oxfam 2004), exports to the European Union and the United States instead increased strongly between 2004 and 2006.

Nevertheless, some countries have seen substantial declines in exports of clothing. Exports to the European Union and the United States from Brazil, the Dominican Republic, and Swaziland have decreased by about 20 percent, and exports from Taiwan Province of China have fallen by nearly 30 percent. The clothing sectors in these economies face significant adjustment. Even in countries that have managed to increase exports, pressure for adjustment may be strong as the more efficient firms expand while those unable to compete in the global market decline. In the absence of other employment opportunities, especially for women, workers laid off from the textile and clothing sectors may fall back into poverty. Minimizing the costs incurred by these workers and their families and facilitating their shift to other productive activities will be a major challenge in a number of developing countries.

In Africa, where the end of the clothing sector had been predicted, exports have generally fallen (by 12.3 percent on a trade-weighted average), but some countries, such as Madagascar and Kenya, have managed to maintain or even increase exports. The slowdown in African clothing exports observed during 2005 has also started to reverse. Sub-Saharan African clothing exports to the European Union in the first eight months of 2006 were nearly 8 percent higher than in the same period in 2005 (but still 8 percent lower than in 2004). Exports to the United States, however, have continued to decline, falling 12.5 percent during 2006 after a 14 percent drop in 2005 (largely driven by Mauritius and South Africa). On the plus side, the downward trend in exports has reversed for 14 countries.[b]

The prospects for African exports of clothing to the United States have been enhanced by the recent extension, to 2012, of the nonrestrictive rules of origin under the African Growth and Opportunities Act (AGOA). These rules allow African producers to globally source the fabrics used in their garments and still receive U.S. trade preferences. In contrast, the European Union offers tariff preferences with restrictive rules that deny producers the ability to use the best and lowest-cost inputs wherever they may be found. The AGOA rules of origin were critical in the substantial increase of African clothing exports to the United States between 2000 and 2004, a period during which exports to the European Union stagnated.

The countries best able to expand clothing exports will be those that have a supportive business environment, low trade costs (efficient customs, ports, and other transport infrastructure), and competitive firms flexible enough to meet the changing demands of the global buyers that now dominate the industry. With these conditions in place, the clothing sector can still be a driver of industrial diversification in many poor countries, even in the face of unfettered competition from China.

a. Europe and the United States have introduced a number of temporary restrictions on imports from China under the special safeguards agreement included as part of China's WTO accession. It has been suggested that the very rapid surge in exports from China to both the European Union and the United States before the safeguard was imposed was partly a response to its anticipated use by increasing the base for quota calculations. The re-imposition of limits on selected Chinese exports is likely also to have spillover effects on third parties.
b. Based on figures for January through October 2006. The United States and the European Union accounted for a large but declining share of global clothing imports, 23 and 35 percent, respectively, in 2005. Madagascar accounts for nearly two-thirds of the net increase in exports to the European Union between 2005 and 2006. At the same time, however, its exports to the United States have fallen.

UPDATE ON COUNTRY POLICIES

Trade policies and domestic welfare. Governments use a variety of instruments that have the effect of restraining trade, whether intentionally or as a side effect. For example, tariffs and antidumping actions have the restriction of imports as their explicit objective; regulatory policies motivated by public health or safety concerns do not, but may limit trade nonetheless. In fact, such policies may affect

trade in a very product-specific way, with different effects on different countries. When quantifying the overall effects of a country's national trade policy, then, it is important to consider nontariff measures as well as tariffs. This report does so using two separate measures of trade-related policies. The first is a trade restrictiveness index (TRI), which is a measure of the impact of tariffs imposed by a country on itself. The second, called the Overall Trade Restrictiveness Index (OTRI), captures the impact of both tariffs and nontariff measures on a country's trading partners, that is, on the exporters that ship goods to the country.[26]

Assuming a country cannot affect its terms of trade, tariffs increase the relative price of imported goods in the country imposing them, thereby reducing national welfare. One way to quantify this loss of welfare is to calculate the deadweight loss due to the existing tariff structure. This can be done by comparing the welfare of the country given its TRI with what would obtain under zero tariffs.[27] The average TRI for all countries is 13 percent, with Bangladesh's the highest at 66 percent (see the annex to this chapter). The TRI is generally higher in developing than in industrial countries (table 4.2). Tariffs in Japan, however, generate the largest absolute deadweight loss of any single country ($28 billion in 2004), with Korea ($25 billion) a close second. Bangladesh and Korea suffer the highest losses in proportion to their economies, each at more than 3 percent of GDP. By comparison, the average low-income country loses the equivalent of about 0.4 percent of its GDP as a result of its tariffs. The total deadweight loss that tariffs inflict on the world as a whole is on the order of $100 billion a year.[28]

Agricultural protection is the main source of these losses (table 4.2), particularly in high-income countries. Canada, Japan, Korea, Norway, Switzerland, and the European Union as a group all have TRIs for agriculture that exceed 40 percent (see the annex). The worldwide average TRI on agricultural goods, at about 22 percent, is twice that for manufactured goods.

Trade policies and trade flows. The last two columns of table 4.2 summarize the effect of all observed trade policies on trade flows of exporters, as measured by the OTRI, for high-, middle-, and low-income countries.[29] The OTRI includes the effects of regulatory measures such as product standards, as well as policies such as import licensing requirements and antidumping actions. As previous editions of *Global Monitoring Report* have stressed, the OTRI is a measure of trade restrictiveness, not protection. It measures the effect of included policies in limiting trade; it is not a measure of protectionist intent. As the table shows, the average OTRI for developing countries is 16 percent, and that for high-income countries about 8 percent. The effect of trade restrictions in the latter group of countries is to reduce annual imports by

TABLE 4.2 Trade restrictiveness and its impact on welfare and trade flows, by country income group, 2004

	Tariffs and impact on importing country							All trade restrictions and impact on trade flows	
	All goods			Agricultural goods		Manufactured goods			
		Welfare loss							
Country group	TRI	Billions of dollars	Percent of GDP	TRI	Welfare loss (billions of dollars)	TRI	Welfare loss (billions of dollars)	OTRI	Loss (billions of dollars)
High income	10	74.5	0.2	40	65.3	4	9.2	8	261.6
Middle income	15	13.3	0.2	30	3.8	12	9.5	16	180.3
Low income[a]	16	5.2	0.4	18	1.4	16	3.9	16	29.2

Source: World Bank staff calculations.
a. Data available for 22 countries only.

about $260 billion. The comparable figure for middle-income countries is about $180 billion, and that for the 22 low-income countries in the sample about $29 billion.

As with the TRI, the average OTRI for agriculture is much higher than that for manufacturing. Many developing countries impose similar levels of restrictiveness on agricultural imports as on manufactures, but for some developing nations the OTRI for agriculture is far higher than for goods. In India, for example, the ratio of agricultural to nonagricultural trade restrictiveness increased significantly following the recent liberalization of trade in industrial products. For developed countries this ratio tends to be much higher than in most developing countries, rising to 10 or more.

Changes in trade restrictiveness, 2000–06. Reflecting a steady reduction in tariffs, the global impact of policies in restricting trade has declined in recent years.[30] Except for a number of African countries, most economies have lower OTRIs than in 2000 (figure 4.12). Developing countries that have seen substantial falls in their OTRIs include India, Egypt, Nigeria, and Mauritius, as well as China and many Latin American nations. Among developed countries, overall trade restrictiveness in Japan and the United States has fallen somewhat, while it has remained largely unchanged in Canada and in the European Union.

Much of the decline in OTRIs pertains to manufacturing; much less has been achieved in agriculture. In a number of countries the agricultural sector is now more restrictive

FIGURE 4.12 Overall trade restrictiveness has declined (2000–06)

	Decrease (>5%)	Some Decrease (1–5%)	Small–No Change	Some Increase (1–5%)	Increase (>5%)
All Products	Burkina Faso, China, Côte d'Ivoire, Egypt, Ghana, India, Jordan, Kazakhstan, Lebanon, Mauritius, Morocco, Nigeria, Papua New Guinea, Paraguay, Peru, Philippines, Tunisia, Uruguay	Albania, Algeria, Argentina, Australia, Belarus, Bolivia, Brazil, Brunei, Chile, Colombia, El Salvador, Guatemala, Honduras, Indonesia, Japan, Kenya, Malaysia, Mali, Mexico, Moldova, Nicaragua, Russian Fed., Saudi Arabia, Senegal, Singapore, Switzerland, Tanzania, Thailand, Turkey, United States, Zambia	Bangladesh, Cameroon, Canada, Costa Rica, Ethiopia, European Union, Gabon, Hong Kong, China, Iceland, Korea, Rep. of, New Zealand, Norway, Oman, Romania, Sri Lanka, Trinidad and Tobago, Ukraine, Venezuela, R.B. de	Madagascar, Malawi, Uganda, South Africa	Sudan, Uganda
Agriculture	Argentina, Bangladesh, Burkina Faso, Chile, China, Côte d'Ivoire, Ghana, Guatemala, Lebanon, Mauritius, Nicaragua, Papua New Guinea, Peru, Thailand, Turkey, Ukraine, Zambia	Albania, Canada, Colombia, El Salvador, Ethiopia, Gabon, Iceland, Indonesia, Malaysia, Mexico, Paraguay, Russian Fed., Saudi Arabia, Senegal, Singapore, Sri Lanka, Uruguay, United States, Venezuela, R.B. de	Australia, Brazil, Brunei, Costa Rica, Egypt, European Union, Honduras, Hong Kong, China, Jordan, Kazakhstan, Korea, Rep. of, Mali, New Zealand, Nigeria, Philippines, Switzerland, Tanzania, Trinidad and Tobago	Algeria, Belarus, Bolivia, Cameroon, Japan, Madagascar, Malawi, Moldova, Morocco, Norway, Romania, Rwanda, South Africa, Sudan, Tunisia	India, Kenya, Oman, Uganda

Source: World Bank staff estimates.

than it was six years ago; the European Union has seen virtually no change, while Canada and the United States have registered a small decline in agricultural trade restrictiveness since 2000. A small number of countries, including Argentina, China, and Chile have achieved substantial reductions in the OTRI for agriculture since 2000.

Trade policies and market access. The effect of policies on exporters' access to markets differs across exporting regions (table 4.3).[31] These differences are partly the result of discriminatory application of trade policies (that is, trade preferences), but mostly they reflect differences in the product composition of exports. Agriculture generally faces much more restrictive market access conditions than manufacturing. Because of this, regions exporting mainly agricultural products generally face more restrictive markets than regions where manufacturing dominates the export sector. This is one reason why trade among developing countries is affected by high levels of trade restrictiveness. For example, Latin American exporters face an average OTRI of 48 percent in the Middle East and North Africa, while products originating in Sub-Saharan Africa confront a 38 percent average OTRI in South Asia.

Table 4.3 reports both the OTRI including nontariff measures and a tariffs-only version of the OTRI. Nontariff measures (NTMs) have a substantial impact on the level of the OTRI, especially in countries with low tariffs. As mentioned previously, NTMs are not necessarily protectionist in intent, but they can represent a significant burden, especially for exports originating in developing countries. In practice, developing countries often benefit from tariff preferences in and enjoy duty- and quota-free access to many industrial-country markets, implying that NTMs, not tariffs, are the main factor restricting their access to these markets. The incidence of nontariff measures is highly product-specific. As the product composition of exports varies widely across exporters, there is often a wide range of OTRIs confronting different countries in the same market.

Antidumping. With the steady decline in tariff barriers, countries seeking to re-impose

TABLE 4.3 Market access (OTRI)

	Exporting Region					
Importing Region	Latin America & Caribbean	Europe & Central Asia	East Asia & Pacific	Middle East & North Africa	South Asia	Sub-Saharan Africa
Latin America	31	11	15	17	24	17
	5	*5*	*6*	*5*	*8*	*11*
Europe & Central Asia	39	21	18	6	40	18
	10	*8*	*7*	*4*	*9*	*14*
East Asia & Pacific	10	12	20	8	15	18
	4	*3*	*4*	*3*	*5*	*8*
Middle East & North Africa	48	25	26	24	28	23
	20	*11*	*12*	*4*	*7*	*6*
South Asia	39	25	29	11	35	38
	19	*15*	*15*	*9*	*7*	*32*
Sub-Saharan Africa	14	13	15	33	25	25
	5	*7*	*9*	*7*	*10*	*4*
All developing countries	27	20	21	13	27	19
	7	*8*	*7*	*5*	*9*	*12*
High-income countries	25	12	18	22	39	32
	6	*4*	*3*	*6*	*10*	*3*

Source: World Bank staff estimates.
Note: Values in *italics* are tariff-only OTRIs (i.e., excluding NTMs). Regions are developing country only.

protection often resort to so-called contingent protection measures, such as antidumping and safeguard actions. Major users of antidumping now include developing as well as industrial countries; indeed, India is now the most frequent user of this instrument. Worldwide, the number of antidumping investigations increased from about 1,200 in 1995–99 to almost 1,400 during 2000–04; the share of investigations started by developing countries rose from 43 percent to 48 percent. China is the leading target of such actions. Notwithstanding their much smaller share in world trade, middle-income countries as a group have surpassed the high-income countries as targets for investigations.

Given the small share of total imports hit by antidumping investigations, antidumping has a negligible effect on trade worldwide and little impact on overall trade restrictiveness. However, the protectionist effect of antidumping can be great for certain specific imports from targeted countries, and the threat of antidumping can have a chilling effect on the expansion and pricing of exports. The average effect of antidumping investigations imposed by India is estimated to be equal to a 44 percent ad-valorem tariff equivalent for the affected products. Antidumping investigations launched by China generate an ad valorem equivalent of 36 percent. In the industrial countries the effect of antidumping investigations tends to be smaller; in the case of the European Union the average ad valorem equivalent is about 13 percent.[32]

The Doha Round Negotiations

Despite intensive consultations throughout June and July, negotiations on the Doha Round were effectively suspended on July 23, 2006, amid disagreement over how ambitious an agreement to seek on agricultural market access and on greater reductions in trade-distorting domestic support in agriculture. Major players expressed their disappointment while uniformly reaffirming their commitment to a successful outcome. The remaining months of 2006 saw efforts to relaunch the negotiations through intensive bilateral consultations and a series of ministerial meetings. These efforts culminated on February 7, 2007, in an agreement by World Trade Organization (WTO) members to restart the talks.

The general view is that there is now a narrow window of opportunity to reach agreement early in 2007 on the key elements of a preliminary package that could pave the way for a final deal and be sufficient to assist the extension of U.S. Trade Promotion Authority (TPA) by July 2007. (TPA allows the U.S. president to submit a negotiated trade agreement to Congress for an up-or-down vote, without amendment.) Even with the prospect of such a preliminary Doha deal, however, renewal of TPA is by no means certain. Moreover, notwithstanding some indications of new flexibility among the major players, it is unclear whether agreement on key elements of a preliminary package can be reached in the first half of this year.

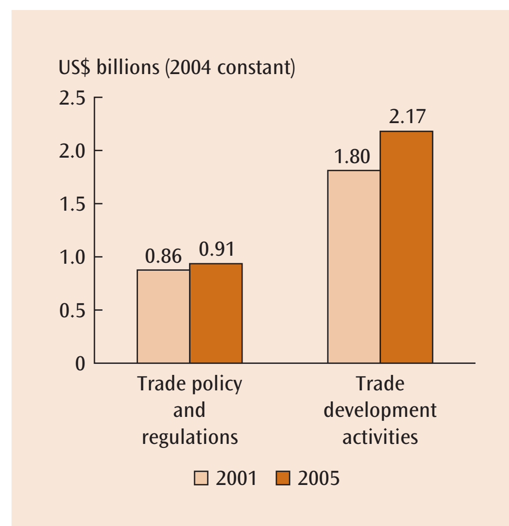
The World Bank and the IMF will continue to advocate a timely conclusion to the Doha negotiations and to argue against backsliding on progress already made. While a deal at any price is not supported, many of the proposals reportedly under discussion, when combined with progress already made (such as offers to eliminate agricultural export subsidies by 2013 and to provide duty- and quota-free market access for at least 97 percent of exports from least developed countries), are sufficiently substantive to make a deal worthwhile. Significant gains for developing countries would also flow from services liberalization and trade facilitation, and from aid for trade accompanying the Doha Round.

Failure to conclude the Doha Round would send a strong negative signal to the world economy about the ability of countries to pursue multilateral solutions. It could weaken the multilateral trading system, which provides developing countries with guaranteed nondiscriminatory market access, rules-based settlement of disputes, and transparency of trade regimes. Trade disputes may

also increase, feeding protectionist sentiment and overstraining the WTO dispute settlement system. The risk of trade diversion from the growing number of preferential trade agreements (PTAs; see the discussion below) will also increase in the absence of progress on multilateral liberalization, and PTAs will, in any case, continue to leave unaddressed the high levels of trade-distorting domestic support in agriculture.

But the biggest risk of failure in the Doha Round is to countries' own economic growth. Trade reform is fundamentally about self-interest: increasing global competition and domestic budgetary pressures both argue against delay in reforming costly domestic protection. Regardless of the outcome of the Doha talks, countries should continue to pursue unilateral trade reform, and the World Bank and the IMF will continue to work closely with developing countries to support efforts to integrate trade into national development strategies, and to advocate the reform of developed-country trade practices that hamper development efforts.

FIGURE 4.13 Aid for trade is rising



Source: WTO/OECD-DAC Trade Capacity Building database.

AID FOR TRADE

Further progress was made on aid for trade in 2006. Support for trade-related assistance continued to grow, while efforts continued to establish the necessary international architecture to ensure improved coordination and effectiveness of this aid. At 2004 constant prices and exchange rates, assistance for trade policy and regulations in 2005 reached $905 million, while trade development activities peaked at $2.17 billion (figure 4.13).[33] Additionally, an estimated $12.1 billion was spent to support the economic infrastructure essential for international trade.

World Bank lending for trade also continued on an upward trend, with 49 trade-related projects undertaken in fiscal 2005 valued at $1.08 billion, and 51 projects in fiscal 2006, valued at $1.61 billion, representing a threefold increase over 2003.[34] Expansion to date has been driven by trade-related infrastructure in support of regional integration in Africa, trade-related infrastructure in East Asia, and budget support to competitiveness reforms in Latin America and the Caribbean. From July to December 2006 (i.e., the first half of fiscal 2007), lending reached $0.8 billion, and this uptrend is expected to be sustained.

The IMF has provided financial support for trade-related adjustment, augmented by the Trade Integration Mechanism (TIM) and the option to use floating tranches of IMF lending to support trade reform in IMF-supported programs.[35] At present, three countries (Bangladesh, the Dominican Republic, and Madagascar) are availing themselves of support under the TIM. Total financing of up to $211 million is being made available to these three countries under the TIM, including amounts that could be drawn (under the TIM deviation feature) in the event the actual BOP effect of qualifying trade policy events turned out to be larger than anticipated.[36]

A focus of international activity on aid for trade in the past year was on establishing the necessary architecture to improve the coordination of such aid. Important elements of this work have taken place under the auspices of the WTO, given the general consensus that aid for trade is an essential complement to,

and not a substitute for, a successful outcome to the Doha Round. The Task Force on Enhancing the Integrated Framework (IF)[37] issued its recommendations on July 5, 2006, which included the following: the creation of a new executive secretariat in Geneva; strengthening of country capacity; a funding target for the IF trust fund of $400 million over an initial five-year period; and creation of a monitoring and evaluation framework. The task force also agreed that an IF-type mechanism could be useful for low-income developing countries that are not among the least developed. Transition teams were subsequently established on institutional issues, in-country issues, and the trust fund, with a view to operationalizing the enhanced IF by January 2007. Although progress was made, this deadline was not met. The World Bank and the IMF continue to actively engage with other parties in Geneva to develop workable and effective administrative arrangements for the enhanced IF.

A further international effort to improve the coordination of aid for trade took place under the auspices of the WTO Task Force on Aid for Trade, which also delivered its report in July 2006.[38] The report provided a welcome clarification of the definition of aid for trade. Under that definition, aid for trade encompasses not only activities related to trade policy and regulation and trade development, but also those involving trade-related infrastructure, building productive capacity, and support for trade-related adjustment. The report also contained a series of proposals to improve monitoring and evaluation, including establishment of a monitoring body in the WTO, an annual discussion on aid for trade in the WTO General Council, and inclusion of an assessment of aid for trade, for donors and recipients, in WTO Trade Policy Reviews. The report put forward a range of proposals for strengthening both the supply and the demand sides of aid for trade (and for matching the two), although it stopped short of providing concrete operational recommendations.[39] The report proposed instead that the Director General of the WTO establish an ad hoc consultative group to follow up on its recommendations.

Aid for trade enjoys broad acceptance within the development community as part of the growth agenda, but a number of important challenges remain. Donors have indicated that they are prepared to offer large increases in aid for trade, but how much of this would be additional to existing aid remains unclear. Much also remains to be done to operationalize aid for trade, particularly with respect to supporting countries other than the least developed in the articulation of trade integration strategies, addressing the needs of the growing regional and cross-country agendas, and establishing systems to monitor and evaluate results. Establishing an effective enhanced IF will also be critical. Central to meeting these challenges will be implementation of aid for trade within the parameters of the Paris Principles, using existing development institutions and mechanisms with proven effectiveness.

PREFERENTIAL TRADE AGREEMENTS

PTAs continued to proliferate in 2006, both among developing countries and between developed and developing countries. Approximately 170 still-active PTAs have been notified to the WTO. However, given that many agreements have not been notified, the actual figure is estimated at around 250, with 20 more awaiting ratification and another 70 under negotiation.

In the past year, interest in PTAs has intensified in developing and developed countries alike. Asia has seen a renewed interest in regional integration, prompted in part by China's rapid growth, and meanwhile integration continues to deepen in Latin America. The United States completed negotiations toward a PTA with the Andean countries and is continuing negotiations with Korea, Malaysia, Thailand, and the United Arab Emirates. The European Union's new trade strategy also places a greater emphasis on PTAs (EU 2006). The Association of Southeast Asian Nations, Korea, and Mercosur are identified as priorities for PTAs,

BOX 4.6 Economic Partnership Agreements

The end of the Cotonou agreement in 2008,[a] along with the need to negotiate another WTO waiver for any further unilateral preferences (given that they have been found to be inconsistent with WTO rules), prompted the EU and ACP countries to launch negotiations on EPAs in 2000. EPAs are to be reciprocally negotiated PTAs, providing for mutual market access; some services liberalization; a regulatory agenda on investment, competition, and intellectual property rights; institutional provisions to facilitate trade; and new technical assistance for trade negotiation and development.

The EPAs could spur trade—and raise incomes—in the African, Caribbean, and Pacific countries *if* they catalyze progress toward integration within regions, with other EPA groupings, and with the global market. However, their development impact will depend on their design, and here there are several concerns. First, the EPA regional groupings do not conform to existing common markets and PTAs. Coupled with the uneven progress in implementing existing regional agreements and the reluctance of the European Union to date to accept variable geometry,[b] this makes it difficult for countries to leverage the negotiations to promote effective intraregional liberalization. Second, preferential access for the EU countries and their neighbors behind currently high most-favored-nation (MFN) tariffs may displace more efficient sources of supply, underlining the need for MFN tariff reductions to precede backloaded preferential access for EU firms in EPA markets. Third, access to the EU market may be restricted if rules of origin, as yet undefined, require local value added greater than (say) 10 percent. Fourth, trade reforms, especially preferences to EU firms, may cut into public sector revenue when they are enacted, requiring compensatory tax reforms phased in to match any losses in tariff revenues. Finally, a key issue is the level of additional aid for trade on the table. Although there are benefits to keeping discussion of appropriate levels of aid for trade separate from the negotiations, this has eliminated one major incentive for the least-developed countries to join EPAs, since they already enjoy duty- and quota-free access to the EU countries under the Everything But Arms initiative. Appropriately designed, pro-development EPAs can help the ACP countries move forward on reforms to promote their competitiveness and regional integration.

Source: Hinkle, Hoppe, and Newfarmer 2005.

a. The Cotonou agreement covers unilateral trade preferences and development cooperation between member states of the European Union and their former colonies in the African, Caribbean, and Pacific regions.

b. Variable geometry refers to arrangements under which not all countries in a regional grouping need to have a common external tariff on a most-favored-nation basis or toward the European Union.

with India, Russia, and the Gulf Cooperation Council members also of interest. The strategy also places emphasis on enhanced trade relations with Turkey, the Southern Mediterranean countries, and some countries of the former Soviet Union (under the New Neighborhood Policy).

The European Union is also due to finalize the ongoing negotiations with African, Caribbean, and Pacific (ACP) countries under the Economic Partnership Agreements (EPAs).[40] The EPAs offer an important opportunity for trade reform in many countries, notably in Africa, but have also highlighted the extent to which the design of agreements can influence their development impact (box 4.6). Properly designed PTAs can benefit their members, especially if combined with a nondiscriminatory reduction in external barriers. But if they are designed badly, the cost of such agreements, in terms of trade diversion, high information costs, and demands on limited institutional capacity, may well exceed the benefits. For example, as many as half of all PTAs may divert more trade than they create, and bilateral "hub and spoke" PTAs benefit the hub (the rich country) disproportionately more than the spokes (developing countries).[41]

Notes

1. The larger emerging economies are also playing a greater role in trade, investment, and private financial flows to poor countries. For example, both China and India doubled their annual growth rates of imports from Africa between 1990–94 and 1999–2004; these two countries account for 50 percent of Asia's exports to Africa (see Broadman 2006 for an analysis of Africa-Asia trade.) Foreign direct investment in Africa from emerging economies, particularly Brazil, China, India, Malaysia, and South Africa, is also growing rapidly.

2. Global Monitoring Report 2006 discussed the increased risk of situations where nonconcessional lenders may indirectly obtain financial gain from debt forgiveness, grants, and concessional financing by the international financial institutions. This could lead to an excessive buildup of debt if nonconcessional borrowing is not carefully managed.

3. In collaboration with Portugal and the European Foundation Centre, the DAC will cosponsor an international conference on the developmental role of philanthropic foundations in early 2007.

4. Under an AMC, donors guarantee a set envelope of funding at a given price for a new vaccine that meets specified target requirements.

5. Also see Heller and others (2006) for fiscal policy issues with scaled-up aid; Gupta, Powell, and Yang (2006) for macroeconomic management with scaling up aid; and Bourguignon and others (2004, 2005) for a general dynamic equilibrium model for analyzing MDG strategies.

6. Based on a review of the PRS-budget link in nine poor countries, Renzio, Wilhelm, and Williamson (2006) find that policy making, planning, and budgeting are typically fragmented processes. To strengthen the PRS-budget link, they recommend accessing high-level support for policies, targeting PRS and budget processes on the actual decision making, and harmonizing existing planning and budgeting processes.

7. The ACGF is a multidonor trust fund with initial capital of $379 million from the UK. The first tranche of $56.8 million was received in the fall of 2006, and five ACGF projects with total projected disbursements of $148 million are under preparation. The Bank's Africa region is actively seeking other contributors to the ACGF, and several donors have expressed interest in contributing to the fund in fiscal 2007.

8. See OECD (2005b) for an analysis of earlier trends in ODA for gender equality.

9. The financial cost of reducing gender inequality is difficult to calculate, both because gender inequality is multidimensional and multisectoral, and because efforts to reduce it must necessarily work through multiple channels, not just those focused on gender. The task of collecting adequate data alone is expensive and difficult, which poses a challenge to countries in estimating the financial resources needed to achieve gender equity goals.

10. The nine agencies are the Australian Agency for International Development, Finland's Ministry of Foreign Affairs, the Norwegian Agency for Development Cooperation, the Swedish International Development Agency, the United Kingdom's Department for International Development, the International Labour Organization, the United Nations Development Programme, UN Habitat, and the World Food Programme. See Gender Mainstreaming Evaluations: An Assessment report discussed at the DAC-WB sponsored OECD DAC Gendernet meeting of November 2006. This section was completed with information from a number of donor members' of DAC Gendernet, including from Canada and the United States.

11. See individual country needs assessments and Grown and others (2006).

12. Health interventions include upgrading clinics with comprehensive prenatal, antenatal, and emergency obstetric care; providing vitamin, mineral, and nutrition supplements for mothers and children; sensitizing men to risks of STDs and providing service; managing malaria and anemia in pregnancy. Education interventions include literacy programs for women and provision of separate bathrooms for girls. Interventions in agriculture, infrastructure, and urban development include subsidizing home energy costs for female-headed households and building day care centers, shelters, and community centers.

13. The World Bank's Country Policy and Institutional Assessment rates countries against a set of 16 criteria grouped in four clusters: (1) economic management; (2) structural policies; (3) policies for social inclusion and equity; and (4) public sector management and institutions. Individual countries are scored on a scale of 1–6, with 6 being the highest.

14. The special circumstances of fragile states could influence the composition of aid.

15. This follows the analysis in Levin and Dollar (2005). The coefficient on the fragile state dummy shows whether this group of countries

receives more (i.e., the coefficient is positive and significant) or less (i.e., the coefficient is negative and significant) aid than would be predicted by the other explanatory variables in the regression equation.

16. Data presented here are preliminary estimates (as of March 1, 2007) and are being reviewed by the OECD/DAC Joint Venture on Monitoring the Paris Declaration. The data reflect implementation as of 2005 for donors that provided a grand total of more than $100 million for the government sector. A final report by that group is expected to be published by early April 2007. The broad trends are, however, expected to remain stable.

17. OECD DAC 2006a.

18. Last year's GMR detailed the following areas: the harmonization road map; the joint/collaborative assistance strategy; the common performance assessment framework; coordinated budget support; sectorwide approaches; joint diagnostic/analytic work; use of common arrangement; and the independent monitoring process.

19. World Bank 2006b.

20. OECD DAC 2007b.

21. Most aid for health programs is targeted to a particular program or disease, often reflecting the priorities and interests of foreign donors, as opposed to local residents, and these programs are seldom integrated into general public health systems. Moreover, by drawing resources away from other public health funding recipients, they often fail to improve the overall health of the population (see Garrett 2007).

22. Chapter 5 of the report presents donors' MDRI financing commitments against targets.

23. Multilateral Debt Relief Initiative (MDRI): Update on debt relief by IDA and donor financing to date (February 2007).

24. In September 2006, the two Boards decided to let the sunset clause of the Initiative take effect at end-2006 and to grandfather the countries that meet the income and indebtedness criteria at end-2004.

25. IMF-World Bank 2006a.

26. One of the major advantages of the OTRI over the more commonly used indicators of trade restrictiveness is that the OTRI takes into account the effect of nontariff policies on trade. While the OTRI estimates have been very robust to recent improvements to the methodology—which is well-established and directly related to generally accepted concepts in trade policy analysis—it is important to note that the existing data on nontariff policy is generally of lower quality than data on tariffs (less timely and less comprehensive). Thus, underlying data weaknesses may affect the accuracy of the OTRI for some countries. Greater investment by governments in support of the activities of the international trade agencies that compile the data on tariffs and, especially, nontariff measures, that feed into the OTRI estimates would improve their quality.

27. A deadweight loss is the loss in economic efficiency (consumer surplus) caused by policies that prevent agents from equating marginal costs to marginal benefits. The TRI is the uniform tariff that would provide the same level of welfare in the importing country as the existing tariff structure. It is calculated on tariffs only, because certain nontariff measures may be welfare enhancing. For a detailed discussion of the methodology used to estimate this index, see Kee, Nicita, and Olarreaga (2006).

28. This figure is comparable to the results from general equilibrium models, which suggest annual global welfare losses from protection ranging from $78 billion to $128 billion.

29. The OTRI is defined as the uniform tariff-equivalent that will yield the observed level of aggregate imports, which is determined by the prevailing set of tariffs and nontariff measures in a country. In addition to tariffs and specific duties, the OTRI includes all the nontariff measures reported in the UNCTAD TRAINS database as well as data on product standards compiled by the World Bank. Only data from publicly available sources are used. It should be recognized that the quality of data on NTMs is below that for data on tariffs, in terms of both comprehensiveness of coverage and timeliness (NTM data may not be updated annually).

30. Because the OTRI is designed to take into account the value of imports and the import demand elasticities at the six-digit level of the Harmonized System of commodity classification, changes in the OTRI may reflect not only changes in observed trade-related policies but also changes in import composition and import prices.

31. Calculations are based on the Market Access version of the OTRI (MA-OTRI). This measures the average level of restrictiveness in all importing countries that receive an export product of a country, keeping the aggregate exports of that country constant. For a detailed discussion of the methodology used to estimate this index, see Kee, Nicita, and Olarreaga (2006).

32. These estimates are based on the impacts of antidumping investigations on bilateral trade in

the affected products, controlling for other determinants of trade in a product between the exporting and the importing (imposing) country. This methodology focuses on the effects of investigations, not their outcomes, and therefore captures the potential "chilling" effect of the mere launching of investigations on trade flows.

33. The definitions and figures used here come from the OECD-DAC/WTO database on trade-related assistance. Figures refer to commitments. Trade policy and regulations include support for participation in multilateral trade negotiations, analysis and implementation of multilateral trade agreements, trade policy mainstreaming and technical standards, trade facilitation including tariff structures and customs regimes, support to PTAs, and human resource development in trade. Trade development activities include business development, activities aimed at improving the business climate, access to trade finance, and trade promotion, including at the enterprise and institutional level.

34. For a broader overview of World Bank and IMF activities on aid for trade, see IMF-World Bank (2006c).

35. The TIM seeks to assist IMF member countries in meeting balance of payments shortfalls that might result from multilateral trade liberalization. In addition to its regular policy dialogue on trade with member countries in the context of Article IV consultations and IMF-supported programs, the IMF has provided diagnostic support and policy discussions to member countries, as well as an increased focus on trade and trade facilitation issues in technical assistance for customs and tax reform.

36. Several regular, ongoing IMF arrangements support adjustment in the context of domestic trade reform. Thus far there has been no request for the incorporation of floating tranches related to trade adjustment in Fund arrangements.

37. The Integrated Framework for Trade-Related Technical Assistance (IF) is a cooperative interagency effort (involving the IMF, the International Trade Centre, UNCTAD, the United Nations Development Programme, the World Bank, and the WTO) supported by bilateral donors aimed at facilitating coordination of trade-related technical assistance to the least-developed countries and mainstreaming trade into national development and poverty reduction strategies.

38. The task force included Barbados, Brazil, Canada, China, Colombia, the European Union, Japan, India, Thailand, the United States, and the coordinators of the ACP (Africa, Caribbean and Pacific), African, and least-developed-country groups.

39. The task force also highlighted the need to address regional or cross-country aid for trade issues, where cooperation on trade-related projects could help promote the competitiveness of low-income countries in ways that purely national interventions could only do inefficiently or not at all. This issue had also been highlighted by the World Bank and the IMF, which put forward a range of proposals to address these concerns at their 2006 annual meetings. The Development Committee agreed on the need to improve existing instruments to address cross-country and regional projects and to strengthen the monitoring of regional initiatives and funding.

40. Particular attention is given to the EPA agreements becausee they concern many of the world's poorest countries, which are facing particular challenges in meeting the MDGs. Furthermore, EPAs have implications for implementation of existing preferential trade arrangements in Africa. Development of PTAs in other regions, notably Asia, is generally among the higher-growth middle-income countries.

41. For a fuller discussion, see World Bank, Global Economic Prospects 2005.