"Aid for Trade"
Increasing Support for Trade Adjustment and Integration – a Proposal

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Abstract

This paper looks at the case for additional support for adjustment to trade reform and integration. It reviews both the economic and political rationale for increased support. Moving ahead multilaterally on a non-discriminatory basis will do most to help development. Therefore a successful outcome to the Doha trade round remains important. However, the consequent trade reforms will, for some, require adjustment both to the economic and social costs and concomitant policy reforms. Taking advantage of improvements in market access will entail additional domestic policy reform to facilitate trade as well as trade-related capacity building. To date, promoting trade and investment within a country's national development strategy has been found to be "weak". In a "constrained environment for aid resources", trade-related issues have justifiably had to compete with priority sectors such as health and education. Securing a successful DDA will generate significant aggregate gains and relative to GDP both developed and developing countries stand to gain equally. A successful Doha round represents a powerful Global Public Good. In absolute terms developed country gains will be considerable. Seen in this context, against the potentially huge benefits arising, increasing support (representing a tiny increment of the likely gains) to facilitate trade, sustainable growth, and convergence of poor countries is a highly desirable win-win policy prescription. The paper considers various options for providing increased support and for improving aid effectiveness. In terms of the operational structure, this paper does not propose a new fund or mechanism but recommends building on existing structures and notably in line with the basic principles of the Integrated Framework (IF). The main purpose of the IF is to generate a broad-based policy agenda for trade and growth consistent with a country's development strategy, and to prioritise capacity building needs to which bilateral and multilateral donors respond. Increased resources should be provided either as project finance or budget support, and in both cases should be considered and disbursed in the context of a country's macroeconomic and development strategy. As such, issues relating to the absorptive capacity and likely exchange rate and competitiveness impact of larger aid flows can be taken into account - essential to any consideration to increase aid. A consortium of development partners, the IF links the IFIs with the UN system (trade development) and the WTO (trade rules). The basic principles of the Integrated Framework promote the "emerging new aid framework" which calls for greater donor "harmonisation" (both bilateral and multilateral) and for additional aid to be provided in the context of a country's overall development strategy and to support poverty reduction objectives. The Integrated Framework is also working to bring in other key stakeholders – notably the private sector.

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"Aid for Trade"
Increasing Support for Trade Adjustment and Integration – a Proposal

Summary and Conclusions

This paper looks at the case for additional support for trade adjustment and integration. A Doha reform package can be expected to generate sizeable gains to both developed and developing countries. However, the consequent trade reforms will, for some, require adjustment, both to the economic and social costs and to undertake concomitant policy reform. Taking advantage of improvements in market access will entail additional domestic policy reform to facilitate trade as well as trade-related capacity building. Strengthening "aid for trade" mechanisms to pursue this agenda would improve the development relevance of the WTO. To secure a successful multilateral trade agreement all partners must be able to benefit.

a. The case for support for trade adjustment and integration

In undertaking trade reform and to participate effectively in the global trading system, poorer countries are faced with a gamut of concerns and issues. These are both economic and political. On the economic side, for some there will be adjustment costs to preference erosion, and others may face a loss in terms of trade (notably for net food importers). Countries where tariff revenues make up a significant proportion of total fiscal resources may well need to undertake tax reform. Moreover the need for support goes well beyond dealing with adjustment to preference erosion and macroeconomic trade-offs. A fundamental issue is that for many developing countries (and notably the poorest) they are ill equipped to take full advantage of new trade opportunities because of significant supply side and human and institutional constraints. Improved market access without the capacity and transportation to sell isn't much use. Gains from trade liberalisation are conditional on an environment that allows the mobility of labour and capital to occur, that facilitates investment in new sectors of activity and also can provide the vulnerable with some assurance that they will be assisted if necessary. Inevitably for most poor countries this requires complementary reforms to be implemented prior to and in conjunction with the trade reforms.

On the political side, even accepting that trade is likely to generate global gains, the distributive and re-distributive dimensions of trade integration need to be taken into account if the political viability of the process is to be assured. Providing sizeable assistance has historically been of considerable importance in helping persuade countries of the benefits of integration. Liberalisation measures under the regional integration of Europe significantly helped to create a favourable economic environment that contributed to growth and welfare of the weaker member states. These policies were combined with substantial economic assistance and helped to shape positive popular perception of integration. The post-war Marshall Plan was instigated in large measure to "neutralise the forces moving Western Europe permanently away from multilateral trade" and to thereby facilitate global economic recovery.

b. Aid for trade – a "win-win" policy prescription

However, recognising the importance of the complementary policy set and the need for support for adjustment and integration to achieve successful trade reform in low-income economies, does not imply that a new multilateral trade agreement should be any less ambitious or deliberately slowed – indeed the reverse is true. Moving ahead multilaterally on a non-discriminatory basis will do most to help development. Trade reform undertaken

in conjunction with the concomitant policy reforms has significant potential to generate additional trade opportunities that would lift a large number of people out of poverty and increase economic convergence.

Seen in this context supporting trade adjustment and integration requires a shift towards more efficient transfer/assistance mechanisms with support directed at priority areas defined in national development plans and strategies. However what takes place in practice tends not to support this policy prescription. To date promoting trade and investment within a country's national development strategy has been weak. Recent reviews of PRSPs (poverty reduction strategy papers) continue to indicate that the productive sectors and the growth agenda receive limited attention.

However, bilateral donors and multilateral organisations that ask developing countries to produce PRSPs, have a responsibility to ensure that policy choices including trade policy are discussed widely. When developing countries choose to make trade a part of their development strategies, donors should ensure that support is provided to enable developing countries to respond to the opportunities which trade liberalisation and integration can bring.

Securing a successful DDA will generate significant aggregate gains. The overall magnitude of gain is difficult to assess accurately and will depend on various liberalisation scenarios and other factors. From the research available, even under the most conservative estimates, the aggregate global gains will be enormous. Relative to GDP the gains between developed and developing countries will be relatively evenly split. However, in absolute terms developed countries would gain economically even more than developing countries. This would provide the means to engage in increased support and development assistance.

An expanded allocation of aid to support trade integration can also help gradually to eliminate the current system of highly discriminatory trade preferences and strengthen a policy bias towards MFN liberalisation and away from preferential trade agreements. Preferences create perverse incentives to resist the global MFN-based reforms that are critical for the non-or less-preferred developing countries.

c. Options to increase support

The distribution of gains from trade liberalisation is multifaceted. They accrue to consumers and producers, improve corporate performance, and will generate higher tax revenues to governments arising from higher economic growth. These sizeable gains offer the opportunity for donor countries to provide genuinely additional assistance to help meet adjustment and integration needs in developing countries. Some of the options considered in this paper include direct additional contributions from ODA budgets; leveraging future aid commitments through an International Finance Facility type mechanism; increasing private sector partnership/engagement; an asymmetric low trade levy on negotiated tariff line reductions; capturing an increment of the consumer gain (temporary levy on specific products); reallocation of subsidies and income support for development assistance and improving aid delivery (getting more from existing resources).

Of all the options the simplest and arguably the best approach to ensuring more aid flows to where it is needed would be for donor countries to increase their aid budgets. However, rapidly increasing aid budgets may for many countries be fiscally and politically difficult to undertake. No attempt is made in this paper to favour one option above any other (including proposals on international taxation, referenced but not covered in this paper).

What is important is recognition of need (additional resources for trade adjustment and integration) against the potential global benefits arising from further multilateral liberalisation. These options do not imply direct earmarking of revenues – they are examples of ways through which countries can link the aid and trade agendas by committing additional assistance on the basis of expected trade reform-related net gains.

d. An effective support mechanism

Assuming agreement in principle to provide increased support "aid for trade" to developing countries, equally relevant to the decision is to ensure that funds are effectively managed and utilised. Options for trade support need to be considered within the emerging "new aid framework" to make aid more effective. Aid management and implementation practices need to continue to shift toward stronger alignment with country policies and programmes, and increased harmonisation (of bilateral and multilateral efforts).

With respect to trade support, two issues are particularly pertinent in considering the operational structure. Firstly no one agency has effective authority to respond to all the needs for trade adjustment and integration, and therefore a system needs to be designed to harmonise more carefully existing processes around a country's development plans. Secondly, providing resources for adjustment and integration to benefit from a multilateral trade round requires greater coherence between the development needs of countries which are largely supported by the IFIs and other development agencies (trade development) and the WTO rules based system that provide substantial cross-border externalities.

The proposal is not for a new fund or mechanism but to build on existing structures and notably in line with the basic principles of the Integrated Framework (IF). The main purpose of the IF is to generate a broad-based policy agenda for trade and growth consistent with a country's development strategy and to prioritise capacity building needs to which bilateral and multilateral donors respond. The IF conforms to the new aid framework. It brings together the main multilateral providers of trade-related support and assistance and also provides a more coherent approach for bilateral donors to work together. To a large extent the IF relies on the consultative group and round table pledging sessions associated with the PRSP and development plans of countries to implement adjustment needs and capacity building (**Box 1**). However, trade and investment activities within the PRSPs have to date had to compete with other priority sectors and progress has been relatively limited. Indeed without additional assistance, over time while the value of embedding trade policy within the context of the PRSP is understood, with little additional support, developing countries will rightly question the efficacy of the programme to provide a more enabling process of integration into the global trading system.

The proposal would be to increase available support to provide a sustained effort to prepare, articulate and identify a coherent (multi-year) trade integration programme in country and within the context of the country's development process. Additional support would also be made available to help meet the identified trade related adjustment and capacity building needs. These resources would be made available at the time of the consultative group/round table pledging sessions. This would allow for continued coordination of assistance between donors and thereby avoid duplication. It would also help overcome concerns related to the absorptive capacity and competitiveness impact of higher aid flows to support poverty reduction objectives. Countries could decide whether to use resources for specific projects identified within the prioritised list of trade-capacity building needs or for direct budget support in case of loss of fiscal revenue and social adjustment costs (**Boxes 2** and **3** provides a schematic diagram).

"AID FOR TRADE"
INCREASING SUPPORT FOR TRADE ADJUSTMENT AND INTEGRATION
- A PROPOSAL

I. Introduction

This paper looks at the case for additional support for trade adjustment and integration. A Doha reform package can be expected to generate sizeable gains to both developed and developing countries. However, the consequent trade reforms will, for some, require adjustment, both to the economic and social costs, and to undertake concomitant policy reform. Taking advantage of improvements in market access will entail additional domestic policy reform to facilitate trade as well as trade-related capacity building.

"Aid for Trade" has become an important element in current discussions in the WTO on special and differential treatment (SDT). Strengthening support to ensure promises of assistance are forthcoming and undertaken within a coherent policy framework could assist in the negotiating dynamics and development relevance of the WTO.[2] Importantly, an expanded allocation of aid to support trade on a multilateral basis can also help to overcome the current system of highly discriminatory trade preferences. Moving ahead multilaterally on a non-discriminatory basis will do most to help development. In addition a distorted global trading system compromises development assistance elsewhere. Improved market access on an MFN basis may well reduce the need for assistance notably by some large middle-income economies.

To date, promoting trade and investment within a country's national development strategy has been found to be "weak". In a "constrained environment for aid resources", trade-related issues have justifiably had to compete with priority sectors such as health and education. Providing support for trade adjustment and integration should be "additional" to assistance currently available and the huge benefits arising from a successful multilateral trade round should make this possible.

Section II outlines the rationale (both economic and political) for proposing additional support for trade adjustment and integration. Section III identifies the potential gains from multilateral trade liberalisation to both developed and developing countries. It reviews how trade and investment policies are addressed within developing country strategies as well as existing support for trade reform and integration. It suggests that resources are inadequate, that increased support for trade reform and integration will benefit not only the recipient country, but also the global economy as a whole and such resources should be genuinely additional to existing aid budgets. Section IV discusses various options to leverage additional support. It also reviews efforts to increase aid effectiveness by improving coherence and co-ordination in trade related assistance.

Equally important to a decision to provide additional support to developing countries, is the need to ensure that funds are effectively managed and disbursed as intended. The operational structure of support needs to be in line with the "emerging new aid framework". This calls for greater donor "harmonisation" (both bilateral and multilateral) and for additional support to be provided in the context of a country's overall development strategy.

[2] More than half of the 88 SDT proposals made by developing countries to improve and make more effective the provisions for developing countries within the WTO relate to adjustment and capacity building needs, concerns over preference erosion, and issues relating to policy coherence.

Section V assesses a possible operational framework and how it can be integrated into the existing trade, development, and financial architecture. Section VI summarises.

II. The Case for Support for Trade Adjustment and Integration

The net effect of multilateral liberalization envisioned under the Doha round is estimated to provide for significant global gains accruing to both developed and developing countries. However negotiations under the WTO's Doha round will involve deeper commitments under a broad range of issues. The consequent trade reforms will therefore require adjustment, and taking advantage of improvements in market access will require developing countries to undertake behind the border policy reform and capacity building. Current trade negotiations and the empirical evidence have brought to the fore the debate on the need to address adjustment costs and support for trade integration arising from a Doha round agreement. The following draws on the existing literature and briefly reviews both the economic case as well as the political economy issues for additional support.

a. The Economic Case For Support

i) Impact of Preference Erosion

Preferential access has become a key issue on the Doha Agenda. This reflects in part an increasing dissatisfaction by those countries that are excluded from preferences accorded to other countries and in part fears of the impact of MFN liberalisation on the preference margins currently received by some developing and the least developed countries.

The real costs of preference erosion can include a range of factors, and can in fact be less than the notional preference margin; this includes actual utilisation, which has on the whole been relatively limited (*UN Millennium Project, 2004*)) and the extent to which any rents actually accrue to producers in the poorest countries. Preferences often apply to highly protected sectors in donor countries, resulting in high rents that are predominantly captured by importers (distributors, retailers distribution subsidiaries of producers) (*Tangermann, 2002*)[3].

The evidence appears to suggest that preference erosion is a significant economic issue for only a limited number of countries. Importantly most of these countries are not the poorest countries, but middle-income economies. Erosion of all preferences, both GSP and the deeper more recent preferences such as EBA and AGOA, as a result of MFN Doha reforms, would have a substantial impact on some countries, especially those with high concentration of exports in heavily protected commodities. However the number of countries in this position is small (*IMF 2004, Alexandraki and Lankes 2004*). The problem is heavily concentrated in small island economies dependent on sugar, bananas and to a lesser extent garment exports (**Table 1**). These are the commodities where protection and therefore preference margins are high. Preference dependent or sensitive countries include Mauritius, Malawi, Mauritania, Cambodia, Maldives, Haiti, Cape Verde, Sao Tome, Tanzania, and the Comoros (*Stevens and Kennen, 2004*). The limited number and small size of most of the economies concerned imply that measures to help mitigate the impact of preference erosion can be closely targeted at the countries at risk (*Alexandraki and Lankes, 2004*). The only large country expected to suffer from preference erosion is

[3] Francois and Hoekman (2005) estimated that under utilization of preferences was 4 percent on average thereby reducing the magnitude of erosion costs significantly. For those products where preferences are used, the primary negative impact follows from erosion of EU preferences.

Bangladesh, which has benefited significantly from the textile quota restrictions imposed on other large competitive developing countries such as China, which are due to be removed at the end of 2004 under the WTO Agreement on Textiles and Clothing.

Importantly the costs of preference erosion also need to be set against gains from MFN liberalisation – both for the recipient country and other developing and least developed countries. Available evidence suggests that preference erosion is unlikely to be a major issue for many countries once the compensatory effect of broad-based multilateral liberalisation is taken into account (*World Bank*, 2003). Under a variety of different scenarios, developing countries would receive tens of billions of dollars in welfare gains from an across the board reduction in MFN rates. For example a 50 percent reduction in agricultural and industrial tariffs would potentially yield welfare gains of US$ 28 billion for developing countries, more than nine times the loss associated with the complete removal of GSP schemes (*Lippoldt and Kowalski*, 2003)

ii) Net Food Importers

The reduction in tariffs, domestic support and export subsides for agricultural products (notably by developed countries) that would arise from a successful trade round would impact other countries largely through higher international prices of previously protected and supported products. Net exporting countries would benefit from an increase in international prices and would export more while net food importers by contrast would generally lose by paying higher prices for their agricultural imports. Within these countries, liberalisation would have opposite effects on different groups, benefiting producers and hurting consumers. On balance, for the net food importers the consumer losses would outweigh the producer gains, so overall they would be worse off. For the net exporting countries, the producer gains would outweigh the consumer losses.

Research indicates that although agricultural trade liberalization would not raise import costs in the case of all net food importing countries[4], a number of countries, mainly in the Middle East and North Africa, and small island economies that must import significant quantities of agricultural goods would be "hurt by liberalisation" and notably by liberalisation of grains (wheat and maize), (*Eiteljorge and Shiells,* 1995, *Tokarick* 2005).

Undoubtedly, as is the case for countries that will be affected by preference erosion, attention (both financial and policy support) will need to be paid to the small number of poor countries that could see sizeable increases in their import bills. However these costs should not deter progress in liberalising agricultural commodities. Again such costs need to be considered in the context of the gains from broad based MFN liberalisation. If for example industrial countries were to remove support to their cotton sectors, this would raise the world price of cotton and increase the export earnings of many poor countries in West Africa and Central Asia that are net exporters of cotton. This would offset some of the increase in food import costs borne by these poor countries following liberalisation of food products. Benin, Burkina Faso, Côte d'Ivoire, Mali, Pakistan, Syria, and Uzbekistan would benefit from particularly large gains in export revenues from liberalisation of cotton. (*Tokarick,* 2005)

[4] 79 countries are designated as net food importers by the World Trade Organisation (WTO)

iii) Macroeconomic trade-offs and adjustment

Trade liberalisation implies a reduction and unification of tariffs and relaxation of quantitative restrictions likely to result in larger reductions in barriers to imports than to exports. At fixed exchange rates this may well lead to higher trade deficits and perhaps balance of payments difficulties. Consequently trade measures may need be accompanied or supported by currency devaluation and domestic tax reform. Currency devaluation has consequences for inflation and stabilisation and may reduce tax revenue further. In terms of devising a programme of trade liberalisation, policymakers need to take into account the relationship between trade liberalisation, the exchange rate and tax revenues.

On revenues, the evidence tends to suggest that tariff revenues depend on the structure of the tariff and customs regimes. Recent empirical research has confirmed that trade taxes amount to between one-quarter and one-third of total tax revenue in some low- and middle-income developing countries. (*IMF* 2004, *Commission for Africa Report* 2005)[5]. Sequenced policy is important to overcome difficulties in countries where tariff revenues constitute such a high component of total public sector resources (this applies particularly to low income countries). However, appropriate fiscal measures can more than offset the erosion of trade taxes and include the following, moving towards a more uniform tariff structure, eliminating exemptions, improving the administration of tariffs and taxes and strengthening domestic taxation (*Ebrill et al, 1999, Tarr 2002*). Through timely and complementary fiscal reform programmes, middle-income developing countries as well as several low-income developing countries (e.g. Pakistan and Uganda) have largely succeeded in recovering tax revenue lost from reducing trade taxes. Their experience tends to suggest that reform of the domestic tax system should be undertaken in parallel with trade reform – and not necessarily delayed until afterwards – thereby increasing the credibility of the liberalisation process and reducing the likelihood of a reversal. Generally as with trade reform, revenue recovery requires a committed and continuous effort to broaden the tax base by eliminating exemptions, simplifying rate structures and improving administration and strengthening domestic consumption taxes such as excise taxes or VAT (*IMF,* 2004).

An appropriate real exchange rate to ensure export competitiveness is important and a real depreciation may be necessary to underpin successful trade reform (*World Bank, 2001*). Domestic price inflation and an exchange rate that is seriously over-or undervalued or particularly volatile, will distort the relative price signals that are critical for taking advantage of a period of trade liberalisation to reallocate resources more efficiently into the tradable goods and services sectors of an economy (*WTO,* 2005). A competitive and stable real exchange rate and domestic price stability underpin investor confidence in establishing a long-term export capability and ensure that producing tradable goods and services can be profitable and remains so over time. Inconsistent or erratic macroeconomic policies can reduce the credibility of the reform programme and lead to a reversal in trade policy as a result of political resistance (*Bacchetta and Jansen,* 2002). An over appreciation of the exchange rate is liable to lead to lower overall tax revenues and consequently trade liberalisation needs to be accompanied by appropriately supportive monetary policies to preserve the tax yield (*Agbeyegbe et al, 2004*).

The vast theoretical and empirical literature on this subject is sufficiently clear. Costs associated with the design and implementation of appropriate (compensating) tax, monetary and exchange rate policy are temporary, but the gains they induce through an

[5] Recent estimates suggest that on average trade tax revenues accounted for around 4 percent of low and middle-income countries' GDP in 1995-2000 while the equivalent estimate for high income was below one percent. If totally abolished then low income countries would have to replace on average around 18 percent and in some cases about 50 percent in revenues from other sources other than import duties (*Kowalski, 2005*).

improved allocation of resources are permanent and significantly higher than the temporary costs. From an economic standpoint, these costs should not be seen as an obstacle to liberalisation but as a necessary investment for longer-term gains (for a comprehensive review of the literature see *OECD, 2004*).

iv) Trade reform necessary yet not sufficient

The need for explicit support for compensation-cum-adjustment and integration goes well beyond dealing with adjustment to preference erosion and macroeconomic trade-offs. The empirical evidence is clear - no country has developed successfully by turning its back on international trade and long-term capital flows; equally part of the benefits of trade liberalisation depends on other policies and institutions being supportive (*Malhotra et al*). While the linkage between trade openness, growth and poverty reduction may represent an econometric challenge, arguably "it is not a policy problem" *(Berg and Krueger, 2003)*. What the evidence does suggest is the need to place trade reform in the broader context of a country's development strategy that will allow a gradual opening to imports and foreign investment as the complementary behind the border institutional and social structures are put in place.

Gains from trade liberalisation are conditional on an environment that allows the associated movements of labour and capital across sectors to occur, that encourages the needed investment in new sectors of activity and that provides the vulnerable with some assurance that they will be assisted if necessary. Insofar as these conditions are not met, complementary reforms need to be implemented prior to and in conjunction with the trade reforms. Policy needs to be designed to offset to the extent possible any major negative impacts global reform may have on a substantial part of the more vulnerable in society. Some governments will have the capacity to redistribute some of the local gains, while others may confront much greater constraints (*UN Millennium Project, 2004*).

Social protection: In low-income countries in particular social insurance and adjustment assistance mechanisms may not exist or be weak; if they exist they may provide only partial compensation for adjustment-related losses incurred by workers/households. There may also be reasonable doubts regarding the creation of new employment opportunities, especially in environments characterised by very weak investment climates. This reality makes complementary reforms to increase the likelihood of realising the benefits from trade reforms particularly important. The same is true for understanding the effects of trade liberalisation on poverty. Aside from the obvious moral imperative, ensuring that trade reforms will help achieve poverty reduction goals is important to facilitate broad ownership of reforms, thereby making them more sustainable.

*Transportation and trade-related infrastructure:* A fundamental issue is that for many developing countries (and notably the poorest) they are ill-equipped to take full advantage of new trade opportunities because of significant supply-side and institutional constraints *(IMF/World Bank, 2005)*. Improved market access without the capacity and transportation to sell isn't much use. Around forty Diagnostic Trade Integration Studies (DTISes) have been conducted to date or are in the pipeline for 2005. These studies have been undertaken under the auspices of the Integrated Framework for LDCs as well as similar assessments for other developing countries[6]. These studies include a comprehensive examination of both internal and external barriers to trade. In general they find that internal,

[6] The Integrated Framework is a multi-donor and agency initiative to assess a broad based trade and investment agenda providing prioritised policy and capacity building recommendations and needs within the context of a country's development strategy. The IF brings together six multilateral agencies including the IMF, ITC, UNCTAD, UNDP, World Bank, and the WTO. For more details see Section IV and the IF website www.integratedframework.org

supply-side problems and weak trade facilitation institutions represent the largest constraints to integration, rather than market access barriers in industrial countries *(World Bank, 2005, Schuler, 2005)*.

A theme of virtually all DTISes is that transportation and border clearance bottlenecks raise the cost of both exports and imports by more than do formal trade policies (e.g. limited storage facilities at the railhead in Lesotho). Exporters in landlocked countries often find their shipments held up at roadblocks in transit countries (e.g. Kyrgyz truckers are stopped by traffic police and environmental inspectors throughout Kazakhstan). Recent research by UNCTAD estimates that international transport costs for imports of landlocked African countries account for an average of 20.7 percent of the value of their imports, compared to the world average of 5.1 percent and the average for African countries of 12.7 percent. UNCTAD notes that access to frequent reliable and low-cost regular liner shipping services largely determines a country's connectivity to overseas markets and thus also its competitiveness in global markets *(UNCTAD, 2004*). Similar work by the World Bank (2004), suggests that for the majority of U.S. trading partners, transport costs outweigh tariff barriers. Countries in Africa normally absorb all or most of their own transport costs of exporting. Africa's net freight and insurance payments in the 1990s were about 15 percent of the total value of the region's exports and for Africa's landlocked countries the figure was 40 percent. For developing countries as a whole, the equivalent figure is nearer 5 percent, implying that in order to be competitive an average producer in Africa has to be 10 percent more efficient than firms of other developing countries, and 35 percent more efficient if the producer is in a landlocked African country *(World Bank 2001).*

<u>Complementary policy reform</u>: The list of beneficial concomitant reforms can be long – but most of the policies are essentially "additive" to those of trade liberalisation in the sense that they do not give rise to trade offs. Moreover, there is also evidence that openness can actually induce improvements in other policy dimensions. Aside from the importance of sound macroeconomic management and the effective provision and adequacy of social safety nets, policy action to ensure that markets continue to function or develop where required may be necessary (*Winters, 2002*). Internal reform to reduce and remove as far as possible internal constraints is a valuable companion to the process of external liberalisation.

The regulatory environment can generally discourage investment and therefore the reallocation of resources necessary for an economy to benefit fully from trade liberalisation. The findings from the DTISes indicate that trade cannot play much of a positive role if the macroeconomic climate is unstable and the business environment is hostile *(World Bank, 2005).* (For example the Burundi DTIS highlights a number of problems with the commercial and investment codes. The Benin DTIS identifies poorly defined property rights and inadequate contract enforcement institutions as deterrents to both foreign and direct investment).

Action matrices of the DTISes routinely identify customs modernization as a key technical assistance need. Complicated and costly customs clearance procedures, complex and non-transparent administrative requirements, high costs of processing information on goods and services crossing borders and uncertainty about the enforceability of legal trade documents are all regarded as being high on the list of problems that can add significantly to the transaction costs of engaging in international trade *(WTO, 2005, Commission for Africa Report, 2005).*

The *World Bank (2005)* has attempted to measure the benefits of carrying out investments and reforms to four separate aspects of trade facilitation: port efficiency, the customs environment, the regulatory environment, and trade-related services infrastructure. The research estimates the potential increase in trade for 75 countries, following improvements in each of these areas. (The improvements assumed would raise the efficiency of trade facilitation in below-average countries halfway to the average for the whole set of developing countries). Even with such modest improvements the findings suggest that better trade facilitation would increase trade among the 75 countries by about 10 percent, or $377 billion. Of this total $116 billion would result from improved customs and regulatory environments, $107 billion from more efficient ports, and $154 billion from enhancing infrastructure in the trade-related services sector[7].

b. The Political Economy Case for Support

Even accepting that trade is likely to generate global gains, the distributive and redistributive dimensions of trade integration need to be taken into account if the political viability of the process is to be assured (*Verdier, 2004*). Simply pointing to the growth induced by trade and investment openness and the implied aggregate welfare gains will not be enough to make trade acceptable to critics of global integration.

Providing sizeable assistance has historically been of considerable importance in helping persuade countries to adopt more democratic, open market oriented systems. Liberalisation measures under the regional integration of Europe significantly helped to create a favourable economic environment that contributed to growth and welfare. As explained by *Wolf (2004)*, the European Union provides a system of “jurisdictional convergence”. Members are obliged to accept freedom to trade, migrate and move capital. In exchange the EU has provided an “extraordinarily successful machine” for the poorer members to integrate and converge with the richer states, from Italy in the 1950s and 1960s to Greece and Ireland in the 1980s and 1990s and no doubt will continue to do so for the 10 new members. These policies were combined with economic assistance to the weaker countries and regions (through the Structural and Cohesion Funds – accounting for around 35 percent of the total EU budget) and helped to shape positive popular perceptions of integration (*Sapir, 2000, Tsoukalis, 2003*). The post-war Marshall Plan was instigated in large measure to “neutralise the forces moving Western Europe permanently away from multilateral trade” (*Foreman-Peck, 1983*) and to thereby facilitate global economic recovery. In the period 1948 to 1952 around $13.0 billion was made available, representing several percentage points of US GDP (*Price, 1955*)).

[7] These benefits compare very favourably with the cost of undertaking reform; for Armenia $1.6 million, for Lebanon £3.82 million, for Tanzania $8-10 million, for Tunisia $16-21 million (*Finger and Schuler, 2005*)

III. "Aid for Trade" – A "Win-Win" Policy Prescription

The previous section highlighted the adjustment and integration needs of low-income countries to undertake further trade liberalisation and benefit from improved market access arising from a global trade round. This section briefly identifies the potential gains from multilateral trade liberalisation to both developed and developing countries. It reviews existing practices to promote trade and investment in national development strategies and to provide assistance to meet adjustment and trade-related capacity needs. It suggests that existing practices and resources are inadequate, that increased support for trade reform and integration will benefit not only the recipient country, but also the global economy as a whole. Increased support should be genuinely additional to existing aid budgets.

(a) The potential gains from further multilateral trade liberalisation

Estimates of the gains from liberalisation vary according to the assumptions used. *Anderson (Copenhagen Consensus Report, 2004)* provides a comprehensive overview of research undertaken. **Table 2** provides a summary of this research showing the comparative static estimates of economic welfare gains from a full and a 50 percent multilateral liberalisation of goods and services trade. For example, the World Bank (2003) has estimated gains from liberalisation of goods trade (services are not included) as US$ 355 billion for the world as a whole and US$ 184 billion for low and middle-income countries in 2015 in 1997 dollars. After full adjustment to a 50 percent reform the unweighted average of the highest and lowest estimates provides a comparative static gain of 1.8 percent of GDP for the world as whole (1.6 percent and 2.5 percent for developed and developing countries respectively (*Anderson, 2004*)).

Moreover these estimates ignore possible dynamic productivity gains, exploitation of economies of scale, benefits from improved competition and liberalisation of trade in services, including greater temporary international mobility of service suppliers. Taking these factors into account greatly increases the potential aggregate gains *(Global Monitoring Report, 2005).* For example, estimates of global gains from deep liberalisation that includes induced productivity effects and services liberalisation exceed $1 trillion (*Anderson, 2004, Anderson et al 2005, Bergsten, 2005)* and range up to $2.1 trillion *(Brown, Deardorff and Stern, 2003).*

Even allowing for economic costs associated with reform and also associated social and environmental benefits and costs, the impact of further trade reform remains sizeable. **Table 3** (source *Anderson, 2004*) summarises the overall net benefits from halving subsidies and trade barriers (optimistic Doha) and for a pessimistic Doha outcome of a 25 percent liberalisation, assuming proportionately higher (lower) costs of adjustment when the reform is greater (smaller).

Even under the most conservative estimates – i.e. believing that the probability of a successful Doha round is low; that it might take a number of years to complete; beyond 2010 before full implementation; that the reduction in subsidies and trade barriers will be considerably less than 50 percent; and that the dynamic gains would boost GDP growth rates by less than one-sixth for developed countries and one-third for developing countries. The net present value estimates are still enormous, both absolutely and relative to the cost associated with reform. Moreover the benefit would be even larger if the counter factual was not the status quo but a rise in protectionism and a decline in the WTO institution and the rules-based global trading system it supports.

Consequently while the overall magnitude of gain is difficult to accurately assess, the research is very clear - further trade liberalisation on a multilateral basis will bring enormous gains. Nevertheless as already discussed the extent to which such gains can be realised in practice and notably in low-income developing countries depends importantly on the complementary policy actions being taken to improve the investment climate, trade-related capacity building and the need to meet adjustment costs. This "behind the border" agenda will require additional support and resources. Given that in absolute terms developed countries would gain economically even more than developing countries from multilateral trade liberalisation, this would provide the means to engage in even more support and development assistance and FDI and thereby to further reduce global income inequality and poverty (*Anderson, 2004*).

(b) Promoting trade and investment in national development strategies

Recognising the importance of the complementary policy set necessary to support successful trade reform in low-income economies does not imply that multilateral trade reforms should be any less ambitious or deliberately slowed – indeed the reverse is true. Moving ahead multilaterally on a non-discriminatory basis will do most to help development. (*Hoekman and Winters, 2004*). Global trade reforms have significant potential to generate additional trade opportunities that could lift a large number of people out of poverty, in the process helping to achieve the Millennium Development Goals. Relative to the status quo (no multilateral reforms), World Bank research suggests an additional 140 million people could be lifted out of extreme poverty as a result of an ambitious set of Doha-WTO reforms. If Africa, East Asia, south Asia, and Latin America were each to increase their share of world exports by one percent, Oxfam estimates that the resulting gains in income could lift 128 million people out of poverty. In Africa alone this increase in trade would generate $70 billion, approximately five times what the continent receives in aid.[8] However the poverty impact of trade reform and increasing export performance is highly conditional on complementary actions being taken in poor countries to support the needed integration response and adjustment. The research also suggests that a less ambitious set of reforms – e.g. a 40 percent average cut in bound tariffs that does little to lower applied tariffs in developing countries, continued protection of agriculture in the OECD plus limited action on services and trade facilitation – will generate disproportionately smaller benefits for the poorest countries, if any. Indeed, a Doha reform package that entails low-income countries not doing anything to improve their policy regimes may result in lower real incomes in many of these countries – i.e. be anti-development (World Bank, 2003).

Seen in this context, supporting trade adjustment and integration requires a shift towards more efficient transfer/assistance mechanisms with support directed at priority areas defined in national development plans and strategies and clear accountability on the delivery of assistance (*Hoekman and Winters, 2004*). What takes place in practice however, tends not to support this policy prescription. To date promoting trade and investment within a country's national development strategy has been weak. Recent reviews of PRSPs (poverty reduction strategy papers) continue to indicate that the productive sectors and the growth agenda receive limited attention. Trade concerns, when they are expressed in PRSPs, do not necessarily result in trade-related investments (*OED, World Bank, Nov. 2004, CAPRA 2003, ODI and Christian Aid, 2003*). Reviews of HIPC countries stressed that this is in part because investment needs for trade compete with other much needed country-level investments in such areas as health and education,

[8] House of Commons, International Development Committee, UK, Seventh Report of Session 2002/03, Trade and Development at the WTO: Issues for Cancun, p7 (citing Oxfam's written submission to the Committee's inquiry)

which donors have been actively pressing developing countries to undertake (*OED, World Bank, 2004*). At the same time, overall aid and rates of investment have not been growing in the least developed countries. Although recent trade programmes (most notably the Integrated Framework) have significantly contributed to raising awareness of trade issues within the key multilateral agencies, donors and in client countries, commitments to trade-related assistance and capacity building still remain low and many countries need additional resources to implement the recommendations of the trade integration strategies.[9]

However, bilateral donors and multilateral organisations that ask developing countries to produce PRSPs, have a responsibility to ensure that policy choices including trade policy are discussed widely. When developing countries choose to make trade a part of their development strategies, donors should ensure that support is provided to enable developing countries to respond to the opportunities which trade liberalisation can bring. The issue is not "trade or aid" but rather, "how can aid be provided so that it enables countries to translate opportunities to trade into economic growth and poverty reduction". *(Hudson, 2005).*

(c) "Aid for Trade" – A "win-win" policy prescription

Realisation of an ambitious multilateral trade round and addressing the capacity priorities in poor countries calls for more to be done *(Global Monitoring Report, 2005*). Not only will the associated trade and related reforms give rise to adjustment costs, but to enhance the benefits to poor households in poor countries, as discussed in Section II, investments are needed to facilitate trade. To secure a successful multilateral trade agreement all partners must be able to benefit. Poorer countries will need support if they are to overcome their fears, cope with adjustment and take full advantage of the opportunities of open trade *(Lankes, 2005)*. As noted by Ricupero *(2005)* the United States for more than 40 years has had a Trade Adjustment Act to complement major trade negotiations. The most recent version, adopted in 2002 together with the Trade Promotion Authority, "earmarked millions of dollars to spend on retraining, education, health insurance and pension benefits. If the most competitive economy in the world considers support an indispensable tool of trade liberalisation, would it not make sense for the international community to envisage a similar multilateral aid program for the countries that lack the resources internally?"

The Doha Declaration confirmed that 'technical co-operation and capacity building are core elements of the development dimension of the multilateral trading system', and recognised that 'sustainable financed technical assistance and capacity building programmes have important roles to play'.[10] Arguably by recognising the need to address the implementation and supply side needs of developing countries, this has advanced the development dimension of the multilateral trading system *(Ismail, 2005)*.

[9] The WTO and OECD secretariat have combined to create a Doha Development Agenda Trade Capacity Building Database. According to information provided by 39 bilateral donors and multilateral agencies in the two year period 2001/02, 177 developing countries received some assistance in trade policy (amounting to US $720 million) and 163 developing countries received assistance in trade development of US$1.4 billion) – i.e. around $1.1 billion per annum spread over some 170 countries. Activities were heavily concentrated. Five countries (China, Indonesia, Thailand, Uganda, and Vietnam) received over 150 activities (*WTO/OECD 2003*). Africa received just 20 percent of trade policy support (some $150 million), the bulk of which went to Uganda.

[10] Doha Mandate, para. 2 and 38. The WTO July 2004 General Council Decision (Framework Agreement) went further and calls for 'developing countries and in particular least developed countries to be provided with enhance trade-related and technical assistance and capacity building to increase their effective participation in the negotiations, to facilitate their implementation of WTO rules and to enable them to adjust and diversify their economies…. And special attention shall be given to the specific trade and development related needs and concerns of developing countries, including capacity constraints'.

The large differences between WTO members in terms of resource capacity constraints and national trade policy and investment priorities affects the ability and willingness to incur the costs associated with implementation of WTO rules, as well as the net benefits of doing so *(Hoekman, 2004).* To balance these tensions, WTO agreements include a gamut of provisions (Special and Differential Treatment (SDT)) to try and take account of developing country concerns. SDT broadly includes preferential access to industrial country markets, longer implementation periods and limited reciprocity "consistent with development needs" of WTO agreements, and best endeavour commitments to assistance. However, both developed and developing countries consider that existing provisions have not been that beneficial. Utilization of preferences has been relatively low, largely as a result of exemptions, narrow rules of origin and limited supply capacity. Broad opt-outs and limiting reciprocity of WTO agreements are controversial as an appropriate policy instrument to provide an enabling process of integration and as discussed assistance to support adjustment and integration has not been meaningfully forthcoming.

Developing countries have put forward over 80 proposals to improve the operational effectiveness of SDT. Over a half of these relate to adjustment costs, capacity building needs, the impact of preference erosion and to net-food importers, and policy coherence. The fundamental issue that largely drives these proposals by low-income countries is a recognition that a multilateral agreement (jurisdictional obligation) to liberalise trade simultaneously requires a credible commitment to provide resources to address adjustment concerns and enhance supply capacity. Additional resources provided within the context of a country's development strategy will in turn offer the greatest potential to promote economic convergence and poverty reduction.

An expanded allocation of aid to support trade integration can also help gradually to eliminate the current system of highly discriminatory trade preferences and strengthen a policy bias towards MFN liberalisation and away from preferential trade agreements. Preferences are inefficient mechanisms to transfer resources to poor countries: the cost to consumers and taxpayers in OECD nations is a multiple of any transfer realised, and benefits are reduced by rules of origin and the exercise of market power by retailer/importers.

Preferences also create perverse incentives to resist the global, MFN-based reforms that are critical for the non- or less-preferred developing countries. The price of defending preferences is continued protection in rich countries. Importantly, a distorted global trading system compromises development assistance elsewhere. For example, Argentina is estimated to gain by $2 billion per annum should the EU liberalise agricultural import tariffs and export subsidies, equivalent to one percent in its living standards (*Hoekman and Martin*, *1999*). This represents a high percentage (around 30 percent) of Argentina's present net external interest payments. In terms of impact on poverty, both national and foreign trade reforms can significantly reduce poverty in Argentina. However, foreign reforms are more important than domestic reform in terms of poverty impact (*Porto, 2004*). Given this, MFN liberalisation-plus appropriate support for adjustment and integration for those countries that may suffer problems – is a better path. Aid (rather than preferences) is a more efficient instrument to provide such assistance.

IV. Options for Additional Support

As considered in the Sections above, support for trade reform and integration benefits not only the recipient country but also the global economy as a whole. However, demand for and capacity to absorb "aid for trade" still exceeds available resources. There is a very strong case for increased assistance, to cover the various needs in trade support from technical assistance to budget support, or project based investment lending. However, such resources should be genuinely additional to existing aid budgets *(IMF/World Bank,* 2005). In a "resourced constrained environment for aid" diverting resources from other priority areas may make little sense.

Providing additional assistance is that much easier when considered against the large economic gains arising from a successful completion of the Doha Round. From the political economy stand point additional assistance may be necessary to secure a successful trade round. Any assistance will be dwarfed by the huge gains from further global trade reform.

The distribution of gains from trade liberalisation is multifaceted. They accrue to consumers, producers, improve corporate performance, and will generate higher tax revenues to governments arising from higher economic growth. These sizeable gains offer the opportunity for donor countries to provide additional assistance, to help meet adjustment and integration needs in developing countries[11]. Some of the options are considered below and include:

a. direct yet additional contributions
b. leveraging future aid commitments (an IFF type mechanism)
c. private sector partnership/involvement
d. an asymmetric low temporary trade tariff on negotiated tariff line reductions
e. capturing an increment of the consumer gain (temporary levy on specific products
f. reallocation of subsidies and income support for development assistance
g. improving aid delivery (getting more from existing resources)

The following looks briefly at these options in turn. Of all the options the simplest and arguably the best approach to ensuring more aid flows to where it is needed would be for donor countries to increase their aid budgets. Therefore increasing popular support for aid would be the most effective way forward. However, rapidly increasing aid budgets may for many countries be fiscally and politically difficult to undertake. Consequently reviewing alternative mechanisms to supplement direct aid assistance are worth pursuing and particularly in the context of trade liberalisation where the expected gains are immense and accrue to differing stakeholders. No attempt is made here to favour one option above any other (including proposals on international taxation - referenced below but not covered)[12]. What is important is a recognition of need (additional resources for trade adjustment and integration) against the potential global benefits arising from further multilateral liberalisation. These options do not imply direct earmarking of revenues – they are examples of ways through which countries can link the aid and trade agendas by

[11] Middle income countries stand to gain considerably from a successful trade round. From a political economy standpoint their inclusion within the donor group would be appropriate.

[12] A number of proposals have been made of ways to raise additional revenue for financing global development through international tax instruments or measures to encourage voluntary giving by individuals, although none are directly linked to the benefits accruing from trade liberalisation. For a comprehensive review of these proposals see Annex 1, of "Aid Effectiveness and Financing Modalities", report for the Joint Development Committee of World Bank and IMF, October 2004, which surveys the issues and proposals, including the report of the working group appointed by President Chirac of France (*Landau report, 2004*).

committing additional assistance on the basis of expected trade reform-related net gains. Equally none of the following represent international taxation or tax harmonisation and it would be up to each donor to decide the most appropriate option(s).

(a) Direct yet additional contributions

The previous sections made the case for "additional" resources to provide for an enabling process of integration into the multilateral trading system and follows largely in tandem to the recent research that larger and more effective aid flows are critical in accelerating the implementation of the international development agenda. Substantial improvements in developing country policy has made aid more effective; developing countries are more able to absorb aid; and criteria for disbursement if pursued within the framework of better harmonisation through donor and agency alignment should provide for better results (*World Bank and IMF Development Committee Report, 2004)*.

At Monterrey, donors agreed to make concrete efforts toward reaching ODA levels of 0.7 percent of gross national income (GNI). Since Monterrey, ODA has indeed increased and moved back to levels of ODA in the early 1990s. However care needs to be taken in interpreting aid figures. The very large exchange-rate changes and reduced inflation in the donor countries accounts for almost 60 percent of the increase in dollar denominated value of aid. In addition in 2002, over half the increase was due to debt relief to just two countries (Afghanistan and Pakistan) and in 2003/4 strategic factors continued to have an important role (reconstruction aid to Iraq accounted for an estimated 87 percent of the increase). Even allowing for these increases ODA as a percentage of GNI was still just 0.25 percent in 2003 and the increment flowing to low-income countries has in fact been very small.

As the previous section details even under the most conservative estimates the gains from further trade liberalisation are enormous and dwarf official development assistance. Moreover developed countries would gain in absolute terms economically even more than developing countries from trade reform giving them the resources to engage in additional development assistance. **Table 4** provides details in real income growth by 2015 based on a favourable outcome to the Doha Development Round by country/region. For example, real income in the European Union would be 0.8 percent per annum higher by 2015 than without further liberalisation (*van der Mensbruggle, 2004*). For the US, recent research (*Bergsten, 2005*) estimates that free trade would deliver global gains of between $450 billion to $1.3 trillion annually and would provide around $4,500 per annum in additional income per American household. The increase in economic growth and corresponding tax revenues would make additional resources to support trade integration that much more possible.

(b) Leveraging future aid commitments (an IFF mechanism)

The International Finance Facility (IFF) is the most advanced proposal to frontload aid. Under the proposal (UK Government led proposal) donor countries would make pledges to future payments to the IFF. On the basis of the pledges the IFF would issue AAA rated bonds in the international capital markets. The IFF would allow aid to be front-loaded and is designed to raise funds in the capital markets so that they can be disbursed as and when they are needed. The idea is that the IFF provides a platform for pledged increases in future ODA commitments to be used in the near term to support development financing. One of the strengths of the IFF proposal is that it provides the flexibility to mediate between what is needed in terms of disbursements and when donors pay for it, so it can be adapted to support a desired ODA profile.

However, judging the effectiveness of the IFF will depend on two issues; not only on the use of the funds and ensuring adequate absorptive capacity in developing countries, but equally on what happens as government aid flows are diverted to repay IFF bonds. IFF flows therefore must be managed carefully to ensure that they contribute to sustainable results that will achieve the desired growth agenda on which the medium-term viability of developing country programmes are based (for further detailed information on the IFF, see, *Aid Effectiveness and Financing Modalities, Background Paper, Development Committee, Joint Committee of the Bank and Fund, September, 2004*).

Applying an IFF type mechanism to trade development could potentially have a number of advantages in meeting existing concerns on the efficacy of the IFF. The medium-term viability (i.e. sustainability) of IFI supported programmes is inevitably predicated on achieving significant improvements in export performance and growth. Promoting trade and investment performance within a country's development strategy should more directly improve the future capacity of the country to repay. With sustainability considerably enhanced, the use of future aid flows for IFF bond repayments thereby becomes less relevant. From the donor perspective, pledges to future ODA commitments are made easier if linked to a successful multilateral trade round – gains in economic growth as implementation of the trade round comes into force will make it that much easier to meet commitments.

(c) Private Sector Partnership/Involvement

The private sector can alleviate poverty by contributing to economic growth, job creation and poor people's incomes. Moreover, savings, investment and innovation that lead to development are undertaken largely by private individuals, corporations and communities. That said the primary responsibility for achieving growth and equitable development lies with developing countries and the state of governance, macroeconomic and microeconomic policies, public finances, the financial system and other basic elements of a country's investment climate, all of which are largely determined by the actions of domestic policy makers. However the challenge is to capitalise on advances in macroeconomic stability and democracy, which will help "unleash and foster the private sector". The Commission on the Private Sector and Development *(UNDP, Martin and Zedillo, 2004)* emphasised the importance of a "development coalition" in which all actors play mutually supportive roles – government, public development agencies and the private sector. The Commission stressed the role the private sector, particularly large local companies and multinational corporations can play in contributing to accelerate economic development and to poverty alleviation. The private sector has "tremendous potential to contribute to development through its knowledge, expertise, resources and relationships".

The benefits of further trade liberalisation to the global corporate sector are immense. Trade reform increases competition from abroad induces changes in the mix of capital and labour and the incorporation of new technologies that raises productivity. According to recent research (*Bergsten et al. 2005*) such "sorting and sifting" under a scenario of free global trade (goods and services) is estimated to yield a potential 5.8 percent of GDP per annum in the USA.

Recognising the significant contribution that further trade liberalisation can make to corporate performance both the European Commission and the USA have recently invited businesses and other partners to discuss how "corporate social responsibility can be integrated into international trade", and notably including funding trade related capacity

building and technical assistance to developing countries. The European Commission's communication on CSR "A Business Contribution to Sustainable Development" devotes a chapter to trade and development policy and calls for CSR to be integrated into policy making "to include the provision of capacity building and trade-related technical assistance".[13]

The Office of the United States Trade Representative (USTR) has also sought to increase the support of corporate sponsors and private foundations that are prepared to provide assistance to conduct trade capacity building efforts. This has been applied recently in support of the Central American Free Trade Agreement (CAFTA). The United States and the Central American countries have attracted additional resource partners to include NGOs, corporate sponsors and private foundations that can volunteer "to conduct trade capacity building efforts in support of CAFTA, working in partnership with the multilateral agencies and regional banks". (Federal Register Notice, Vol. 68, No. 88/May 2003).

Successful engagement of public-private partnerships in practice requires an effective *modus operandi* and mechanisms *(UNDP, 2004).* This requires detailed policy and capacity building assessments with prioritised action matrices to which the private sector can respond and engage with donor agencies and developing country partners. The US with several other donors are leading an effort to engage the private sector in follow-up to the action matrices arising from the trade diagnostic work under the auspices of the Integrated Framework (bringing together developing country partners, donor agencies (both multilateral and bilateral) and the private sector). The intention is to supplement available resources and help in the implementation of the prioritised action matrices arising from the trade policy diagnostic work. The first regional event will be held in Ethiopia in September 2005 [14].

(d) *Asymmetric Trade Levy - "giving back revenue to those that we should not be taxing and in return we all agree to tax each other less"*

Consideration could be given to a partial transfer of import duties levied on products that are liberalised. This option does not imply direct earmarking of revenues but is a way of committing additional aid on the basis of expected trade reform-related net gains. (i.e. the greater the commitment to cut tariffs on a MFN basis the larger the resources available for adjustment). Any such implicit levy would be restricted to currently dutiable imports where tariffs are subject to reduction commitments under a new agreement, and hence does not imply an increase in tariffs (see schematic **Graph 1**).

To give an order of magnitude, for example, from the import duty data readily available on 17 of the OECD countries (IMF source, data is not readily available for EU members states Japan), estimated duty collected per annum from these 17 countries is around $30 billion (**Table 6** 1999/2001 prices). Importantly, a very high proportion of the duty collected comes from imports from developing countries, and low income countries in particular. For example, in the US, duties collected on imports from developing countries represent over 50 percent of the total.

Trade liberalization under a Doha trade round should be able to achieve 40 percent multilateral liberalisation in goods and one would hope considerably more. OECD import duty revenue would decline over the implementation period agreed by the round. A notional

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[13] For further details see "Integrating CSR in International Trade (2003) http:www.csreurope.org/news/csrinternationaltrade/

[14] Arising from the work of the Commission for Africa, a Business Action Group has been established which *inter alia* are discussing "the role of the private sector in encouraging and facilitating the role of the private sector in trade facilitation in general and customs reform in particular". Conference Paper, Building Partnerships between Business and Government. CBC/Commission for Africa April 2005.

increment of the affected duty collected could be set aside for adjustment. For example, if negotiated tariff lines are scheduled to decline by 10 percentage points over a ten year period – an increment of one/two percentage points per annum on these tariff lines could be notionally set aside for a fund – i.e. industrialised countries' fiscal revenues would have to adjust sooner to MFN liberalisation in order to provide resources for developing country reform. However, import duty represents a very low component of total fiscal revenues in industrialised countries and one would expect increased tax revenues from higher economic growth arising from a successful trade round. Funds would only be forthcoming on negotiated tariff lines – and hence the greater the commitment to cut tariffs on an MFN basis the larger the resources available for adjustment. The total revenue available would automatically decline over time as implementation takes place. This would be entirely appropriate and consistent with the aim and motivation of support that it facilitate adjustment and integration; it would be temporary and tied to the implementation period agreed.

The forthcoming reform in the EU banana markets also offers the opportunity to generate revenue. The proposed tariff under the regime to be implemented in 2006 would generate additional revenue to the EU budget. The concept of a "self-financing" tariff has been advocated as a means to help those countries affected by the banana reform (*Tangermann and Verissimo, 1999*). Criticism of the idea is that the level of tariff and therefore revenue is far above that which is necessary to "compensate" the countries affected by the change in the banana regime (*Gilson, et al, 2004*). Obviously the tariff could be set lower if "compensation" was the desirable objective. Logically however the additional resources could be utilised for trade-related assistance in the broader context.

(e) Additional resources arising from the consumer gain

The consumer gains from multilateral trade liberalisation are likely to be considerable and most notably on certain agricultural products, textiles and clothing, certain services and industrial products. (Estimated to be $175 billion per annum from free trade to around $50 billion under a more realistic scenario of trade liberalisation.) **Table 7** provides a summary indication of the overall impact on real prices resulting from the removal of tariffs; export subsidies, input and output subsidies, direct payments to land and capital in agriculture and the phase-out of the quotas on textiles and apparel. The reforms are phased in over six years between 2005 and 2010 (*Mensbrugghe, 2004*), and the results are consistent with the income gains presented by the World Bank (*Global Economic Prospects 2005*).

However, capturing an increment of the consumer gain from reform is probably best applied to selective products where price reductions are likely to be very large (rather than applied through a broad based consumption tax). Consumption levies to meet adjustment needs have been used in the past and most notably by Australia. In reforming the domestic dairy market an adjustment fund was established for Australian farmers and resourced by an 11 cent per litre levy at the retail level on all drinking milk products over an 8 year period (*Brockman and Anderson, 2003*). Meanwhile the reform provided Australian consumers with access to the world's cheapest milk and after allowing for the levy, to date real milk prices have remained below those that prevailed prior to reform (the levy is expected to end in 2008-09 and is expected to raise Aus$1.75 billion (*Australian, Parliamentary Library Notice 2002-03*)). Similarly on sugar the Australian Sugar Industry Reform Programme is being funded by a levy on domestic sugar sales, including imported sugar (commenced 2003). Sugar for retail sale, food services and manufacturing are is included. The levy is collected at the point of first sale or transfer from the refinery following the refining process.

There is levy rebate for sugar in exported manufactured products. Exports of sugar are exempt from the levy.

Given the health risks associated with high sugar consumption, capturing an increment of the price reduction on sugar could serve more than one purpose. The proposed EU sugar reform should bring about significant price reductions. As can be seen from **Table 8** CEC (2004) estimates that the institutional sugar price will decline from a reference price of EUR 632 per tonne to EUR 421 per tonne by 2007/08. Even with this reform, at current world prices, EU prices would be almost double those globally. Never the less the EU sugar reform represents a cumulative reduction in sugar beet prices of 37 percent. EU sugar consumption is estimated to be around 15 million tonnes per annum (FAS, USDA). The EU sugar regime is primarily financed by EU consumers (paying higher than world prices) and levies on EU sugar production (paid to the EU budget). The expected reduction in consumer prices does offer the opportunity to consider a levy. Research as to the most effective level would need to take into consideration the overall impact on sugar demand and possible impact on producer prices. However, carefully calibrated, it should be possible to ensure (as has been the case with milk prices in Australia) the real price of sugar to consumers does not increase.

Other price premia in the EU agricultural sector can be seen from **Table 9 (**source ATPSM database). EU price premia, as a percentage of world prices, range from 107 percent on beef, 64 percent on bananas, and 41 percent on milk.

Capturing an increment of the consumer gain could well be promoted voluntarily. For example, the end of the Multi-fibre Arrangement (MFA) and possible further reductions in tariffs on textiles, clothing and shoes will almost certainly see the “landed cost” of these items decline substantially. With the phase out (2005) of the MFA alone, estimates of the possible decline in retail clothing prices range between 9 to 30 percent, and could take almost immediate effect, depending on how proactive retailers are in restructuring their supply chains *(Walter Wilhelm Associates, 2004)*. A voluntary contribution/donation by clothing retail corporations and/or consumers (representing a small increment of the price reduction) could be promoted for a temporary period (e.g. 50 cents per $10.00 reduction in the price of jeans split equally between consumer and retail corporations to promote “Aid for Trade” in low-income countries). This would have the benefit of raising consumer awareness of the huge benefits that multilateral trade brings through cheaper and varied products and simultaneously the desire to help the poorest integrate and benefit from the global trading system.

(f) Budget Reallocation

The elimination of export subsidies and trade distorting domestic support mechanisms should provide for budgetary savings at least in the medium to longer-term. A reallocation of support from subsidies and trade distorting domestic support to internal compensation mechanisms and increased development assistance to meet adjustment needs should be possible and needs to be researched. In the short to medium-term however, it may well be difficult to raise additional resources for development assistance. For example, the EU budget is determined and fixed over a two-year period. Also meaningful reform particularly to the CAP, which will benefit developing countries enormously, may well require additional resources to meet domestic adjustment.

(g) Aid effectiveness – getting more from existing resources

There is increased recognition that to improve aid effectiveness requires alignment of assistance around country strategies and priorities, as well as harmonising donor policies, procedures and practices around strengthened partner country systems. Despite progress, much remains to be done. It is still the case that multilateral and bilateral assistance is provided from different sources, and beneficiaries are often burdened by multiple donor-specific priorities.

Promoting trade development is no exception. There remains a vertical multiplicity of trade-related assistance initiatives by both bilateral and multilateral agencies. Assistance needs to be delivered within a coherent policy framework, where a broad trade and investment agenda prioritises areas of action both in terms of policy and support.

In the recent past, efforts have been made by both multilateral and bilateral donors to improve coherence and co-ordination and provide for a more systematic and effective delivery. Recent important initiatives include the *Integrated Framework for Trade-Related Assistance* (IF) and the *Trade-Integration Mechanism* (TIM-an IMF facility). Bilateral efforts include the US Millennium Challenge Account/Corporation whereby additional resources are made available within the context of a country's overall policy and governance framework. The European Commission has also revised procedures for trade-related funding to ensure it is more supportive of country's overall development objectives. These are briefly reviewed below.

Integrated Framework for Trade-Related Assistance: This programme brings together the key multilateral agencies working on trade development issues - the IMF, the International Trade Centre, UNCTAD, UNDP, WTO and the World Bank. The basic purpose is to embed a trade agenda into a country's overall development strategy (usually the PRSP) and ensure that prioritised trade-related adjustment and capacity building identified is coherent to the broad trade policy aims of the country concerned and prioritised with other development assistance needs. The process starts with analysis. This assessment looks at a number of issues, including establishing the link between trade development on the one hand and poverty reduction on the other, the impact of trade reform on economic growth and development in the country, the complementary policy agenda necessary to support successful trade reform, market access issues and an assessment (action matrix) of prioritised trade-related capacity building and assistance needs that are linked to the country's overall development strategy.

To a large extent the philosophy behind the IF mechanism mirrors the intentions of what is now known as the "new aid framework" to improve harmonisation between the providers of trade assistance (both bilateral and multilateral) and place trade within the context of a country's overall development strategy - i.e. improving international policy coherence (*Prowse, 2002*). It was originally piloted on three countries. The majority of LDCs (over forty) have now applied for assistance under the scheme.

There are now seventeen bilateral donors (including Canada, the EU, Japan and the USA) and the USA chairs donor co-ordination. Given the demand by LDC countries a small IF secretariat has recently been established funded by the EU, Denmark, Switzerland and Sweden. A small trust fund finances the trade assessments and small scale technical assistance arising from the action matrices. The larger identified and prioritised trade capacity building plans are presented within the context of the consultative group meetings

and round tables associated with the PRSP process to which both bilateral and multilateral donors can respond (**Box 1**).

However as detailed in Section III against an "aid resource constrained environment", prioritised trade action plans have had to compete, justifiably, with other priority sectors (namely health, education) and to date implementation on the ground in these prioritised areas has been limited.

IMF – Trade Integration Mechanism (TIM): The IMF recently announced the Trade Integration Mechanism (TIM) to help countries expecting short-tem balance of payments difficulties in coping with the effects of multilateral liberalisation (*IMF, April 2004*). The TIM is intended to address not only preference erosion but also covers instances such as balance of payments shortfalls as a result of ATC quota integration and the possible impact on net food importing developing countries (NFIDCs) of higher foods import prices. The TIM is not a new facility but operates through existing IMF facilities. Its virtue is that the impact of possible adjustment resulting from preference erosion for example, is considered and placed in the context of a country's overall macroeconomic framework through Fund supported programmes. A coherent policy framework is provided to enable the country to meet adjustment and positively benefit from the improved resource allocation that multilateral liberalisation offers. Obviously the usual IMF policy conditionality and terms and costs of lending apply. Therefore the impact of assistance on a country's external debt burden would need to be taken into account.

The Millennium Challenge Account (MCA): The MCA is a US facility designed to assist developing countries within the framework of their own development programme to achieve sustainable economic growth and poverty reduction. Eligibility to the fund (MCA) is determined by an objective range of indicators to assess the policy environment of good governance and sound economic management. As such it represents an objective rating system to ensure that aid resources are effectively utilised. Once a country is determined to be eligible for assistance it is up to the country to submit projects in accordance with their own development priorities (consequently projects can be in any sector and are not pre-determined by the donor).

To a large extent the MCA programme, announced in 2003, is still very much in its infancy. However early indications suggest that eligible developing countries are drawing on the prioritised trade and growth diagnostic assessments associated with the Integrated Framework to develop projects. Madagascar, for example, is to receive funding from the MCA to support a range of agricultural business investment activities which were identified in the DTIS. Other countries that are now assessed as eligible for MCA funding are currently designing projects drawing on the prioritised assessments contained within the DTIS and PRSP process. [15]

ACP-EC Partnership Agreement and the European Development Fund (EDF): In the past the EU has made financial transfers to national governments in developing countries to compensate for declining and volatile export earnings. However a number of problems largely associated with the nature of stand-alone assistance, has undermined the

[15] For further information on the MCA including "Criteria and Methodology" for determining the eligibility of candidate countries and country projects – see www.mca.gov/compacts/
.

effectiveness of this support.[16] Under the Cotonou Agreement, a new instrument (FLEX) was established to provide additional financial support to mitigate the adverse developmental effects of instability of export earnings. Further revisions were undertaken in 2004. The FLEX instrument aims to provide general budget support rather than sector-specific allocations. Funds made available through FLEX are now, where possible, channelled into direct budget support within the framework of an agreed PRSP and therefore complement on-going macro-economic programmes. Eligibility is determined by changes in the overall export earnings and the impact on the budget. It provides support to countries that have registered a 10 percent loss in exports earnings (2 percent in the case of LDCs) and a 10 percent worsening of the programmed public deficit (*European Commission, 2004*). Importantly FLEX is not a separate mechanism but operates within the context of lending under the European Development Fund (EDF), which itself has been subject to major operational revisions[17].

As can be seen steps have been taken to improve the international policy coherence including better coordination between key donors and international organisations in the provision of assistance to help countries adjust and participate in the trading system and integrate into the world economy. However despite efforts to improve policy coherence and co-ordination, it still remains the case that commitments to trade-related assistance and capacity building are low.

V. Operational Structure of Fund

Assuming agreement in principle to provide increased support "aid for trade" to developing countries, equally relevant to the decision is to ensure that funds are effectively managed and utilised. This section briefly sets out the guiding criteria for providing support (the "new aid framework"). Against these criteria the proposal is not to create a new stand alone facility but to build on the basic principles of the Integrated Framework, and to establish a broad based trade and investment agenda within the context of a country's development strategy with identified and prioritised policy and trade-related capacity building needs to which partner countries and donors can respond[18].

a. Guiding Criteria (the "New Aid Framework")

Options for trade support need to be considered within the emerging "new aid framework" to make aid more effective (for a comprehensive review see, *Aid Effectiveness and Financing Modalities, Development Committee, IMF/World Bank, September 2004*). Meeting the international development agenda requires concerted movement on a number of fronts: more aid is one element for success; reforming international trade and improving the way aid is delivered are essential (*World Bank, 2004*), as are policy reforms in developing countries. Developing countries need to pursue a range of reforms that will

[16] Financial support for export revenue shortfalls was provided by the EU-ACP Stablex arrangement. This covered only a set list of eligible products, transfers had to be used to support the commodity affected, and further restrictions on use and time delays left funds significantly undisbursed.

[17] The 9th EDF (EDF-9) provides financial commitments to at least 2007 and expenditure over a longer period. All funds remaining uncommitted from previous EDFs have been rolled into one fund and there is now a single set of procedures for commitment of all EDF assistance. Country programmes will be financed from one overall "long-term development" envelope rather than via a number of separate instruments, and will be determined by a single EC Country Support Strategy. EDF-9 is 13.8 billion euros added to which 7 billion euros from unspent previous EDFs, provides a possible programme spend of 3 billion euros per annum. All 77 African, Caribbean and Pacific countries are technically eligible.

[18] Increased recognition, and moreover a political motivation, on the need to address the adjustment costs arising from further multilateral trade liberalisation (notably with respect to preference erosion) has inevitably led to proposals for new stand-alone facilities. A couple of these are reviewed in **Annex 1**. As discussed however, the options to a large extent go against the emerging wisdom on improving aid effectiveness and enhancing international policy coherence. As a development tool such mechanisms are likely to be ineffective and therefore unlikely to find widespread support by donors nor recipient countries.

enhance the environment for private investment (both foreign and domestic), including infrastructure, management of public resources, improving the effectiveness of service delivery and strengthening governance. Equally, aid management and implementation practices need to continue to shift toward stronger alignment with country policies and programmes, increased harmonisation (of bilateral and multilateral efforts) and greater focus on results*. (IMF/World Bank, 2004)*.[19] Further, increased aid will only be effective if there is adequate absorptive capacity and may need to be developed simultaneously with higher aid flows. Increasing aid needs to take account of the likely impact on the exchange rate and overall competitiveness. In this a country-specific strategy is required. However, raising the absorptive capacity is not an excuse for delaying aid mobilisation *(Development Committee Report, 2004).*

Two issues are particularly pertinent in considering the operational structure to provide increased support for trade adjustment and integration:

> firstly, no one agency has effective authority to respond to all the needs for trade adjustment and integration, and therefore a system needs to be designed to more carefully harmonise existing processes around a country's development plans. That said however, any system needs to take account of existing donor practices (recognising that progress towards increased harmonisation around country programmes inevitably will be incremental); [20]
>
> secondly, providing resources for adjustment and integration to benefit from a multilateral trade round requires greater coherence between the system of rules and (trade) policy regimes that provides substantial cross-border externalities (i.e. the WTO rules based system as a Global Public Good) to the development needs of countries, which are largely supported by the IFIs and other development agencies.[21]

However increased coherence does not imply duplication (i.e. the WTO should not become a development agency *(Ismail, 2005))*. In line with the recommendations in the provision of Global Public Goods, (*G7 Report, 2001*), the role of the WTO, IFIs and the multilateral development banks (MDBs) needs to correspond to the core competencies, comparative advantage and effective capacity of each. The provision of trade-related support is no exception. Each MDB's activity in these fields should be grounded in its core business and country work. The IFIs and MDGs should work in close collaboration with other UN agencies (including the WTO) and bilateral donors, exploiting synergies and effective partnerships.

b. Building on the basic Principles of the Integrated Framework

As detailed in Section IV the main purpose of the IF is to generate a broad-based policy agenda for trade and growth consistent with a country's development strategy, and to

[19] As discussed by Ngaire Wood in Prospect, May 2005, "Does Aid Work?" largely depends on the quality of both the donor and the recipient. Reviewing work by Mallaby (2005), Wood emphasises that all too frequently donors do not pay much attention to what other donors are doing, ignoring what plans a government itself has made, donors can overwhelm the bureaucracy with paperwork and negotiations. For example, in 2003, "Tanzania produced an average of 2,400 reports a year for external donors and was visited by some 1,000 donor missions. That leaves little time for the business of governing the country. There is little co-ordination among donors despite the fact that governments have created institutions to foster co-operation."

[20] The Secretary-General's Millennium Report to the UN (2000) stresses that "the need to strengthen the UN system implies avoiding the unnecessary creation of new institutions or the duplication of activities [but rather that common objectives are achieved] through informal policy networks that bring together international organisations, national governments, the private sector and civil society. Available at http://www.un.org/millennium/sg/summ.htm

[21] Recently there has been a "paradigm shift" giving "special place to common interests" by recognising that some development issues both benefit and require the obligation of the entire global community. The global trade regime as a global public good has and can further have a strong impact on development, poverty reduction, and arguably political stability (Chazournes, 2003).

prioritise capacity building needs to which bilateral and multilateral donors respond. It brings together the main multilateral providers of trade-related support and assistance (IMF,ITC, UNDP, UNCTAD, WTO, World Bank) and also provides a more coherent approach for bilateral donors to work together (17 bilateral donors now work together on this programme).

Box 1 provides a schematic diagram of how the IF operates in practice. The trade and investment agenda is undertaken by the country usually in partnership with the IMF and World Bank/UNDP. [22] This assessment looks at a range of issues including the linkage between trade reform and poverty impact, the need for additional fiscal measures, likely social adjustment costs and other necessary complementary behind the border policy reform. It also identifies a prioritised list of trade-related capacity building needs – many of which relate to trade-related infrastructure, trade facilitation and standards and meeting social costs. This prioritised list has the advantage that it allows both bilateral and multilateral donors to respond to each country's identified needs in a systematic and coherent manner, according to comparative advantage and preference. The intention of the process is that the policy advice provided by the trade diagnostic is included within the context of a country's overall development strategy (in most cases PRSP) and the prioritised trade capacity building plans are presented at the consultative group meetings and round tables associated with the PRSP process where donors (both multilateral and bilateral) usually make pledges. In addition bilateral donors can continue to contribute bilaterally, or choose to provide resources through multilateral organisations. Either way it reduces the duplication and proliferation of vertical initiatives. Assistance is provided according to the assessed needs by the country themselves.

The Integrated Framework has become an established and well-regarded mechanism to mainstream trade into a country's development programme and provides a programmatic approach to assistance for adjustment and integration (External Evaluation, *Capra, 2003*). A consortium of development partners, the Integrated Framework links the IFIs with the UN system (trade development) and the WTO (trade rules) which is a clear advantage. The basic principles of the Integrated Framework promote the "emerging new aid framework" which calls for greater donor (both bilateral and multilateral) "harmonisation" and for additional aid to be provided in the context of a country's overall development strategy. The IF is also working to bring in other key stakeholders-notably the private sector.

To date however it has been largely an unfunded mandate relying on the consultative group and round table pledging sessions to implement adjustment needs and capacity building. Moreover, as already detailed, consideration of trade and investment activities within the PRSPs has to date had to compete with other sectors and has been relatively limited. Indeed without additional assistance, over time, while the value of embedding trade policy within the context of the PRSP is understood with little support, developing countries will rightly question the efficacy of the programme to provide a more enabling process of integration into the global trading system.

The proposal would be to increase available support to provide a sustained effort to prepare, articulate, and identify a coherent trade, investment and growth strategy in country and within the context of a country's development process (PRS), and also provide additional resources towards the identified trade adjustment costs and capacity building needs.

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[22] At present a small IF secretariat located at the WTO handles paper flow and UNDP manages the trust fund.

Many countries lack resources in-country to design and implement effective trade and investment policies (*McLeod, 2004*). The intention would be to provide additional support in country to build sustainable capacity that would help in the implementation of a multi-year programme of policy reform, trade related activities and investment, including involving the private sector in the context of the PRS. As such a strengthened IF within the context of the PRS would provide a clear framework of the adjustment costs, trade facilitation needs, trade-related infrastructure investment and institutional reform programmes that would help eliminate bottlenecks to expand trade.

This framework would provide a basis for subsequent new investments and programmes which could be undertaken with support from existing institutions and using existing instruments coordinated under the auspices of the PRS. Increased resources would be made available at the time of the consultative group and round table process. Countries could decide whether to use resources for specific projects identified within the prioritised list of trade-capacity building needs or for direct budget support in case of loss of fiscal revenue and social adjustment costs. As such, increased support and disbursement would be considered in the context of a country's macroeconomic and development strategy and therefore issues relating to the absorptive capacity and likely exchange rate and competitiveness impact of larger aid flows can be taken into account.

Consideration should be given to extending the IF programme beyond the 49 (WTO defined) LDCs to include other low income countries which are likely to incur adjustment costs to trade reform and will also need to undertake significant trade-related investment to benefit from improvements in market access - for example, increasing the IF programme to all IDA or PRS recipient countries. This would also facilitate a more regional approach to assistance in cases where supply-side constraints could usefully be addressed at a multi-country level *(IMF/World Bank, 2005).* Extending assistance to a wider group of countries should be manageable, taking into account eligible countries[23], the size of some recipients, disbursements already made and the likely period over which other disbursements would be made available. The round table and consultative group meetings usually take place over a three-to five year planning cycle.

Building on the basic principles of the IF does not imply that the current organisation structure should be retained.[24] However, improving the linkages to the PRS process would inevitably require strengthening of institutional arrangements. This would include institutional strengthening of in-country capacity (often but not exclusively through the trade, planning and finance ministries), promoting a stronger linkage of trade, investment and growth within the PRS, better management of the Trust Fund and increasing the capacity of the functionally independent IF secretariat. **Boxes 2** and **3** provide a suggested operational structure. [25]

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[23] With the increased demand by developing countries for IF type assessments, eligibility criteria has had to evolve and become more refined and now includes a decision model based on governance, poverty and fiscal capacity indicators. In addition, countries need to demonstrate a clear commitment to integrate a trade agenda into their development strategies by established domestic alliances.

[24] Governance of the IF is currently undertaken within two governing and managerial bodies, namely the IF Steering Committee (IFSC) and the IF Working Group (IFWG), both of which are supported in their activities by a small IF secretariat. The IFSC comprises representatives from the three partners in the IF (donors, recipient countries and agencies) with participation open to any member or representative of the three partners. The IFSC oversees the broad policy and contextual issues for the IF. The IFWG is responsible for dealing with the executive functioning of the IF and specific implementation issues including day-to day operations. To keep the functioning of the IFWG small and balanced, the six agencies are represented and donors and recipient countries have just two representatives each. Both donors and recipients have established co-ordinating donor and recipient groups to inform the IFWG and IFSC. The donor chairs are rotated between North America and others (currently the USA chairs the donor group). Given the growth of the programme a small functionally independent secretariat is being established with donor contributions from the EU, Switzerland, Denmark and Sweden. The trust fund is currently managed by the UNDP.

[25] Annex 2 takes a look at the evolution and operational structure of the Global Environment Facility, compared with that of the Integrated Framework. The GEF is also a consortium approach to achieve common objectives, and can possibly offer an insight into the organisational implications of strengthening the IF and it's linkages to the PRS.

VI. Summary

In sum, trade and investment integration provides for enormous and sustainable gains to growth and poverty reduction. Trade reform needs to be set in the broader context of a country's development strategy that will allow a gradual opening to imports and foreign investment as the complementary behind the border institutional and social structures are put in place. Providing additional support to developing countries to improve the productive and growth agendas within their development strategies makes enormous sense. A successful Doha round represents a powerful Global Public Good generating huge aggregate gains to the world economy. Seen in this context increasing support to facilitate trade, sustainable growth and economic convergence of the poorest is a highly desirable win-win policy prescription.

Table 1: Percentage decrease in average export unit values following a 40% cut in preference margins as a result of multilateral tariff reduction (estimate)

Least Developed Countries		Other Developing Countries	
Malawi	6.6	Mauritius	11.5
Mauritania	4.8	St Lucia	9.8
Cambodia	4.1	Belize	9.1
Bangladesh	3.9	St Kitts and Nevis	8.9
Maldives	3.5	Guyana	7.9
Haiti	3.3	Fiji	7.8
Cape Verde	3.3	Dominica	5.5
Sao Tome and Principe	2.7	Seychelles	4.2
Tanzania	2.4	St Vincent and the Grenadines	3.4
Comoros	2.0	Jamaica	3.3
		Albania	3.3
		Nicaragua	3.2
		Swaziland	3.0
		Serbia and Montenegro	2.9
		Tunisia	2.2
		Cote d'Ivoire	2.2
		Morocco	2.1
		Dominican Republic	2.1

Sources: Export structure and direction: COMTRADE (United Nations). Preference regimes: WTO Trade Policy Reviews, TRAINS database.

Note: Only preference erosion vis-à-vis Canada, the EU, Japan and the United States considered. Calculation of current preference margins uses tariff data per 2-digit line for each preference scheme. Direction of trade data is then applied to obtain a trade-weighted preference margin.

Source: IMF, 2004; as reported in Page and Kleen (2004)

Table 2: Comparative static estimates of economic welfare gains from full and from a 50% (successful Doha) global liberalization of goods and services trade

Study	Market assumptions[a]	Sectors liberalized	50% cut to bound or applied tariffs?	Baseline year (of EV welfare measure)	Welfare gain, non-OECD (US$ billions)	Welfare gain, global (US$ billions)	Year of currency (US dollars)
a. Full							
ADFHHM (2002)	CRS/PC	Goods only	-	2005	108	**254**	1995
BDS (2003)	IRS/MC	Goods, services and FDI	-	2005	431	**2080**	1995
FMT (2003)	IRS/MC	Goods and services	-	1997	113	**367**	1997
WBGEP (2003)	CRS/PC	Goods only	-	2015	184	**355**	1997
WBGEP (2003)	CRS/PC plus productivity boost	Goods only	-	2015	539	**832**	1997
b. Successful Doha Round							
BDS (2003)	IRS/MC	Goods and services incl FDI	Applied	2005	216	**1040**	1995
FMT (2003)	IRS/MC	Goods and services	Bound	1997	88	**196**	1997
FMT (2003)	CRS/PC	Goods and services	Bound	1997	51	**132**	1997
HRTG (2003)	CRS/PC	Goods only	Applied	1997	97	**186**	1996

Sources: Anderson et al (2002); Brown, Deardorff and Stern (2003); Francois, van Meijl and van Tongeren (2003); World Bank (2003) and Harrison, Rutherford, Tarr and Gurgel (2003), as reported in Anderson (2004)

[a] CRS/PC: constant returns to scale/perfect competition; IRS/MC: increasing returns to scale/monopolistic competition/firm-level differentiated products.

Table 3: Summary of benefits and costs of liberalizing subsidies and trade barriers[26]

(2002 US$ billion)

Opportunity	Benefit (net present value in 2005)	Cost (net present value in 2005)	Benefit/ cost ratio	Key assumptions
Successful Doha: 50% liberalization of trade barriers and agricultural subsidies.	$23,040	$947	24.3	5% discount rate, benefits rise each year even after the five-year phase-in to 2010 (because the economy is growing) and last to 2050, costs are $219 billion per year and last from 2006 to 2010.
Full reform: 100% liberalization of trade barriers and agricultural subsidies.	$46,080	$2,104	21.9	As above except costs are $583 billion per year.
Pessimistic Doha: 25% liberalization of trade barriers and agricultural subsidies.	$11,520	$395	29.2	As above except costs are $91 billion year.

Sources: Anderson (2004), BDS (Brown, Deardorff and Stern (2003)

[26] Based on the estimates in the BDS study, the Free Trade Area of the Americas (FTAA) opportunity would yield benefits of (possibly very much) less than one-twelfth of that for the successful Doha opportunity above, and a lower benefit/cost ratio, because of standard FTA complexities such as rules of origin. The EBA opportunity for least-developed countries to get preferential (duty- and quota-free) access to developed country markets would yield global benefits of less than one-hundredth of the above, and those benefits would diminish as and when developed countries lowered their MFN tariffs. While the least-developed countries would be the main beneficiaries in proportional terms from EBA, their benefit would be at the expense of other developing countries (including ones as poor as Vietnam) who lose from the trade-diverting nature of this preferential agreement.

Table 4: Change in real income from full liberalization of goods trade
(change in 2015 relative to baseline scenario)

	$Billion	Percent
Australia, Canada and New Zealand	9.7	0.8
European Union with EFTA	63.3	0.8
United States	26.4	0.2
Japan	34.4	0.9
Korea and Taiwan	41.4	3.8
Hong Kong and Singapore	10.4	2.9
Brazil	10.2	1.7
China	15.4	0.7
India	4.1	0.5
Indonesia	3.5	1.4
Vietnam	2.3	5.0
Russia	3.1	0.8
Mexico	0.3	0.0
SACU	2.6	1.8
Rest of South Asia	0.4	0.2
Rest of East Asia	20.2	4.8
Rest of LAC	17.3	1.6
EU accession countries	1.0	0.2
Rest of ECA	2.3	0.5
Middle East	6.7	1.0
North Africa	19.6	7.0
Rest of Sub Saharan Africa	2.9	1.2
Rest of the World	3.0	1.4
High Income	185.7	0.7
Low- and middle-income	115.2	1.2
Low-income	16.3	0.9
Middle-income	98.9	1.3
World total	300.8	0.8

Source: Van der Mensbrugghe (2004)

Table 5: Tariff revenue generated on minimal import duty ($)

						Import Levy of		
Reporter	Partner	Year	Product Name	Flow Name	Trade Value ($)	0.0025	0.005	0.01
OECD	OECD	2002	Total Trade	Import	3,456,864,807,566	8,642,162,019	17,284,324,038	34,568,648,076
OECD	WLD	2002	Total Trade	Import	4,752,382,101,772	11,880,955,254	23,761,910,509	47,523,821,018
				%	**72.74**			
G8	G8	2002	Total Trade	Import	1,362,032,181,641	3,405,080,454	6,810,160,908	13,620,321,816
G8	WLD	2002	Total Trade	Import	3,178,289,640,289	7,945,724,101	15,891,448,201	31,782,896,403
				%	**42.85**			
G20	G20	2002	Total Trade	Import	80,320,410,535	200,801,026	401,602,053	803,204,105
G20	WLD	2002	Total Trade	Import	711,246,931,393	1,778,117,328	3,556,234,657	7,112,469,314
				%	**11.29**			
G20 & G8	G20 & G8	2002	Total Trade	Import	2,378,261,442,043	5,945,653,605	11,891,307,210	23,782,614,420
G20 & G8	WLD	2002	Total Trade	Import	3,889,536,571,682	9,723,841,429	19,447,682,858	38,895,365,717
				%	**61.15**			

***G20** – Argentina, Bolivia, Brazil, Chile, China, Cuba, Egypt, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Philippines, South Africa, Tanzania, Venezuela, Zimbabwe*

Source: World Bank (2004)

Table 6: Total import duties for selective OECD countries

Country Name	Latest Year	Import Duties current US$ mil	Volume of imports current US$ mil
Australia	1998	2289	60774
Canada	2001	1937	221554
Czech Republic	2001	263	36477
Greece	1998	17	30267
Hungary	2001	437	33682
Iceland	1998	31	2483
Italy	1998	352	215590
Mexico	2000	3476	174412
New Zealand	2001	264	13307
Norway	1999	309	34173
Poland	2001	992	50245
Portugal	1998	2	37048
Slovak Republic	2001	79	14770
Sweden	1999	40	63989
Switzerland	2000	620	83584
Turkey	2001	423	41399
United States	2001	19460	1180074
	TOTAL	30992	

Source: IMF Government Finance Statistics

Table 7: Change in real consumer prices from full liberalization of goods trade
(change in 2015 relative to baseline scenario)

	Agriculture and food	Textile and wearing apparel	Industrial excl processed foods[a]	Non tradeables	Total
Australia, Canada and New Zealand	0.1	-1.3	-0.4	0.0	0.0
European Union with EFTA	0.0	-1.0	-0.3	-0.1	-0.2
United States	0.3	-1.1	-0.3	-0.1	-0.1
Japan	-0.2	-0.5	0.0	0.3	0.2
Korea and Taiwan	-1.4	-0.5	-0.2	0.6	0.1
Hong Kong and Singapore	0.4	0.0	0.0	0.3	0.2
Brazil	0.5	-0.2	-0.4	0.2	0.1
China	0.0	-0.3	-0.3	0.3	0.0
India	-0.2	-0.7	-1.2	-0.5	-0.5
Indonesia	0.5	-0.2	-0.1	0.4	0.3
Vietnam	-0.4	-3.0	-2.0	0.7	0.0
Russia	-0.3	-1.8	-0.8	-0.1	-0.4
Mexico	0.1	-0.6	-0.5	-0.2	-0.2
SACU	-0.2	-1.5	-0.6	-0.1	-0.2
Rest of South Asia	-0.3	-0.9	-1.0	-0.4	-0.5
Rest of East Asia	-0.2	-0.6	-0.6	0.4	0.0
Rest of LAC	0.0	-0.8	-0.7	-0.1	-0.2
EU accession countries	0.0	-0.7	-0.4	0.0	-0.1
Rest of ECA	-0.1	-0.6	-0.3	-0.1	-0.2
Middle East	-0.3	-1.0	-0.7	0.0	-0.2
North Africa	-0.2	-4.6	-2.6	-0.3	-0.7
Rest of Sub Saharan Africa	-0.5	-2.1	-1.4	-0.3	-0.6
Rest of the World	-0.2	-0.3	-0.4	-0.1	-0.2

Note: a. Includes textile and apparel.

Source: Van der Mensbrugghe (2004)

Table 8: Proposed EU Sugar Sector Price Changes

	Reference period	2005/06	2006/07	2007/08
Institutional Sugar Price (EUR/t)	632	506	506	421
Cumulative reduction in institutional price	0.0%	-20.0%	-20.0%	-33.0%
Minimum Sugar Beet Price (EUR/t)	43.6	32.8	32.8	27.4
Cumulative reduction in minimum sugar beet price	0.0%	-25.0%	-25.0%	-37.0%

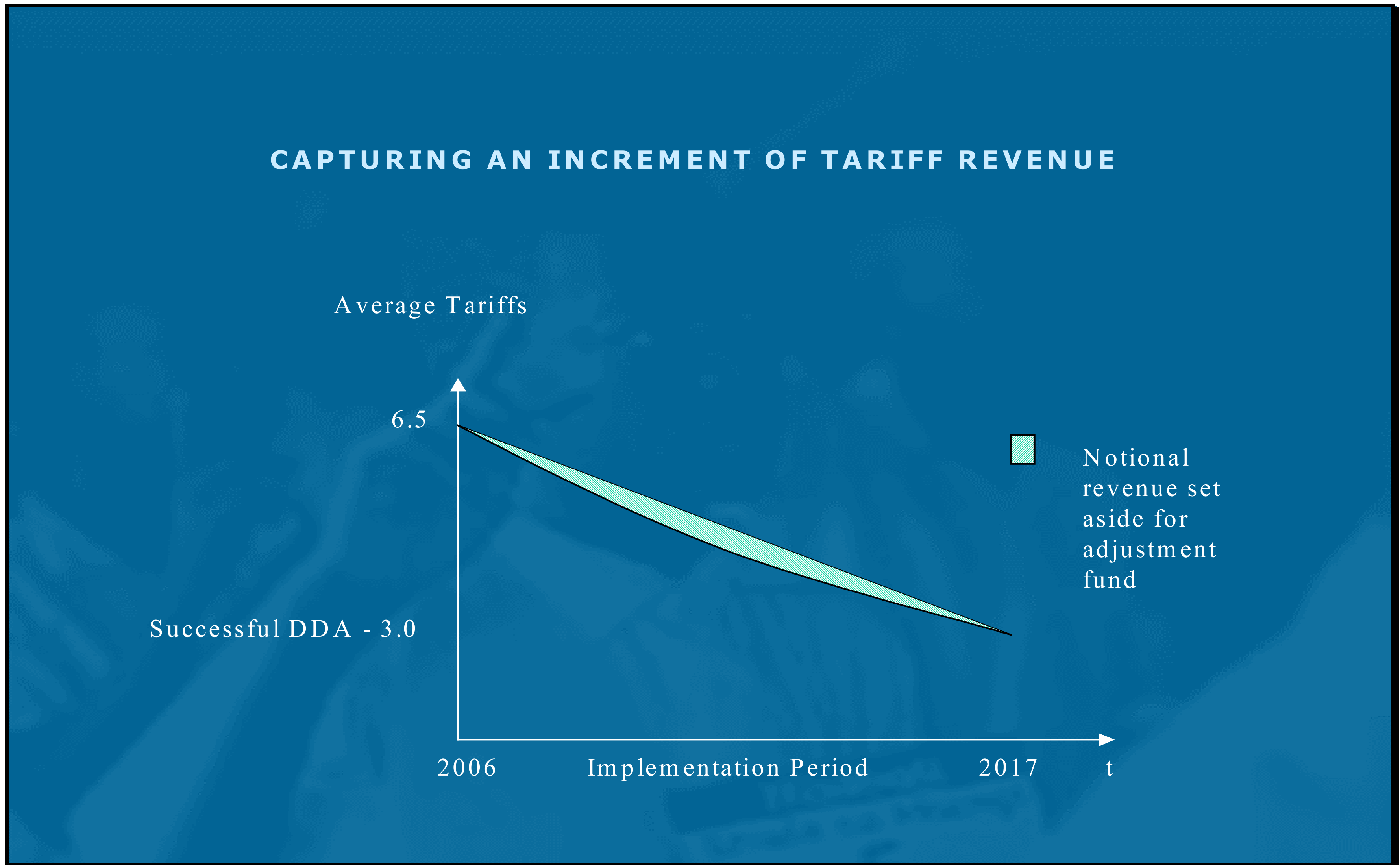
Source: CEC (2004)

Table 9: Price Premiums in the EU Agricultural Sector (US$/metric tonne *unless* otherwise indicated)

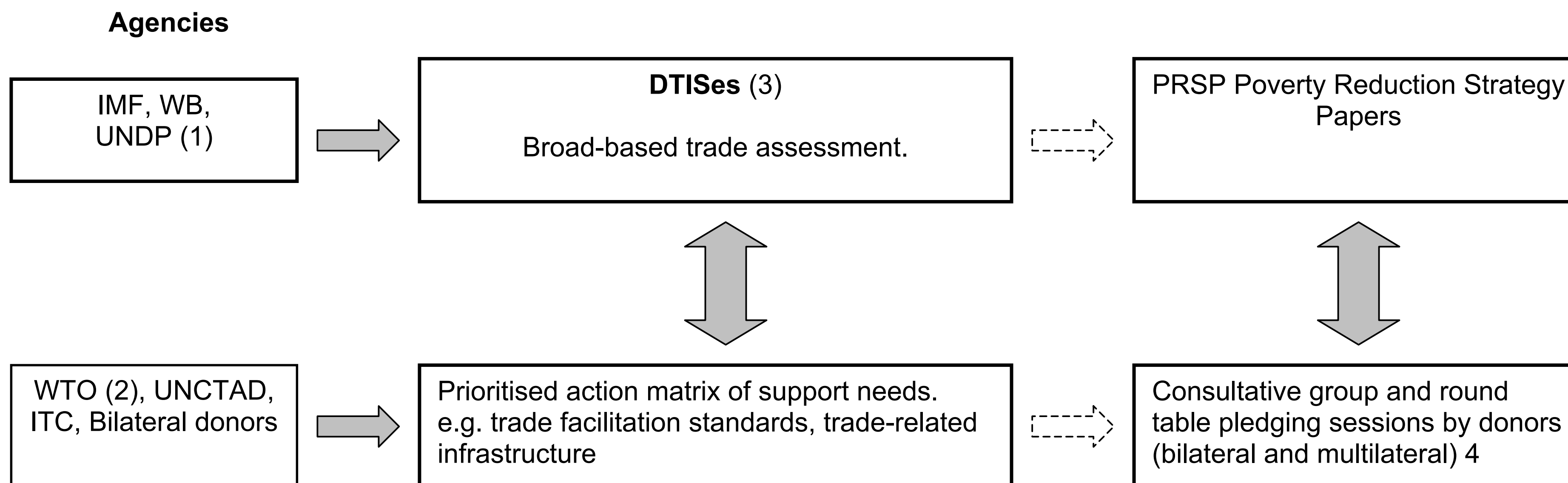
	Beef	Milk	Cheese	Bananas	Sugar
EU	4761	3034	5170	569	466
World	2300	2159	3764	347	274
EU Price Premium as % of World Price	107%	41%	37%	64%	70%

Source: ATPSM database

Graph 1



Box 1 – Integrated framework – Current Status



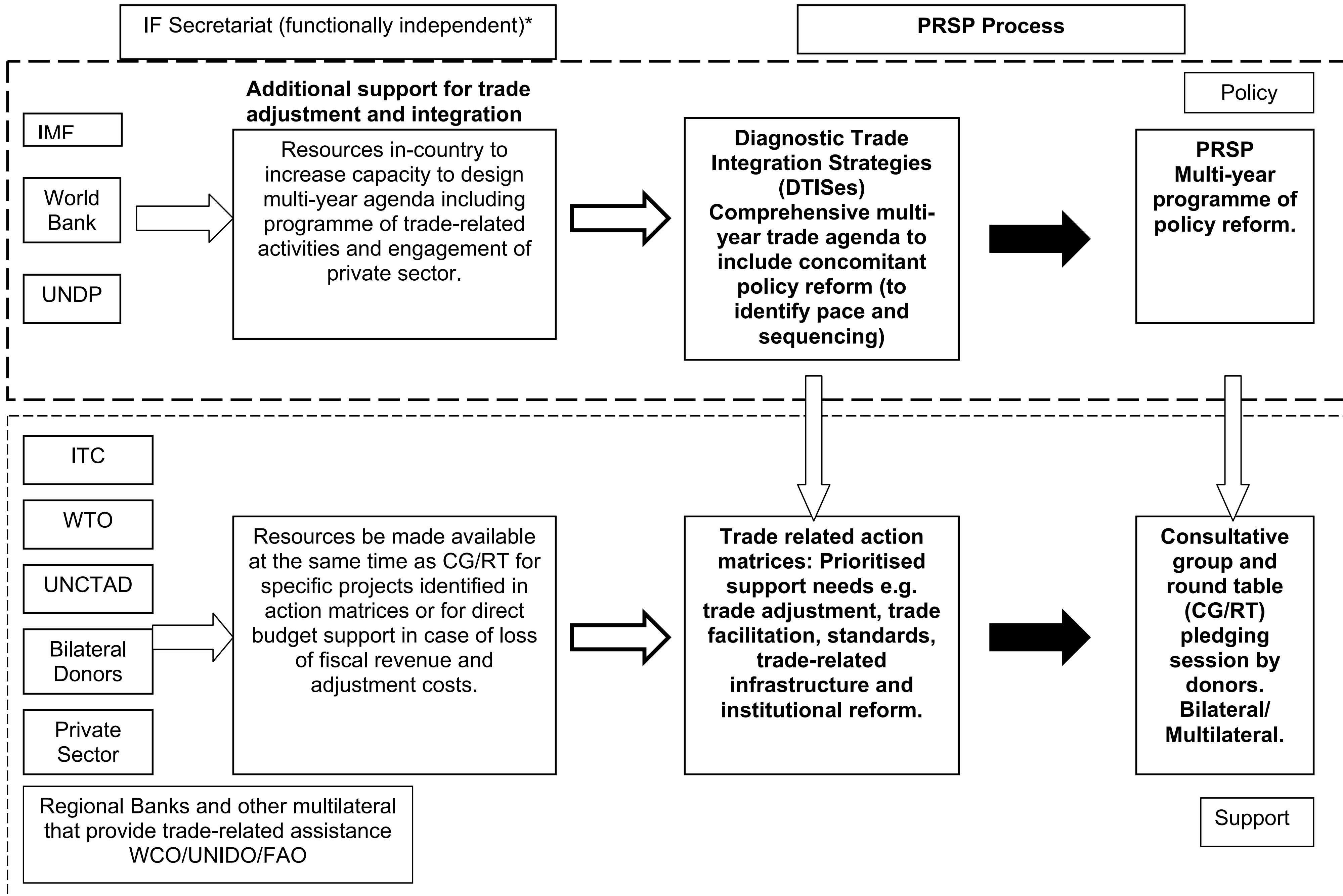
(1) IF trust fund currently managed by UNDP (small fund to undertake DTISes and limited trade-related technical assistance up to $1 million per country)

(2) Small IF Secretariat currently housed in WTO (functionally independent)

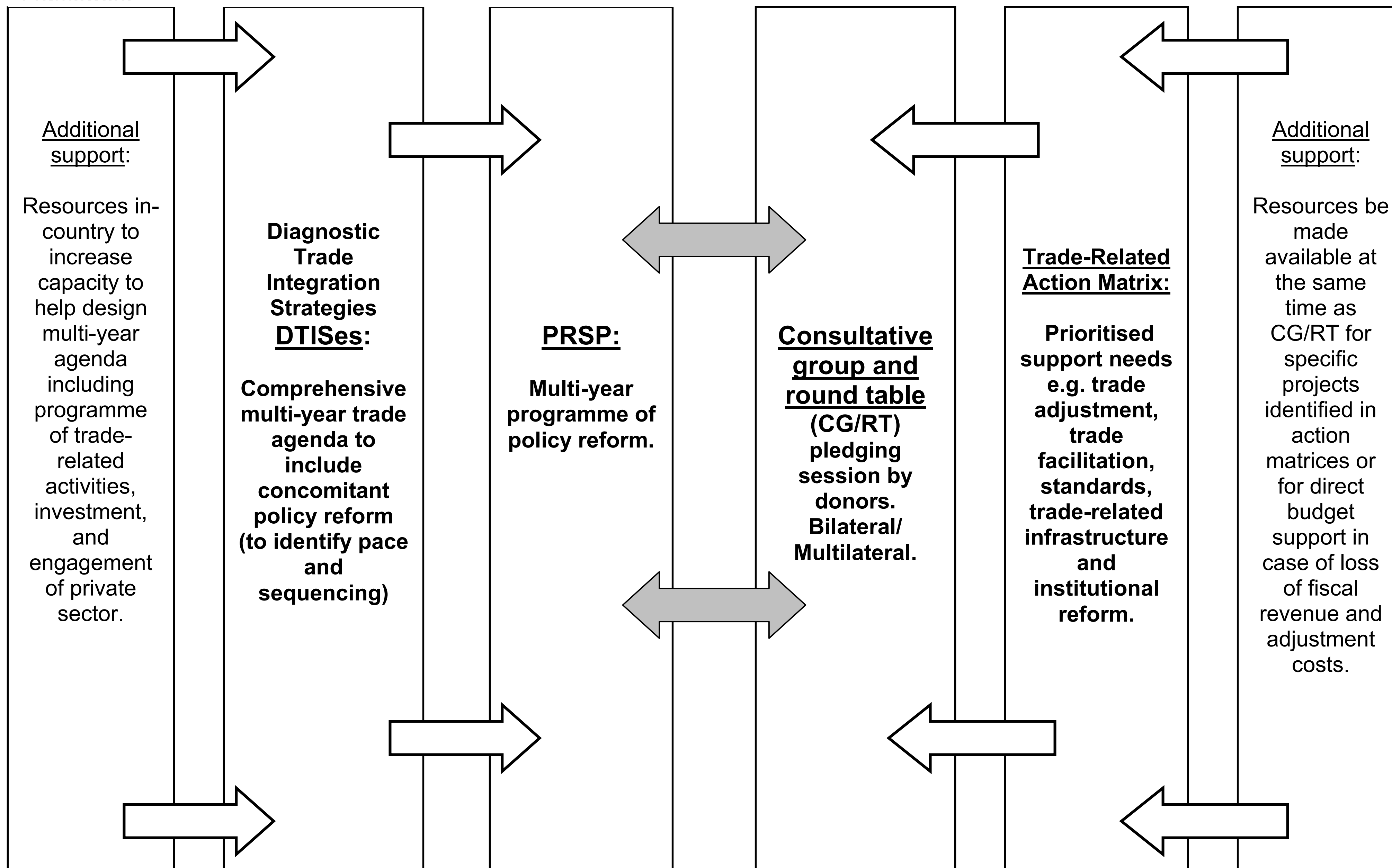
(3) Diagnostic Trade Integration Studies. The assessment looks at a number of issues including the link between trade development, growth and poverty, the complementary policy agenda necessary to support successful trade reform and market access issues, an assessment (action matrix) of prioritised trade-related capacity building and assistance needs that are linked to the country's overall development strategy.

(4) The linkage between the trade action plans and PRSP process and the associated consultative group and round table pledging sessions has been weak. There are a number of reasons for this. The PRSP/pledging process is undertaken on a multi-year (3-5 year) programme basis. Funding is already committed. "In an aid resource constrained environment" – the IF process justifiably has to compete with other priority sectors.

Box 2. "Aid for Trade" – Increased support for trade adjustment and integration building on the basic principles of the Integrated Framework



Box 3. "Aid for Trade" – Increased support for trade adjustment and integration building on the basic principles of the Integrated Framework



*Currently the IF Secretariat (functionaly independent) is housed at the WTO. The Secretariat could remain at the WTO. Consideration could be given to house the Secretariat with another institution, or housed separately. The Secretariat could also for example manage the trust fund (Swiss proposal) thereby reducing management costs of the trust fund and Secretariat. Consideration could also be given to extending eligibility to countries beyond the 49 LDCs.

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ANNEX 1 - Proposals for stand-alone trade facilities

Given the need for assistance, and the political motivation to address adjustment costs to promote further multilateral trade liberalisation (notably with respect to preference erosion) this has inevitably given rise to calls for new facilities. A couple are reviewed below:

(i) Special fund for diversification (SFfD) – Commonwealth Secretariat, (2004)

A Special Fund for Diversification (SFfD) has recently been proposed by the Commonwealth Secretariat, (2004) to mitigate the impact of the erosion of preferences due to MFN liberalisation. Proposed financing (from "pooled donor funds") would be provided to "commensurate with preference losses" for private sector-led export diversification investments. A share of SFfD funds would be set aside for a private sector window to facilitate SME investment start-up expansion, restructuring or rehabilitation in non-traditional sectors. Remaining funds will be provided for a public sector window for enabling infrastructure investments and two optional technical assistance and social safety net windows.

The losses in income transfers for sugar, beef, bananas, textiles and clothing producers in trade-preference-dependent economies are estimated to be $1.72 billion annually. The research estimates that producers will require 14 to twenty years to adjust and thereby estimate total net present value financing of $6.0 billion to $13.8 billion. No account appears to have been taken to assess the likely offsetting positive benefits of MFN liberalisation.

(ii) Fund for Preference Compensation

In the absence of meaningful trade adjustment assistance by the development community it has been suggested that securing a successful WTO agreement remains the overriding consideration – i.e. there is a "global public good" case for a fund to meet the 'costs of compensation' (*Page and Kleen, 2004*). Against the potential global efficiency and welfare gains, beneficiary countries might be expected to contribute to a fund. As a 'public good', it would be incorrect to consider this fund as aid. Such a fund should therefore be housed at the WTO. How donor countries would provide resources would be a matter of "choice", although the level of contributions would be determined by various criteria (for example share of trade, income, 'guilt' in preferences). Seen as 'compensation for a previous benefit' funding should be allocated without conditions and to beneficiary countries according to the estimation of loss of preferences. The fund would need to be secure. Voluntary commitments would need to be made 'legally irrevocable'.

Although accepting the "global public good" case on the need to meet adjustment concerns arising from a successful trade round in order to secure the global welfare gains, the proposed fund would in many respects be a major departure from current practices. Firstly the WTO is neither a development nor financial agency and nor should it be. Placing a funding mechanism for trade adjustment associated with preference erosion in the WTO would change the role of the organisation as a trade agency. Assistance would be considered as ODA and therefore would be expected to come from current aid budgets and on efficiency criteria be expected to be administered by development agencies.

To a very large extent the above options go against the emerging wisdom on improving aid effectiveness and enhancing international policy coherence. Leaving estimation concerns aside, establishing a new fund to address issues arising from preference erosion is problematic. There is no doubt that the adjustment costs arising from preference erosion must be addressed but establishing a separate fund targeted at one specific structural adjustment need and set of countries runs counter to a more harmonised approach to development assistance. Adjustment to MFN liberalisation will also affect many that have not benefited from preferences but are located in highly protected domestic industries and sectors, for example. They will also require assistance to adjust. The need to diversify is not unique to economies that have benefited from preferences but are common to numerous countries and notably those facing a narrow export base.

Historically schemes aimed at promoting “export diversification” may do no more than entrench already inefficient industrial and production patterns. Funding has to be provided within the context of the overall country development programme and a broad macroeconomic policy framework to realise the dynamic gains associated with MFN liberalisation. Therefore as a development tool such mechanisms are likely to be largely ineffective and consequently are unlikely to find widespread support by donors nor recipient countries. Moreover these options could be counterproductive. “Compensation” facilities without clearly defined additional resources and an enabling development mechanism to trade reform and integration, justifiably, would be view sceptically by developing countries as “compensation” and pay-off to sign up to new trade agreements.

ANNEX 2 - The Integrated Framework and Global Environment Facility (GEF) compared – a Consortium Approach to Achieve Common Objectives

In 1989, at the IMF and World Bank annual meetings, the French Prime Minister suggested establishing a fund of voluntary grants devoted to the global environment. The GEF was established first through a pilot phase that "appears to have been crucial for getting the GEF off the ground". (*Chazournes, 2003*). It allowed donor governments and the international system to gain experienced in operation without having to agree on the formalities and technicalities of the entity. The three implementing agencies involved with the fund are: the World Bank, the UN Environment Programme, and the UN Development Programme (UNDP). They were expected to collaborate each in accordance with their respective core competencies. The cooperation between the agencies brought practical and political advantages. Some countries favoured a strong role for the UN agencies, while others supported the leading role of the Bank.

The governance structure of the GEF has evolved over time. Initially all countries participating in the financial mechanism in its pilot phase and this formed the Implementation Committee. This committee reviewed the work programme proposed by the Implementing Agencies. An external evaluation of the pilot phase (completed in 1993) concluded, that the coordination arrangements among the Implementing Agencies to result in interagency synergy and provide leadership for the GEF as a whole, had proved ineffective. The problem was due "less to competition between the agencies than to the absence of an arbiter who could have provided guidance and decisions".

The restructured GEF remained located within the World Bank, although its autonomy and independence were, both confirmed and strengthened. A functionally independent Secretariat was created, with its Chief Executive officer (CEO) being accountable to the main executive organ, the GEF Council. The GEF's independent governance structure and the existence of its own Secretariat has been considered "crucial" for providing overall direction of the programme. The GEF Council is made up of 32 members, with equal representation from developed and developing countries.

A new "programmatic approach" is currently being put forward based on an agreement between a country with the members of the GEF system i.e. the GEF Secretariat, the Implementing Agencies as well as with other donors. The intention is to move away from a fragmented approach based on projects being developed independently from each other.

The *Second Overall Performance Study of the GEF (2002)* provided a strong endorsement of a successful example of "constructive interagency cooperation". The GEF model offers a good example of "clustering" different agencies and activities. It works on synergies and linkages. As such it provides a viable and tried blueprint for the management of common interests. At the institutional level, the GEF's "governing structure is considered to provide a pragmatic reconciliation of the ideals of universality and democracy and transparency on the one hand and a small and efficient decision-making body on the other".

To a large extent the evolution of the Integrated Framework (IF) to date has followed that of the GEF. Once restructured (in 2001) the IF was first piloted on three countries before being expanded to other countries when additional resources were made available. The pilot phase was also crucial, largely for the same reasons as those for the GEF. It allowed the partner agencies, donors and recipient countries to gain operational experience of the process. Building on the success of the pilot phase, this brought in more donors, funding, and requests for assistance from recipient countries – including non-LDCs. The co-

operation of the agencies has also had both practical and political advantages with many developing countries (and civil society) keen to see the UN agencies complementing the IFIs on trade issues, while others support the strong role of the World Bank.

Interestingly the restructuring of the IF (in 2001) to a more programmatic approach began earlier than that of the GEF. The trade diagnostics are specifically designed to assess trade policy and development within the context of a country's PRSP and the resulting matrix of action for trade support are prioritised and prepared in the context of a country's donor round table and consultative processes. With the now high demand for IF type assessments, eligibility criteria has had to evolve and become more refined and now includes a decision model based on governance, poverty and fiscal capacity indicators. In addition, countries need to demonstrate a clear commitment to integrate a trade agenda into their development strategies by established domestic alliances.

One of the key advantages of the GEF and IF type structure is that they demonstrate how the UN system can adapt itself to face new challenges, while making use of existing institutions. Flexibility and pragmatism were important tools for setting the policy and legal profile of these programmes but not with a full-fledged international legal framework. This has created a new partnership between the IFIs and the UN. They have encouraged new ways of cooperation among institutions and other partners, such as the regional development banks. All of which have a role to play in promoting development and common interests.

Importantly institutions such as the GEF and IF (trust-based institutions) premised on a fiduciary principle, are well placed for providing a mechanism for private sector involvement – and the GEF has already done so (the IF is in the preliminary stages of engaging the private sector)[27]. However, engagement of the private sector notably in trade related support may give rise to the potential conflicts of interest and impartiality in decision-making. Mechanisms such as the GEF and IF offer appropriate means of avoiding both bias and just as importantly allegations of biases, with the programme working in the overall interests of beneficiaries (*Chazournes, 2003*).

Building on the basic principles of the Integrated Framework to enhance support for trade integration would make considerable sense. The mechanism is already established, has been piloted, and subject to external evaluation. It has established eligibility criteria. It has broad based donor and recipient support. Proposals for new mechanisms and institutions would take considerable time to gain multilateral support (if at all), would also need to be undertaken in a phased approached (i.e. piloted), and evaluated. The IF is not a new institution or mechanism but benefits from strong partnerships and has the potential to bring in other key stakeholders (and notably the private sector).

[27] For further details see, http://www.unglobalcompact.org/gc/unweb.nsf/content/whatitis.htm