DEVELOPMENT COMMITTEE
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On the
Transfer of Real Resources to Developing Countries)

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LEVERAGING TRADE FOR DEVELOPMENT: WORLD BANK ROLE

Attached for the April 30, 2001 Development Committee meeting is a paper entitled "Leveraging Trade for Development: World Bank Role" prepared by the staff of the World Bank. Ministers may wish to comment on this subject (Agenda item II.A) in their prepared statements.

DEVELOPMENT COMMITTEE
APRIL 30, 2001

LEVERAGING TRADE FOR DEVELOPMENT:

THE WORLD BANK'S ROLE

April 4, 2001

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LIST OF ABBREVIATIONS

ACP- African, Caribbean Pacific Group of States
APEC – Asia Pacific Economic Cooperation
ASEAN – Association of Southeast Asian Nations
ATC - Agreement on Textile and Clothing
CAPAS - Coordinated African Program of Assistance on Services
CAS—Country assistance strategy
CEPR - Consortium and the Centre for Economic Policy Research
DEC—Development Economics and Chief Economist of the World Bank
DFID - Department for International Development (UK)
EAC – East African Community
ESW—Economic and sector work
EU – European Union
FDI - Foreign Direct Investment
FIAS – Foreign Investment Advisory Service
FTAA – Free Trade Area of the Americas
G-8—Canada, France, Germany, Italy, Japan, the Russian Federation, the United Kingdom, and the United States.
GATT – General Agreement on Tariffs and Trade
GEP – Global Economic Prospects
IDB – Inter-American Development Bank
IMF—International Monetary Fund
ITC— International Trade Center
LDCs - Least Developed Countries
MENA – Middle East and North Africa
NAFTA – North American Free Trade Agreement
NTBs – Nontariff Barriers
PECC - Pacific Economic Cooperation Council
PREM – Poverty Reduction and Economic Management
PRSP – Poverty Reduction Strategy Papers
PSAS - Private Sector Advisory Service
QRs - quantitative restrictions
RIAs – Regional Integration Agreement
ROSC- Report on Observance of Standards and Codes
TRIMs – Trade-Related Investment Measures
TRIPS – Trade-Related Intellectual Property Rights
UNCTAD – United Nations Conference on Trade and Development
UNDP – United Nations Development Program
WBI – World Bank Institute
WCO – World Customs Organization
WTO – World Trade Organization

LEVERAGING TRADE FOR DEVELOPMENT: THE WORLD BANK'S ROLE

EXECUTIVE SUMMARY

1. As globalization intensifies, trade in goods and services is becoming increasingly important to economic growth and poverty reduction. The Bank, usually in partnership with other entities, is working to help developing countries create—and take advantage of—new trade opportunities. It is doing so in three policy domains: global, regional, and national.

2. At the global level, developing countries, more important in size and sophistication than ever before, are now pivotal to the success of the world trading system. Their interests have to be taken into account if any new multilateral trade negotiations are to be successful and if the multilateral system is to be strengthened. The Bank's objective is to help developing countries use the system of multilateral rules to expand their trade and development. In particular, the Bank is focusing intensively on the barriers facing least developed countries (LDCs) in using trade to promote development. These barriers matter. For example, if the United States, the European Union (EU), Canada, and Japan were to give free access to the least developed countries, net exports of LDCs would increase by about 11 percent, and non-oil exports from Africa would expand by 14 percent. Beyond the issue of access for least developed countries, the Bank is working on global issues that affect all developing countries: trade in services, standards, transport, and intellectual property as well as foreign direct investment.

3. Regional arrangements are becoming increasingly important for trade policymakers in the developing world. The Bank is focusing on analyzing their effects, on helping governments to shape arrangements so that they expand trade and become steppingstones to more effective multilateral participation, and on advising prospective members about costs and benefits. Understanding the effects of the largest arrangements, such as the proposed Free Trade Arrangement of the Americas and the European Union agreements, is especially important.

4. Finally, and most important, at the country level, work on traditional border barriers remains a priority, particularly for countries in South Asia, the Middle East, and Africa. At the same time, virtually all our client countries are paying increased attention to "behind the border" issues—for example, investment regulations, transportation infrastructure, standards and technical regulations, trade facilitation, telecommunications, and business services—to ensure that producers can take full advantage of the opportunities globalization presents. This part of the new trade agenda may partially overlap with extant sectoral reform initiatives, and in these cases, the task is to ensure consistency between trade-related objectives and the other objectives of sectoral reforms. In all cases, the Bank's goal is to help governments design and implement pro-poor reform programs that can leverage trade into faster growth and poverty reduction. Of particular importance is the Integrated Framework effort, a multilateral initiative designed to help least developed countries respond to market opportunities and accelerate their integration into the multilateral system.[1] Most of the Bank's trade-related administrative resources are concentrated in support of country programs.

5. The Bank has a unique role: to help developing countries leverage international trade and investment into faster growth and poverty reduction. But this can be achieved only if the Bank works in partnership with others. In the last two years, the Bank has launched activities in trade and investment, working in tandem with the IMF in the PRSP process in low-income countries and in the development programs of middle-income countries. The Bank has also been working with the IMF, WTO, UNCTAD, UNDP, ITC, and bilateral agencies as part of the Integrated Framework assistance program.

6. After a period in the mid-1990s in which trade received less emphasis, the Bank is intensifying its trade-related activities at all three levels—global, regional, and national. This paper outlines current activities and priorities for the future (see box for overview).

Overview of Bank Program: Objectives and Instruments

Objective: Help developing countries use the multilateral system to expand trade, especially market access for low-income countries.

Instruments and expected outcomes:

- *Global Economic Prospects 2001* and *2002*: Agenda setting, positioning developing countries for a new round, and calling world attention to market access and trade-related development issues
- *Handbooks on Trade Policy and Negotiations*: Preparing developing countries for a new round with two handbooks, one on comprehensive WTO issues and one on agriculture
- Policy Studies: Insight into opportunities and potential anti-development bias in services, TRIPS, and standards, and so influence WTO discussions in coming years
- Capacity building for accession to the WTO: More informed decisions on WTO accession, better development outcomes, and more enduring agreements among clients

Objective: Help developing countries use regional arrangements efficiently to expand trade and neighborhood integration.

Instruments and outcomes:

- Advice on arrangements' architecture: policy research and regional studies that improve the design of arrangements, consistent with movement toward multilateral principles
- Dialogue on regional arrangements: studies and policy dialogue that encourage trade-creating designs, improve accession terms to RIAs, and promote pro-poor trade liberalization

Objective: Help governments design and implement reforms that will expand trade and transmit benefits to low-income groups.

Instruments and outcomes:

- Advice and support for low-income countries for PRSPs: Integrated Framework studies that identify key constraints to integrating into the world economy (about 10 countries in 2001/2002)
- Advice and support for trade policy reform: ESW, program lending, including Poverty Reduction Support Credits, and some investment loans.
- Sectoral advice and support in investment policies, regulatory reform and standards and services: PSAS advice, ESW and lending in finance, transport, telecommunications, trade facilitation and business services, and advice on foreign direct investment policy regimes through FIAS (44 projects)
- Trade policy capacity building: Training programs through WBI.

LEVERAGING TRADE FOR DEVELOPMENT: THE WORLD BANK'S ROLE

1. TRENDS IN GLOBAL INTEGRATION

7. Trade has been one driver of global growth for the last three decades (see Box 1). Growth of exports worldwide has outpaced growth of output every year in the last three decades by an average ratio of 1.5 to 1 (Figure 1). Moreover, this trend has increased over time and, after a pause in the mid-1980s, jumped to nearly 2.5 to 1 in the 1990s. As a consequence, in the space of just the last decade, the average ratio of trade-to-GDP in developing countries has risen from 29 percent to 43 percent.

Box 1 Trade Liberalization, Growth, and Poverty Reduction

Several cross-country studies and case studies have documented a strong relationship between trade and growth.[2] Sachs and Warner (1995) found that an openness index reflecting tariff and nontariff barriers, the black market premium, and the existence of commodity marketing boards has a high and negative association with growth. Ben David (1993) found that income levels in countries that joined the European Common Market have tended to converge toward the level of the richest partners. Similar studies have documented income convergence among states within the United States. Edwards (1997) found a significant positive relationship between openness and productivity growth. In a recent study designed to identify measures of openness that cannot be said to be affected by economic growth. Frankel and Romer (1999) found that countries that are geographically closest to centers of demand have grown faster. Several studies have found that restrictions hurt growth. Jong-Wha Lee (1993) found that high tariff rates have a negative effect on growth when the tariff rate is weighted by the importance of total imports in GDP. Ann Harrison (1996) found that several measures of restrictions on free trade tended to lower growth. Edwards (1997) found that several indicators of interference with free trade (tariffs, nontariff barriers, collected trade taxes, etc.) tend to lower productivity growth. David Dollar and Aart Kraay (2001), in a recent study that tries to avoid some of the methodological problems of earlier work, found that changes in trade volume have a strong relationship to changes in growth rates. The positive relationship between openness and growth has also been supported by numerous case studies[3], as well as a combination of economic theory and anecdotal evidence dating back to Adam Smith. The opposite also should be noted: No study has found that high levels of protection and/or trade closing have led to rapid and sustained growth over a long period in any set of countries.

But not everyone has found the evidence convincing. For example, Rodriguez and Rodrik (1999) argued that some indicators of openness are highly correlated with other indicators of economic performance, including macroeconomic policy, or that they imperfectly reflect a country's trade policy regime.[4] In fact, it is difficult to isolate statistically the effects of trade reform on growth because, among other things, trade liberalization is rarely implemented as a stand-alone policy measure. Rodrik's conclusion that trade liberalization should not be oversold as a singular policy panacea is undoubtedly wise counsel. "Countries that have achieved long-term economic growth have usually combined the opportunities offered by world markets with a growth strategy that mobilizes the capabilities of domestic institutions" (Rodrik 2000:5).

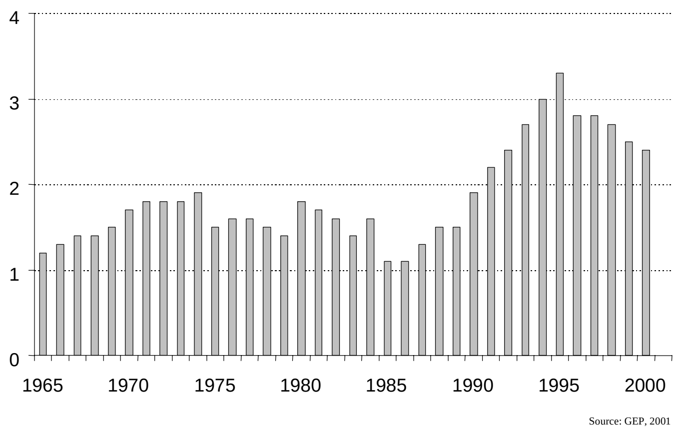
To ignite pro-poor growth, therefore, trade liberalization requires companion policies, including macroeconomic stability, a sound investment climate, domestic regulatory reform, and investments in education and adequate safety nets. These same policies are needed to ensure that economic growth has full positive effect in lifting people out of poverty (see World Bank 2000d: 70–71). In sum, "...openness is part of a development strategy; it does not substitute for it" (Rodrik, 1999:2). For that reason, the Bank is working with countries on PRSPs and other development programs in which trade is often an integral part—but not the only part—of a growth and poverty reduction strategy.

Figure 1

Trade has become a driver of growth, but barriers remain….

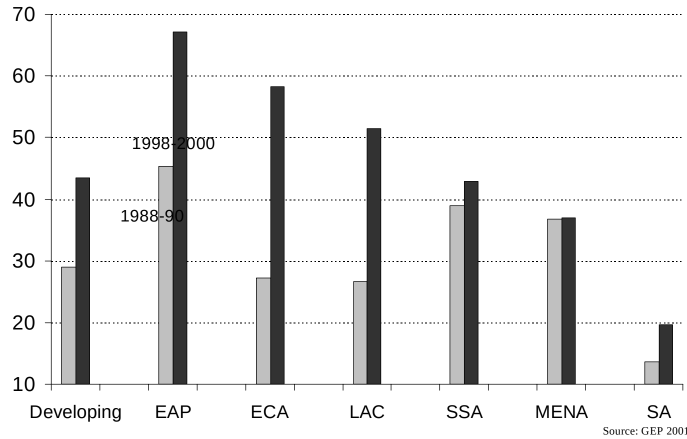
Trade has outpaced output to propel growth...

Ratio of trade growth to GDP growth

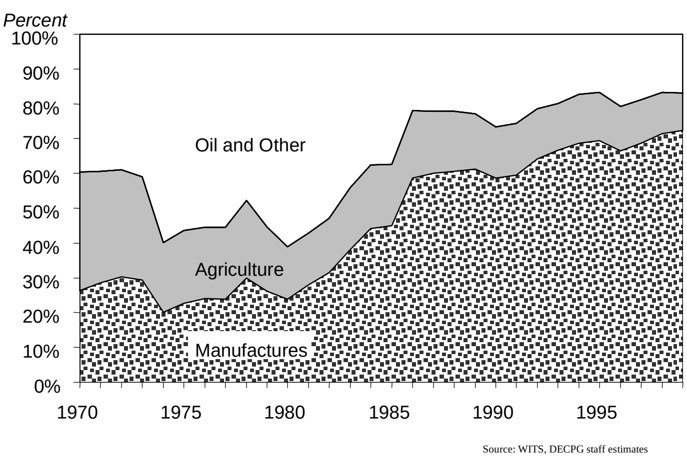


...and is now more important in all regions...

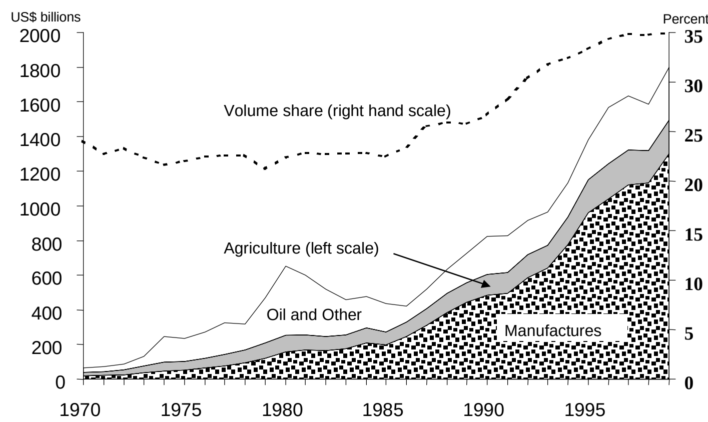
Trade (exports plus imports) as share of GDP (real)



The share of manufactures in developing country exports is rising...

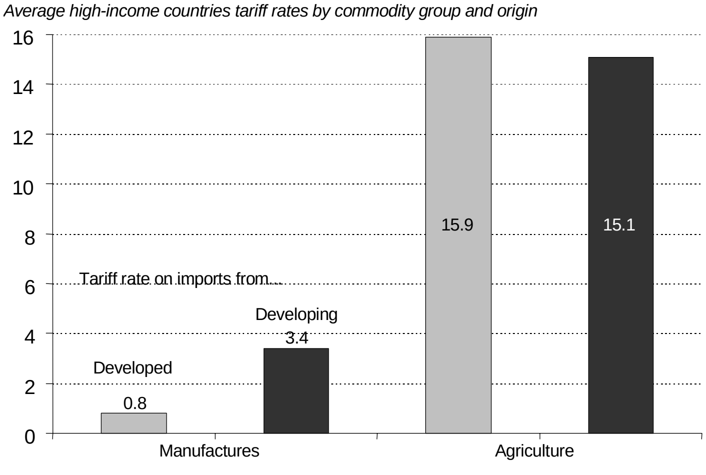


...and they have now become major players in world trade...



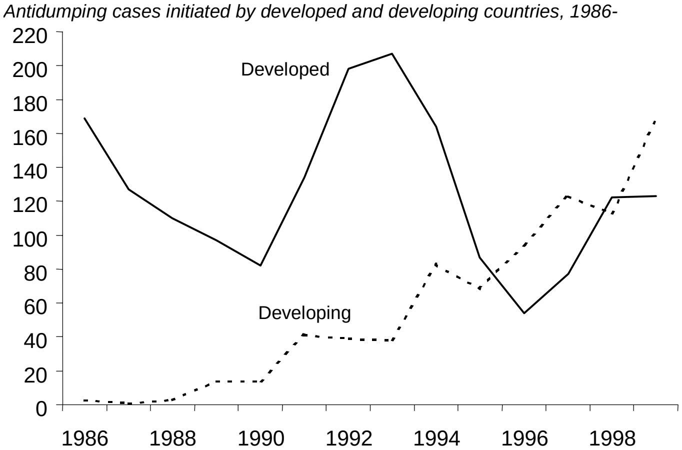
...but still face high barriers to trade in developed countries...

Average high-income countries tariff rates by commodity group and origin



...and are now victims and players in the rising game of antidumping...

Antidumping cases initiated by developed and developing countries, 1986-



8. In the process, developing countries have become more important players in the global marketplace. Their share of world trade has increased over the last 30 years from about one-quarter in 1970–72 to one-third in 1997-99(Figure 1),[5] and their share of manufacturing trade has more than doubled—from about 15 percent to nearly 30 percent. Developing countries as a group are exporting more manufactures and have become less reliant on traditional exports of agricultural and mineral products. Most developing countries participated in this structural shift.

9. China in particular has increased its exports and imports. This reflects the policy decision to move from virtual autarchy to active participation in the globalization process after 1978. China's share of the global marketplace has risen to 3.5 percent, double its share in the mid-1980s. This pace of expansion echoed the rise of the Republic of Korea and other East Asian countries during the 1970s and 1980s, and went hand in hand with their sustained fast growth of output. Of late, several Latin American countries and India seem poised to make a similar jump in global trade participation.

10. Not all countries have participated in this process. Many low-income countries in particular have yet to benefit from the wave of trade expansion. For example, the African share in world trade declined from 3.5 to 1.3 percent from 1970 to 1998. Merchandise exports in Africa grew only at 2.5 percent from 1991 to 1998, compared to 15.2 percent in East Asia or 9.3 percent in overall developing countries in the same period (Ng and Yeats, 2000). Nor did these countries ride the wave of diversification from primary products that other developing countries did. Today, they remain heavily dependent on exports of a few commodities. Moreover, their exports are much more susceptible to terms-of-trade shocks; Sub-Saharan African exports experienced roughly twice the volatility in terms-of-trade that East Asia's exports did in the 1970s, 1980s, and 1990s, and nearly four times the volatility in terms of trade that the industrial countries experienced (de Ferranti et al., 2000: 47).

11. Protection—in both the industrial *and* developing countries—is one factor preventing poor countries from leveraging trade integration for development. OECD protection imposes costs on developing countries that exceed aid flows. Even though overall average tariffs are relatively low and have come down considerably during the Uruguay Round, tariff and trade barriers of industrial countries remain higher on many products exported by developing countries. Least developed countries' exports, for example, confront tariff peaks in several product categories: only 6 percent of 5,000 tariff lines in the United States are above 15 percent, yet fully 15 percent of least developed countries' exports face these tariffs. Also, agricultural subsidies in industrial countries undermine developing countries' agricultural exports by depressing global prices and pre-empting markets. These subsidies averaged 35 percent of gross farm receipts—some $266 billion annually in 1997–99, more than five times the level of all official financial flows to developing countries. Many developing countries themselves have high tariffs: their tariffs on manufactured exports to each other are three times higher than the high-income countries impose on developing countries and 20 percent higher on agricultural products (World Bank 2000b: 65–71). Similarly, developing countries have joined in the recent wave of anti-dumping and countervailing duties that now have trade-impeding consequences around the globe (Figure 1).

12. A similar asymmetry between middle and low income country performance on trade exists for foreign direct investment (FDI), often a vehicle for trade expansion as well as growth. Exports of foreign affiliates in developing countries to the parent organization abroad account for one-third of all exports from developing countries, and two-thirds of their exports involve a

multinational buyer or seller. These ratios are probably higher for developing countries, where investments to take advantage of lower labor costs require higher vertical integration.[6] FDI thus offers marketing channels for the exports of developing countries, and foreign affiliates often enjoy preferential access to home markets that unaffiliated firms do not. It is no wonder that several studies have shown that trade propensities of foreign affiliates are higher than for domestic firms. Finally, FDI is intimately linked to the dynamic sectors of trade, notably services, in recent years. Investments in the service sectors—insurance, finance, transportation, and telecommunications—have become an increasingly large share of total outward foreign direct investment, now rivaling manufacturing investments and dwarfing investments in primary production. For many services, the main way to trade is through foreign affiliates.

13. Some 70 percent of FDI flows routinely go to the most advanced of developing countries. It is to be expected that the great bulk of FDI goes to the largest economies, since these countries have the largest internal markets and large pools of human resources to integrate into global production networks. (In fact, most FDI worldwide goes to the developed economies: the United States received more inward FDI in 1999 than all developing countries combined; see UNCTAD 2000). Even though FDI flows have accelerated in recent years, developing countries as a group have been losing share, and among developing countries, the poorest have fared the worst. And the slippage of low-income developing countries has been precipitous since the mid-1990s (Figure 2). Part of the poor performance is associated with Indonesia's post-1997 collapse. But these numbers also reflect the fact that recent policy improvements in middle-income developing countries have outpaced those in low-income countries. Attracting FDI requires a *sound investment climate* and a well-designed *investment policy,* particularly toward FDI. The exceptions prove the rule: those small market countries that have good policy environments, such as Mauritius and Costa Rica, have received relatively large inflows of FDI.

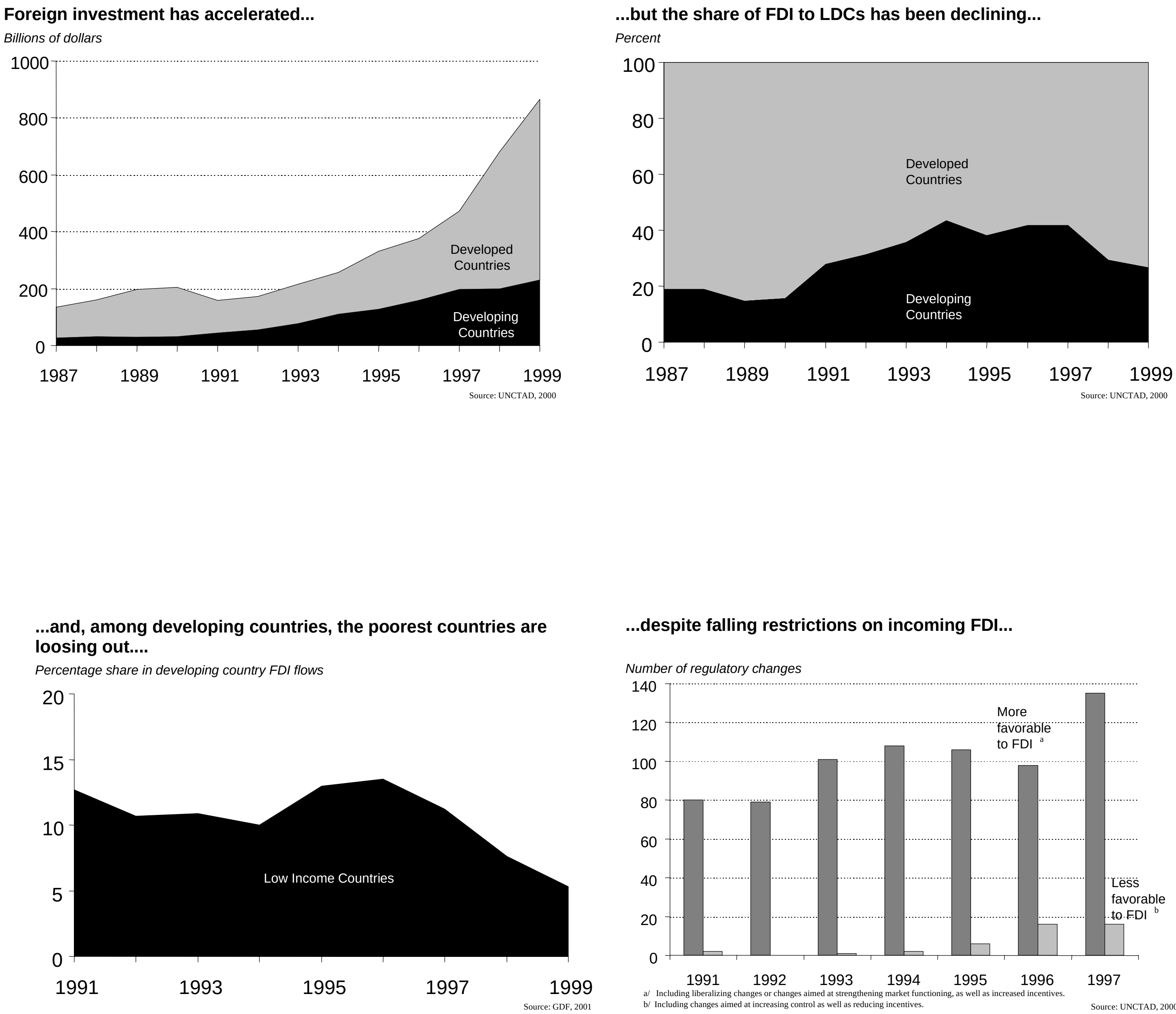
14. Trade and investment can be a powerful locomotive for development. Realizing this promise, however, is not certain. The multilateral trading system after Seattle is under stress. Countries have increasingly turned to regional and bilateral trade and investment arrangements, and the number of such arrangements has proliferated. Meanwhile, the pace of trade integration of developing countries has made the national agenda even more complex. Recent developments in each policy domain—multilateral, regional, and national—make this clear.

Multilateralism and Developing Countries

15. The multilateral trading system, despite the progress achieved under the Uruguay Round in 1994, leaves many issues central to developing countries unresolved. Ever since the industrial countries announced their back-loaded schedules for implementing the Uruguay Round Agreement on Textiles and Clothing, developing countries have been frustrated by the pace of liberalization of the textiles and clothing trade. Subsidies, quota arrangements, and high tariffs in OECD countries in agriculture, a sector of special importance to development, continued unabated and in some cases increased. Many developing countries felt that the intensive use of anti-dumping measures against them in industrial countries was stifling their exports. At the same time, new agreements on intellectual property (TRIPS) and investment measures (TRIMs), as well as the new Agreement on Technical Barriers to Trade (TBT) and Agreement on Sanitary and Phytosanitary Standards (SPS) created difficult issues of implementation, infrastructure modernization and capacity building.

Figure 2

Foreign investment promotes trade…but developing countries are not keeping pace



16. Not only did some developing countries believe these new disciplines were disadvantageous to them, but the process by which new proposals were being adopted left them too frequently excluded. For example, many developing countries refused to accept the agenda propounded by several high-income countries in some areas at the Seattle ministerial meeting of the WTO. Many governments expressed dissatisfaction with the way the negotiating agenda was set, as many countries, small ones in particular, did not have access to the forums where potential agenda-setting compromises were crafted. These concerns led to proposals for "confidence building measures" for the developing countries, and to the idea of a "development round" of multilateral negotiations that would take up some of these concerns.[7]

17. The hiatus in negotiations after Seattle has not meant that developing countries have abandoned multilateral institutions. To the contrary, developing countries now constitute a sizable majority of WTO membership and have a particular stake in a strong, nondiscriminatory multilateral system of rules. Progress on important issues such as liberalization in agriculture and services is only likely to occur as part of multilateral negotiations. Small countries, often with limited bilateral bargaining power vis–à-vis larger trading partners, can derive protection from the system of global rules. Large developing countries benefit from several provisions, not the least of which is dispute settlement procedures that help depoliticize trade conflicts. And participation in the WTO can lock in domestic reforms in a way that raises investor confidence. Regional arrangements are not a substitute. Not all countries can accede to advantageous regional arrangements for reasons of geography or other factors. Moreover, multilateral rules provide a benchmark for regional agreements and unilateral tariff reforms.

18. For these reasons, several major trading powers from the developing world that have historically been outside the multilateral trading system have redoubled their efforts to participate. China's 15-year quest to join the GATT/WTO looks likely to bear fruit during 2001. The country has committed to substantial reforms of its trade regime and a sharp reduction in its levels of protection. These reductions in protection are expected to dramatically increase China's share of world markets. With the liberalization commitments made at WTO, China's share of world exports and world imports is expected to roughly double to close to 7 percent by 2005 (Ianchovichina and Martin 2001). Taiwan (China), as an independent customs territory, would also enter the WTO around the same time, and this will constitute a major addition. Finally, the Russian Federation is progressing with negotiations on entry to the WTO. Other important trading countries are also moving forward, including countries as diverse as Saudi Arabia and Vietnam.

19. A new round may yet be launched, perhaps at the time of the WTO fourth ministerial meeting in Qatar in late 2001. The OECD countries have to consider ways to put in place steppingstones toward a broader framework that recognizes the special problems developing countries experience as they adopt new rules. The traditional WTO approach of developing common rules may not be appropriate in several areas where there are substantial implementation costs[8] and critical institutional development needs, although it remains as valid as ever in areas such as the principles of non-discrimination and national treatment. All countries would benefit from a round of liberalization that improves market access for developing countries, that simplifies WTO procedures to better suit their administrative capabilities and requirements, and in general ensures that global rules support the development process.

Rising Regionalism

20. Regional arrangements to expand trade continue to proliferate. Governments, now more receptive to openness than in previous periods, have sought to expand existing trade by locking in increased market access with trading partners—most often neighbors. Moreover, regional arrangements are attractive because they can increase the credibility of reforms and may be less cumbersome to negotiate than multilateral reforms. Smaller memberships may also make it easier to negotiate the increasingly important issues inherent in regulatory regimes, a sharp contrast with complicated multilateral negotiations involving more than 100 countries. Also, small countries can exercise greater influence in regional arrangements.

21. Regional arrangements, properly designed, have the potential to stimulate global trade through improving the efficiency and hence competitiveness of regional producers and expanding demand for inputs from nonregional sources. But regional agreements behind trade barriers may artificially shift import supply from external countries to countries within the trade area, and this may lead to reduced efficiency for participants if displaced external suppliers would provide goods at lower cost. This trade diversion may disadvantage global export competitiveness in much the same way that national barriers do. “Rules of origin” arrangements in some regional arrangements can raise costs and stifle local industry. This is also true of Mutual Recognition Agreements (MRAs) which may shield regional partners behind discriminatory testing and certification protocols or regional standards. Smaller countries with less technical capacity to evaluate these schemes may find themselves at a net disadvantage, and be better off with first-best unilateral trade reform.

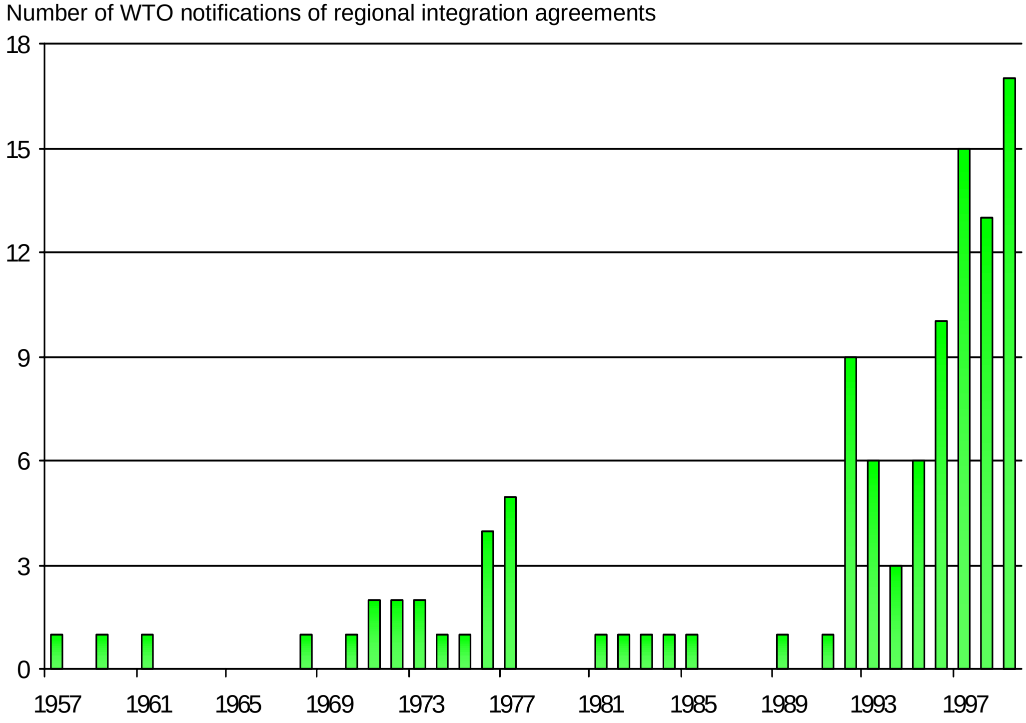
22. Whether a particular agreement improves national incomes depends on its design and on the trading partners involved. Key design tests include whether regional arrangements involve lowering common external trade barriers, whether they stimulate increased competition, and whether they reduce transaction costs and extend to nondiscriminatory investment and services policies—all elements central to “open regionalism.” The World Bank Policy Research Report *Trade Blocs* (2000e) concludes that North-South regional agreements are more likely to improve welfare than South-South ones, simply because experience to date shows they usually result in lower trade barriers with less trade diversion, and because the greater structural differences in North-South economies usually produce greater potential gains from trade creation. The EU arrangements under the 1992 Single Market Program are the clearest case where the analysis shows income-increasing effects. The North American Free Trade Agreement (NAFTA) also appears to have had a positive impact on its members. While studies have shown that NAFTA’s impact on the United States and Canada has been small, its impact on Mexico has probably been greater: some static losses in tariff revenue have probably been offset by large increases in capital flows, particularly FDI, with significant dynamic gains. It is clear that NAFTA’s success built upon Mexico’s earlier unilateral trade reforms.

23. This is not to say that South-South arrangements cannot be made to work. However, many South-South regional integration agreements have been formed that have had negative or ambiguous effects on income. The *Trade Blocs* report found that South-South agreements between richer and poorer developing countries are likely to generate losses for the poorer ones when the poorer members import products from the richer members whose firms are not internationally competitive. For example, in the 1960s, Kenya had a more developed

manufacturing sector than Uganda and Tanzania, and when the three formed the East African Community (EAC), the latter two lost tariff revenue by importing from Kenya at the high protected price rather than at the lower world price, with transfers going from them to Kenya. This asymmetry proved unsustainable and resulted in the demise of the EAC.

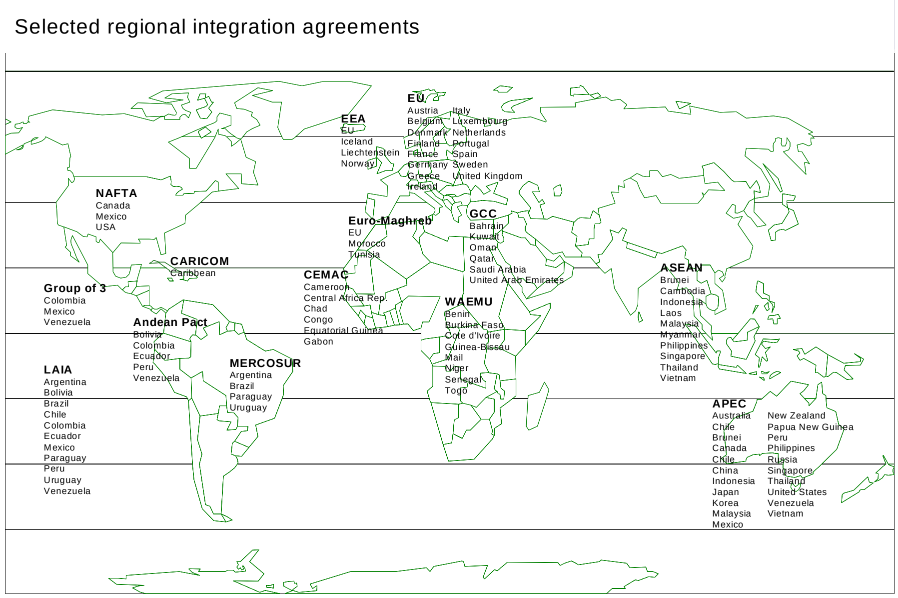
Figure 3

Regional integration agreements are proliferating...



Source: World Trade Organization.

... and now span the globe.



24. Regional arrangements are likely to remain an enduring feature of the trade panorama. To realize possible benefits of trade and investment expansion, arrangements have to be designed in a way that they become steppingstones to greater openness and development, rather than a vehicle for protection and unintended inefficiency. An important component of making them steppingstones rather than stumbling blocs to greater openness is for the countries involved to have low protection against non-member countries. For example, Harrison, Rutherford and Tarr (1997) estimate that Chile was able to gain from its free trade agreement with MERCOSUR due to the fact that it lowered its external uniform tariff from 11 to 6 percent. In addition, participating countries should actively participate in the multilateral process, including moving rapidly toward accession for those countries not yet members of the WTO.

National Policies: Increasing Complexity

25. Developing countries have undergone a sea change in their approach to global integration. Many have reduced *border barriers*—tariffs, nontariff barriers, and, customs inefficiencies—even though these barriers still remain important for selected regions. This has exposed a huge new agenda in all regions of "*behind the border*" issues: trade in services, standards and technical regulations and investment policies as well as sectoral issues in finance, transportation, and telecommunications; policies in these areas have to be sound to ensure effective use of opportunities globalization presents.

26. Progressive reforms in trade and exchange rate policies during the 1990s have driven down border barriers. Tariffs were cut, their dispersion declined in many countries, fewer products were covered by quantitative restrictions (QRs), the number of countries allocating foreign exchange through administrative means dwindled, and the black market premium narrowed. Although any one of these measures is an imperfect guide to the restrictiveness of the trade regime, taken together they show enormous progress in opening the developing economies to international trade. The trend toward lowering tariffs and eliminating foreign exchange restrictions is evident in both low-income and middle-income countries. The average tariff rate for low-income countries fell from almost 45 percent in the early 1980s to 20 percent in the late 1990s, only slightly above the average rate for middle-income countries (Figure 4).

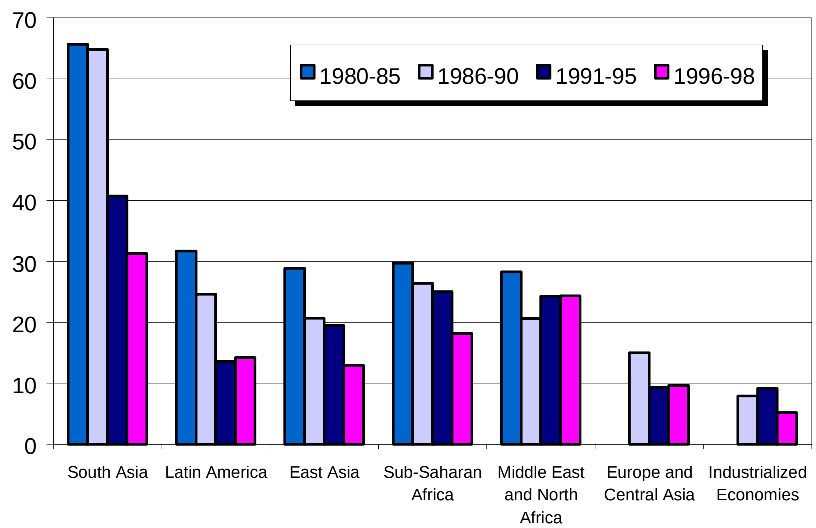
27. The 1990s also saw a general move toward market-based foreign exchange regimes. In 1991, 66 countries had restrictions on payments for current account transactions, but by 1995 only 28 did. Many countries also undertook significant exchange rate reforms. The average black market premium for developing countries, one indicator of the restrictiveness of foreign exchange allocations as well as of macroeconomic imbalances, fell almost 70 percent between the 1980s and the 1990s. This pattern held, if with some variance, for all regions. By the late 1990s, most of the low-income countries had eliminated current account restrictions and reduced black market premiums to negligible levels. Several studies have underscored the desirability of maintaining competitive real exchange rates to support trade expansion (see World Bank 2000b).

28. There remain considerable differences across regions. Border trade barriers continue to be high in three regions (Africa, the Middle East, and South Asia). Average (unweighted) tariffs in these regions are 20 percent or higher, nearly double the 10 percent average now found in East

Asia, Latin America, and Europe and Central Asia. Moreover, in many countries, tariff dispersion remains large, and so nominal tariff averages may understate the resulting economic distortion. In the small number of countries where nontariff barriers (NTBs) continue to be used, elimination of such instruments should be a priority. Their conversion into tariffs will generally generate revenues.

Figure 4 ***Tariffs are tumbling***

Average unweighted tariff rates, by region (percent)



Source: World Bank 2000b.

29. Another type of border barrier is inefficient customs administration. From the vantage of a trader, delays or corruption can have much the same economic effect as a tariff. They raise costs to consumers.

30. Lowering tariffs may not by itself produce growth. Getting businesses to seize the new opportunities associated with trade reform requires a stable macroeconomic environment together with complementary improvements in the investment climate and trade-related service sectors (e.g., transportation)—"*behind the border*" policies to facilitate trade. For example, trade liberalization in the presence of severe macroeconomic instability is unlikely to be successful, as companies have difficulty borrowing to finance investments in exports or, more generally, have less confidence to invest. If restrictions on foreign ownership are not lifted concomitantly with trade reform, one source of potential investment in exports is closed off. If discriminatory standards remain in place, inefficient domestic producers are rewarded relative to low cost foreign competitors. Finally, if small farmers in the interior of a country cannot get their products to market because of poor transportation, the supply response of agricultural exports to trade reform will be muted. *This nonborder trade agenda includes investment policies, standards, and trade in services.*

31. *Small States.* Small states face major constraints because of their size. They are particularly vulnerable to natural disasters and trade swings; they face major challenges, but also opportunities, from globalization; and they need to surmount diseconomies of scale in the public

and private sector. For many, trade integration is a priority. The Small States Joint Task Force Report articulated an agenda for the development community in providing assistance to small states and action plans for individual development agencies to carry the agenda forward.[9] The Bank has identified seven areas in which it focuses its assistance to small states: reducing transactions costs for small states, and donor coordination; supporting regional initiatives; lowering the costs of natural disasters and improving risk management; supporting private sector development; assisting in exploiting opportunities that information technology and electronic commerce can bring to small isolated states; protecting the physical environment; and facilitating knowledge sharing. Recent CASs for small states—e.g., Pacific Islands region, Bhutan, and Belize—contain detailed discussions of trade issues and how they affect each country's development prospects and related Bank assistance.

32. The annual growth rates of small states are more volatile than large ones. This reflects in part their greater sensitivity to terms-of-trade shocks because they are relatively less diversified and relatively open economies. It is inherently more difficult to insure or diversify against risks in small economies than in large ones. But on balance their policies of greater openness pays off positively in growth and that openness is even more important for small states to realize economies of scale. However, small states can generally ill afford the cost of negotiating complex trade agreements, monitor their implementation and mediate disputes.

33. *Commodity Price Volatility*. Volatility of commodity prices for economies that are dependent on commodity exports has motivated some trade interventions to stabilize commodity markets. Poor consumers, small businesses and smallholder producers may be particularly vulnerable to price swings. However, during the last decade, many of the traditional approaches and institutions associated with price stabilization have been discarded as ineffective, expensive, quite costly to the economies involved or unfair. Examples include domestic marketing boards, stabilization funds, quota or buffer-stock based international commodity agreements, and STABEX. Especially in developing countries, long-standing interventionist approaches have crowded out market-based instruments for managing price volatility, exacerbating the effects of volatile markets (see World Bank 2001b).

34. Volatile prices affect incomes and expenditures of the poor directly. Through changes in government revenue and expenditures volatile prices can also affect public services to the poor in commodity-dependent countries. The World Bank is trying to address the direct problem of the adverse impact of price volatility on income and expenditures by hosting an International Task Force on Commodity Risk Management in Developing Countries. The goal of the task force is to find ways of extending the reach of commodity risk management markets to consumers, smallholders and small businesses in developing countries. The World Bank is also trying to help reduce the consequences of volatile prices on government balance sheets by integrating commodity risk management tools – for example swaps and options – directly in its lending.

35. *Environmental Issues.* Measures aimed at restoring macroeconomic stability and implementing structural reforms, such as the removal of trade and price distortions and promotion of market incentives, often produce simultaneous economic, social, and environmental gains. Adverse environmental effects may occur, however, when reforms such as trade liberalization are pursued without complementary attention to market or institutional failures. In response to these and other concerns, the World Bank has been undertaking a major

revision of its environmental strategy. The draft strategy will be finalized during the next few months. It will focus on enhancing the Bank's Safeguards policy, integrating environmental concerns into Country Assistance Strategies, and ensuring that policy-based lending programs promote sustainable development.

36. *Investment policies.* Eliciting a supply response to reform of the trade regime requires a sound investment climate in general and specific policies conducive to efficient and competitive investment. General policies favorable to investment include a stable political environment, sound macroeconomic policies, a low level of corruption, an effective judicial system, and regulations that achieve public purposes with minimal distortions in incentives.

37. One area of special importance is regulation of foreign direct investment. During the last decade, governments everywhere have begun to dismantle restrictions on incoming multinational investments as part of strategies to bring in FDI-related technology, new sources of competition, and less footloose capital flows (see Conklin and Lecraw, 1997). UNCTAD (2000) found that governments enacted policies easing restrictions on incoming foreign direct investment seven times more frequently than they did to tighten restrictions in 1995–97. Many of these restrictions pertained to the service sector, which is increasingly important to development objectives. For example, East Asian governments in the years after the crisis opened formerly restricted sectors in finance, retail sales, and manufacturing to foreign direct investment. In Thailand, for example, the government has recently permitted new entry in the financial sector. Korea has gone from being among the economies most closed to foreign investment to being one of the most open in the four short years since the Asia crisis. Malaysia, with its already relatively open FDI regime, has been the single exception in maintaining its few precrisis restrictions (see World Bank 2000c). Greater investment in education may allow countries to use FDI more productively (see Borenzstein et al. 1998) and pro-competition policies, especially in removing policy-induced barriers to entry and high border protection, are important to realizing gains from foreign investment (see Frischtak and Newfarmer 1996).

38. *Standards and trade-related regulations.* Many developing countries, particularly low-income countries, are not adequately equipped to deal with product standard requirements, including sanitary and phytosanitary standards (Wilson 2001a). The EU, for example, turned away Ugandan fish and South Asian shrimp exports on these grounds. The implementation of standards involves costs when commitments are bound in negotiated agreements. Some of these costs are inevitable. They arise from the testing and certification (conformity assessment) procedures necessary to determine if a product, such as fresh fish or produce, meets standardized requirements. Efforts by developing countries to raise product and process standards to meet international requirements can confer significant economic benefits (Wilson 2001b). For example, health and sanitation requirements can raise average health status in an economy, with spillover benefits into higher productivity. Telecommunications standards set by international consensus expand the gains from global communications and information networks. Network standards can aid directly in provision of services in the least developed countries, via tele-medicine or advance warnings of floods and other natural disasters.

39. Standards which are not based on principles of sound science or balanced against risk, however, can block trade and represent unnecessary and significant costs to manufacturers, consumers, and society. Discriminatory testing and certification rules are also of rising concern. These non-tariff barriers can be particularly costly to developing countries. In Africa, for

example, compliance costs are especially high for small agricultural producers and exporters. New European standards on aflatoxin are estimated to cost exporters $670 million (Otsuki, Wilson, Sewadeh 2000). Market access requirements raise compliance costs of foreign producers and result in reduced imports of foreign commodities, while increasing domestic production.

40. *Trade in services and trade-promoting service development*. Improving the efficiency of service sectors, which is necessary for responding to global opportunities, usually means exposing domestic markets for services to international competition. But opening is unlikely—by itself—to be sufficient to promote the productivity gains necessary to fully leverage globalization for growth; this larger objective often requires policies and institutions to develop these trade-related sectors. These encompass several sectors:

- An efficient and well-regulated *financial sector* is necessary to finance trading activities, to channel scarce savings into new investments in internationally competitive activities, and to ensure that during episodes of trade reform, resources flow swiftly from protected sectors to efficient activities with minimal disruption. A prudently regulated financial sector is also necessary to avoid macroeconomic volatility associated with highly cyclical capital flows. Because of potential instability associated with volatile capital flows and fragile banking systems, liberalization and exposure to foreign competition has to be part of a careful strategy of integration.[10]

- *Transport services* contribute to the efficient distribution of goods within a country and are particularly important in influencing a country's ability to participate in global trade (the cost of international transport is often higher than the applicable tariff). Shipping costs in developing countries are inflated by an average of over 25 percent by a combination of regulations and private cartelization (Fink et al. 2001).

- *Telecommunications* are increasingly at the apex of cross-border flows of information and are crucial to the dissemination and diffusion of knowledge as well as the facilitation of trade. The rise of Internet-driven commerce means that telecommunications may become as important to trade tomorrow as ports are today. The Internet is rapidly becoming the gateway to trade (see World Bank 2000b, chapter 4).

- *Business services* such as accounting and legal services are important in reducing transaction costs. They are also essential for creating and enforcing contracts, without which business development will be stifled.

41. All of these areas benefit from greater competition, and their development is essential for taking further advantage of global opportunities. Research has shown that the gains from eliminating barriers to trade in services can easily be a multiple of those associated with merchandise liberalization. Dee and Hanslow (1999) estimated that full trade liberalization, including liberalization of services, would lead to a median GDP increase of 3.9 percent among major developing countries in East Asia; because border barriers are already low in East Asia, most of these gains are associated with service liberalization.

2. Expanding Trade for Development: Bank Priorities

42. Responding to this agenda requires clear objectives on all three levels of policy. On the *multilateral level*, the Bank's objective is to help developing countries use the multilateral system to promote trade and development. This includes efforts to increase access of developing countries to the markets of the OECD countries and to markets of other developing countries. It also has to ensure that agreements on investment-related measures, intellectual property, and standards take into account the needs and enforcement capabilities of developing countries. At the *regional level*, the Bank intends to help developing countries use regional arrangements efficiently to expand trade and neighborhood integration and eschew the temptations of building regional fortresses. And on a *national level*, the Bank will help governments design and implement reforms that will expand trade and transmit benefits to low-income groups. Central to this effort is integrating strategies to reduce border barriers with strategies to improve the behind–the-border services necessary to make reforms successful.

43. The Bank's role is unique. It is capable of integrating the complex multilateral and sectoral trade policy issues with economic growth and poverty reduction objectives. The Bank's advantage is that it can combine trade policy analysis with significant sectoral expertise (especially in agriculture, finance, telecommunications, transportation infrastructure, and private sector advisory services) into a comprehensive view of how globalization can promote development. This capacity can be used in conjunction with other instruments, ranging from research in DEC to training and capacity building through WBI, to policy advice through regional and country studies, to program and project lending in association with IDA and IBRD lending. The objective of these efforts is clear: to help our clients make better use of trade and investment integration to promote rapid growth and poverty reduction.

44. Achieving this objective requires that the Bank reconstitute its trade activities. During the mid-1990s, the Bank shifted its focus to a broader reform agenda and decreased its emphasis on trade, particularly on border barriers. This reflected the rather steady progress in lowering border barriers and the emerging centrality of other development issues (such as governance and financial sector development). While perhaps appropriate at the time, given limited resources, it has become clear that globalization is raising new development issues, that integration requires deeper reform efforts necessary to take advantage of new opportunities, and that nations in the WTO are now considering a much larger scope of trade-related issues that go right to the heart of development policy. This new trade agenda requires melding integration efforts with development programs that take into account the external barriers facing developing countries, the internal administrative capabilities of poor countries, and special interests of their poor. It requires merging trade-specific expertise with sectoral expertise as the "border agenda" gets melded with the "behind the border agenda" (a theme particularly important at the country level of policy discussed below).

45. The Bank can be effective only when working in partnership with agencies that have mandates and capabilities the Bank does not have. We are working hand in glove with the IMF. This has tangible synergies. The Fund works with governments to help create a macroeconomic environment consistent with sustainable growth and external balance (including appropriate exchange rate policy and financial soundness); the Bank works with governments to integrate trade policies at the border with investment and "behind the border" sectoral policies; together, these policies are designed to facilitate an investment response while protecting the poor.

46. We have initiated partnerships with bilateral donors, UNDP, and regional development banks that finance studies and do projects. We also collaborate with institutions such as UNCTAD and the World Customs Organization (WCO) that, although restricted to technical assistance and analysis, cover areas that we do not. The WTO, a negotiating forum for trade agreements and dispute resolution looks to the Bank to provide views about pro-development integration policies. One example is the ongoing project on developing countries and the next round of trade negotiations, the WTO 2000 project (see Box 2).

Box 2 Partnerships in Action: the WTO 2000 Project

In 1998, the Bank began work on the WTO 2000 program in partnership with several bilateral donors. The program has two major components. One focuses on agriculture (it is managed by the World Bank's Rural Development Department) and the other covers all other issues (Development Research Group/WBI). The program has sponsored workshops on WTO-relevant topics involving international experts and analysts working in developing countries, cosponsored with regional research institutions. Out of this will come two handbooks for trade negotiators, to be completed in 2001. These handbooks will include practical software tools that can be used to evaluate market access conditions and negotiating options. Also, the activity will assist developing countries after negotiations commence, producing further studies, training workshops, and outreach activities for the press, chambers of commerce and relevant nongovernmental organizations (NGOs). Particular attention will be paid to underserved regions, such as Sub-Saharan Africa and South Asia.

The project is supported by the Department for International Development (DFID), United Kingdom; the governments of Italy and the Netherlands; and Société Générale de Surveillance, Geneva, as well as the World Bank's Research Support Budget. Major partner institutions include the WTO; the Latin American Trade Network; the Economic Research Forum for the Arab Countries, Iran and Turkey; the African Economic Research Consortium; the Coordinated African Program of Assistance on Services; the Trade Policy Forum of the Pacific Economic Cooperation Council (PECC); the Global Trade Analysis Project Consortium; and the Centre for Economic Policy Research.

Key findings helped shape the recent paper on trade and development presented to the Board and disseminated at the Annual Meetings. The seminars held at the WTO have helped enhance the cooperation and policy coherence between the Bank and the WTO. The research findings from the project will also help guide the Bank's efforts to integrate countries more fully into the world trading system.

47. Against this backdrop of objectives and work modalities, the next sections describe Bank priorities in support of poverty-reducing integration in each of the global, regional, and country domains.

Global Priorities: Making Multilateralism Work for Development

48. The World Bank's objective is to help developing countries use the multilateral framework to promote trade and development. The current costs to developing countries of restrictions facing their merchandise exports and services, together with the effects of contingent protection (anti-dumping and safeguards), estimated conservatively, surpass $100 billion per year in foregone income.[11] Greater market access for the developing countries' goods and services in general, and for the least developed countries (LDCs) in particular, has to be one of the cornerstones of the multilateral system in the coming decade.

49. Our instruments are *analysis*, *advocacy,* and *advic*e: analysis of impediments to trade integration and development; advocacy of better trade policies that support development; and advice to policymakers around the world, including developing countries as they prepare to join the WTO or engage in multilateral negotiations. This demands a close dialogue with the WTO secretariat and a steady interchange with leading trade analysts around the world on developing country issues. It also requires dialogue with developing country clients that are involved in multilateral discussions. Our priorities are on five areas: market access for merchandise trade, trade in services, intellectual property, product standards, and preparation for WTO accession.

50. ***Market access for goods*.** Protection in OECD and other developing countries is one factor preventing developing countries from leveraging trade integration for development. Benefits to developing countries from phasing down these forms of protection are significant. Among the Bank's highest priorities is market access for least developed countries. A recent Bank study shows that if the United States, the European Union, Canada, and Japan gave free access to the least developed countries, the least developed countries' net exports would increase by about 11 percent (Hoekman et al. 2001). Non-oil exports from sub-Saharan African countries would expand by 14 percent (Ianchovichina et al. 2001). (This would have negligible adverse effects on either other developing countries or OECD producers because of the small market share of LDCs). Also, exports from developing countries confront high barriers in other developing countries. In fact, the average tariff of developing countries to imports from other developing countries was substantially higher than barriers into the Northern markets, 20 percent higher in agricultural products and three times higher in manufacturing (Hertel and Martin 2000).

51. Bank activities are focusing particularly on agriculture because of its importance to developing countries and the rural poor. In this regard, the "Everything But Arms" initiative of the EU to grant LDCs duty- and quota-free access for all products except arms, recently ratified by the Council of Ministers, is a path-breaking initiative in that it encompasses all trade in goods, including agriculture, [12] and is estimated to increase non-oil exports of sub-Saharan producers by 3 percent. The New Zealand government has decided to allow duty free access to imports from LDCs as of July 1, 2001. The Italian government, now holding the presidency of the G-8, is exploring the possibility of obtaining a commitment from the United States, Canada, and Japan at the next G-8 summit to also adopt such a proposal. Extending the initiative to the Quad is expected to increase sub-Saharan non-oil exports by some 14 percent (Ianchovichina, Mattoo and Olarreaga, 2001). The Bank has publicized these findings among many of our partner institutions as well as through such publications as last year's *Global Economic Prospects 2001*, this year's upcoming *Global Economic Prospects 2002,* and the forthcoming Policy Research Report on globalization.

52. In addition, to help countries use the multilateral system more effectively, the Bank has been preparing new analytical tools to assist countries in their analyses of their own policies. We have been working on handbooks for trade negotiators that will cover key issues relevant for regional and multilateral negotiations, and provide practical tools to analyze offers by trading partners. We have undertaken policy analysis associated with specific multilateral liberalization initiatives such as reforms of trade barriers in agriculture and manufactures under a future round of WTO negotiations (Hertel, Hoekman, and Martin 2000; Josling and Rae 2001). The WBI is conducting numerous training activities to ensure that studies get translated into greater knowledge and enhanced technical capacity among our clients. Finally, the World Bank and IMF are working on a joint study of market access for developing countries in preparation for the next G-8 summit.

53. These priorities—promoting market access, helping governments use the multilateral system more effectively, and providing analysis of specific initiatives—will continue into the future. A central focus will be continued work on market access of least developed countries, including analytical work that will serve as the basis of discussions among the United States, the European Union, Japan, and Canada, and least developed countries.

54. *Services.* The Bank has launched a major effort to improve formulation of policy in services and facilitate the participation of developing countries in services negotiation at the WTO. This includes new policy analysis in maritime transport, telecommunications, and financial services as well as broaching new themes such as export of services through temporary movement of workers. In addition, work has focused on the improvement of trade strategies implicit in Poverty Reduction Strategies as a steppingstone to more effective participation in the multilateral system and negotiations. A first step has been to design templates that can be used by policymakers to analyze the trade, growth, and distributional consequences of trade policies on the economy. Second, together with IMF staff, we have produced a section for the PRSP sourcebook on trade. Third, the WBI is a major vehicle for capacity building using these tools. An organizing objective of these and other activities is building capacity in developing countries, a precondition for better policies and more effective negotiations in the WTO.

55. *Intellectual property*. Whether it is patent laws that impede African access to advanced plant technology or protection of software originating in high- or low-income countries, developing countries as much as industrial countries have an important interest in fair rules of exchange. But the specific needs of developing countries may differ substantially. Developing countries need help to develop forms of intellectual property rights that protect assets, such as music, other arts, and computer programs. Developing countries may also want to use the flexibility in the TRIPS agreement to develop intellectual property regimes that take into account their specific needs in areas such as agriculture and pharmaceuticals (Maskus and Lahouel 2000). Safeguards for the international property rights regime should also recognize the rights of farmers cultivating traditional plant varieties, and reconcile WTO provisions on intellectual property rights with the International Convention on Biodiversity and the International Undertaking on Plant Genetic Resources.

56. Appropriate management of intellectual property rights should strike a balance between the need to spur innovation in knowledge intensive industries and the need to facilitate technology transfer to developing countries – especially in medical and agricultural research. The Bank has produced several papers that highlight problems with approaches to implementation of

intellectual property rights that mimic approaches used in the industrial countries, and that note the need for approaches oriented to countries' development needs.[13] Further work will provide advice to developing countries in design of policy and bilateral negotiations.

57. *Trade facilitation, standards, and technical barriers.* The Bank intends to build on its work, begun in 1999, to increase understanding of the quantitative dimensions of technical barriers and standards, provide policy analysis for developing countries and provide technical assistance to developing countries. Trust Fund support by the United Kingdom's DFID initiated the Bank's program in this area and through a new Trust Fund established by the United States this year, the Bank is launching capacity building work on trade and standards in sub-Saharan Africa. Recent work on the impact of health and safety standards for products on LDC exports reveals that small changes in such standards can have significant negative effects. Facilitating trade transactions through better transport regulations, better banking and insurance regulations, and cleaner administration of customs processing can speed throughput at ports and markedly reduce costs. This work suggests that greater attention needs to be given to the effects on developing countries of changes in standards and the creation of mechanisms to facilitate participation by developing countries in the setting and enforcement/implementation of standards (Wilson, 2001). As with other issues of market access, we have studied these problems, made this information available to partner institutions, and published these findings widely (for example, *Global Economic Prospects 2001*). They are also the subject of WBI training courses, such as those in Latin America and francophone Africa.

58. *Preparing for WTO accession.* Countries acceding to the WTO are now expected to undertake a wide range of reforms—including reforms of both border measures and behind-the-border policies—that frequently exceed those undertaken by many current members. If these policies are implemented with a central focus on development needs, the result is likely to be a stronger domestic regulatory framework in the member country, and a healthier multilateral system in which new members have a strong stake in further global trade reform. However, implementation of such comprehensive trade reforms in the acceding countries requires careful and wide-ranging analysis that goes beyond implementation of obligations and considers needs for institutional strengthening and the availability of social safety nets. The Bank has undertaken or is undertaking research and has provided policy advice to several countries preparing for WTO accession, including China, Russia, Saudi Arabia, Yemen, and Vietnam.

59. For the full range of these issues, it is apparent that the Bank can support our clients in their efforts to participate fully in the multilateral system as a way of promoting their trade and development.

Regional Priorities: Promoting Trade Creation and Competition

60. Because activity associated with regional arrangements will undoubtedly increase in coming years, the Bank's objective is to help developing countries use regional arrangements efficiently to expand trade and neighborhood integration while avoiding the potential pitfalls. The Pacific Basin, formerly largely inhospitable to the formation of preferential regional arrangements, is currently embarking on a path that could lead to the formation of a number of important agreements. APEC's traditional resistance to preferential trade liberalization is eroding. Free-trading Singapore has entered negotiations to form free trade areas with several other countries. Proposals are under discussion to form free trade areas among Japan, China, and the Republic of

Korea, together with ASEAN, Australia, and New Zealand. This would create a free trade area much larger than all current trading blocs, but proposals are in an early stage and will take time to materialize. Momentum on the formation of a Free Trade Area of the Americas (FTAA)—stalled for some years—could rebuild quickly with support from the new U.S. administration. Europe has laid down a path that will bring the 77 African, Caribbean, Pacific (ACP) economies, including many of the poorest countries in the world, into a free trade agreement with Europe. The Greater Arab Free Trade Area (GAFTA) seeks the establishment of a reciprocal free trade area among Arab League members in 2007, and 14 members have started fulfilling their commitments on tariffs reduction.

61. The ACP countries are clearly the countries with the greatest need for assistance if European Community proposals to convert the Lomé Convention (now the Cotonou Agreement) into a free trade agreement go forward. Many of these countries have serious institutional weaknesses that will make participation difficult. There are risks that key products of interest to these countries might be excluded, and that trade diversion and revenue transfers in favor of distant European suppliers might be particularly costly. Only with considerable support from the international community—including political efforts to resolve ongoing conflicts—will many of these countries be able to take advantage of opportunities to benefit from the development of viable institutions at the regional level, such as standards bodies, that would not be cost-effective in the individual small economies. Moreover, ACP countries will benefit from signing FTAs not only with the EU but with all OECD countries. For ACP countries to sign FTAs with North America in addition to the one with the EU will provide them with greater market access and will raise the likelihood that they will benefit from their own liberalization. To ensure that the FTAs they sign are beneficial, ACP members should also lower their MFN trade barriers unilaterally.[14]

62. Regional agreements go beyond free trade arrangements for goods and increasingly include services and other behind–the-border issues. For example, West African countries are contemplating a regional authority for transport regulation to economize on supervision of air traffic for several small markets. These efforts raise the level of complexity and require that the Bank mobilize its sectoral and trade expertise and, in combination with other actors, represent an integrated view to policymakers on program design and implementation.

63. To help countries design and use regional arrangements to expand trade efficiently, the Bank therefore intends to deepen its dialogue on regional arrangements. A common starting point is regional studies of trade integration, growth, and poverty reduction, linked to problems particular to the regions. This year and next the Bank is undertaking significant work with a regional focus:

- In Africa, South-South trade agreements are a major factor affecting national trade policies. With the adoption of a common external tariff by the West African Economic and Monetary Union in January 2000, Sub-Saharan Africa now has three functioning customs unions with a total of 19 member countries, as well as five other important regional trade arrangements covering virtually all of the region’s countries. Export-led growth and open regional integration were major themes of the region’s recently completed study, *Can Africa Claim the 21st Century?* (World Bank 2000a), and these issues have been significant features of the region’s work program recently. In response to requests from African countries, the Africa Region recently appointed a program director for its regional programs to give these greater focus and priority. The region's staff are now in the process of preparing regional assistance strategy papers for the continent's major subregions. This fiscal year the region also formally established a sector research and development program on international trade and a regional thematic group to create a network among its economists working on trade issues and improve technical support for the ongoing work at the country level.

- In Eastern and Central Europe, a centerpiece of Bank strategy is to help Central European countries prepare for accession to the European Union. The region has prepared several reports that have focused on EU accession, analyzing, for example, the effects on income, and importance of, nontrade benefits (e.g., macro stability and foreign investment), and the costs of compliance. This strategy has been based on collaboration with the EU Commission in helping to build capacity in regulation and enforcement institutions, transport, social sector assistance, and environmental improvements. Moreover, the region has launched a study for five Southeastern European countries. Finally, it has launched a six country Trade and Transport Facilitation Project in Southeastern Europe that will promote trade.

- The Latin American region has launched a major study that will analyze ways the region can use globalization to promote more rapid growth of its mainly natural resource–based economies. It will analyze patterns of specialization and their consequences for growth, inequality, volatility, and poverty. It will lay out an agenda of activities at the time of its publication early in the coming fiscal year. Next year the region intends to undertake a study of NAFTA. The Bank may also analyze new proposals for the FTAA, once these take shape.

- In the Middle East and North Africa, a regional study will focus on integration to improve growth prospects. The region's economy remains among the least integrated in the world economy, has relatively high average levels of protection, and has grown relatively slowly. At the same time, the implementation of the various regional integration agreements with the EU and within the region, as well as new WTO membership for many countries, will be high on the policy agenda over the next decade. This should lead to greater integration. This would lay the groundwork for discussions of the EU's programs.

- In South Asia, the potential benefits of greater integration within the region are being examined in a study that will provide a basis for policy discussion and possible reforms. The South Asia trade study is designed, among other things, to advise countries of the net costs of proposed regional arrangements to each of the prospective members. Another key issue for the region is the burgeoning illegal trade occurring despite the current prohibitions on trade in many products. Other activities include an analysis of the effects of implementing the phaseout of quotas called for in the Agreement on Textile and Clothing (ATC) and opportunities for further regional integration.

- In East Asia, the Bank management attaches a priority to trade for regional development. In two recent studies, *East Asia: Road to Recovery* (World Bank 1998) and *East Asia: Recovery and Beyond* (2000c), the region presented detailed analyses of trade-related issues. To address concerns about the impact of trade on poverty, the region is developing tools to help clients understand the complex links between household welfare and trade and vulnerability and poverty. The region intends to launch a study of competitiveness and of regional bilateral trade agreements in 2002.

64. These efforts will inform the debate on regional initiatives, and would take the form of a more active program of studies, conferences, and policy dialogue as regional arrangements are formed and enlarged.

National Policy: Trade Reforms for Pro-Poor Growth

65. The Bank's objective is to help governments design and implement reforms that will expand trade and transmit benefits to low-income groups. National policies still hold the potential for the greatest gains from trade for most countries, and the bulk of the Bank's resources on trade will be devoted to country policy. However, to be effective, reducing border barriers must be accompanied by other policies and institutional improvements in the investment climate, so that this potentially powerful instrument of trade reform results in improved productivity and growth. Openness, in combination with sound macroeconomic and financial policies, is one determinant of sustained rapid growth (see Box 1), which, as discussed in the *WDR 2000* (World Bank 2000d), has a direct and positive relation to increases in the incomes of the poor (see also Dollar and Kraay 2000).[15] So the first country-level priority is to analyze the obstacles to trade integration, help countries formulate strategies to remove them, and design programs to ensure an investment response when these are removed.

66. Trade liberalization affects the poor differently depending on the country (see World Bank 2000d: 49 ff). The immediate effects of trade reform on the poor depend (among other things) on the initial nature of protection, the structure of production, the effects of reforms on relative prices, and whether reforms increase demand for labor (the basic asset of the poor). For example, in cases where the poor primarily produce for export or rely on imports for consumption, lowering tariff barriers can improve their situation through changes in relative prices, but when the poor work mainly in import-competing sectors, trade liberalization can cause dislocation that adversely affects them (World Bank 2000d: 70–71). That trade reforms can produce increases in income and, in the long term, offset negative effects offers little solace to those poor suffering transitional costs. For these reasons, a next priority of the Bank is to identify the effects of reforms on the poor, design targeted compensatory programs where possible, and help countries build in pro-poor growth programs through advice on Poverty Reduction Strategies and development programs of middle-income countries.

67. Weaving reforms that lower border protection together with reforms to elicit a supply response is more complicated than first-generation reforms. They require greater coordination among trade specialists, sectoral specialists, and macroeconomists. This task is made easier because of the overlap of the new trade activities with ongoing sectoral reform programs. Done well, these will come together in country programs outlined in Poverty Reduction Strategies, supported by the Fund's Poverty Reduction and Growth Facility and the Bank's IDA program.

68. The Bank will have to weave country activities to promote trade integration into the whole cloth of the Bank's country assistance strategy (CAS) for each country. For *low-income countries*, trade policy is increasingly important to many governments Poverty Reduction Strategies. Because much analytical and capacity-building work remains to be undertaken, donors have agreed to adopt an Integrated Framework for the Least Developed Countries (see Box 3). The purpose is to analyze options for trade-led integration, determine the relative payoff to trade-related reform, and work with local counterparts to design appropriate policy reform

packages that both promote growth and protect the poor during the reform transition as options the government might consider in preparing its poverty reduction strategy papers (PRSPs). The process starts with analysis: how trade might fit into national development strategies, followed by assistance in the design and financing of projects (drawing on cross-country experience). An interagency task force was formed during 2000, and a trust fund has recently been established to fund the "integration studies" and technical assistance that can be integrated into the country strategies as the government sees fit.

Box 3 The Recently Renovated Integrated Framework

The Integrated Framework (IF) was established in 1996 to increase the effectiveness of trade-related technical assistance to the least developed countries. Participating agencies include the WTO, the IMF, the International Trade Center, UNDP, UNCTAD, and the World Bank. By the summer of 2000, 40 least developed countries had completed a "needs assessment" for technical assistance in trade, the first step of the IF process. However, progress in mobilizing donor support proved difficult, and the program started slowly. An independent review of the IF, completed in June 2000, highlighted the lack of clear priorities in the program, weak administration, and shortfall in donor resources. As a result, a steering committee of six participating agencies was set up to redefine the IF, ensure better integration of trade with national development strategies, and establish a trust fund for IF activities, together with a stronger secretariat. In early 2001, a pilot program was agreed upon, and many bilateral donors decided to support the program by contributing to the trust fund. A new governing structure was established to manage the pilot program. It was further decided that a series of diagnostic "trade integration studies" be carried out to analyze trade obstacles and prioritize technical assistance requirements, starting with three "pilot" countries, to be completed by November 2001. These could become important building blocks for governments to consider as they formulate their poverty reduction strategies and country development strategies. The Bank has agreed to take the leadership in this process, working closely with other agencies.

69. For *middle-income countries* that are active borrowers, trade policy is likely to figure prominently in CASs. For countries with higher levels of border protection, such as many in Europe and Central Asia, South Asia, and the Middle East and North Africa, border barrier issues that impede market access are central. For East Asia and Latin America, strategy may well have a component focused on trade-related sectoral policies designed to improve competitiveness.

70. Activities to support both sets of countries take five general forms:

- *Undertaking diagnoses of obstacles to trade integration.* The objective of such analysis is to assist clients through policy advice and help shape assistance strategies. Ensuring that there is a good understanding of the effects of existing policies on investment incentives and on poverty is a first step. For the high-protection countries, border barriers usually figure prominently in the ongoing dialogue, both because they impede effective participation in the global market and because they deny market access to other developing countries. New support may take the form of "Integrated Framework" studies that assess the remaining constraints to successful globalization and the impact of eliminating these constraints on economic growth and poverty reduction. The World Bank, in cooperation with Integrated Framework partners, will seek to undertake a few "integration strategies" on a pilot basis for a few PRSP countries. Governments can use these to include trade reform in their PRSPs if they find that promoting trade will help increase growth and reduce poverty. The Joint Staff

Assessment of PRSPs will also consider the findings of the integrated framework studies in reviewing PRSPs. If successful, these studies will be expanded to a larger group of countries. It will also take up behind-the-border issues. One example is a study of transportation and logistics in South Asia that may provide a model of behind-the-border approaches. For many middle-income countries, the analytical challenge is jointly to evaluate the incentive regime (e.g., the impact of trade, tax, and exchange rate policies on relative prices) and the key behind-the-border issues. One example is the recent study of Brazil's future growth, which focuses on many of these issues to advise the government on ways to accelerate growth. We will also assist in improving trade-related infrastructure, institutions, and services markets through lending operations that support liberalization and strengthen the institutions that are needed to ensure markets are contestable and well regulated. In Thailand, for example, through our efforts to support public sector reform, the Bank is working with authorities on customs administration, import valuation, and competition policy.

- *Designing pro-poor trade reform strategies.* Since segments of the poor may be hurt by trade liberalization in the short run, determining the incidence of the tariff structure and the implications of this incidence—for the poor, for employment, for regions, and so forth—is important for incorporating the poor into subsequent growth as well as for mobilizing support for reform. Further efforts are needed to analyze the gainers and losers in the transition process and adjust the policies, wherever possible, to take into account the political economy of income redistribution. One example is the East Asia and Pacific Region's three studies for Vietnam focusing on the impact of liberalization of sugar and petroleum, and of trade more broadly, on low-income groups. The Bank intends to deepen its knowledge and provide policymakers with analytical tools needed to answer some key questions. The first building block is the PRSP handbook on trade now under preparation jointly with the IMF; the second will be new modeling tools to accompany the handbook; the third will be to help governments build these into their poverty reduction strategies.

- *Pursue capacity building for trade-related policies and institutions* as part of lending operations and country dialogue. Target institutions for our dialogue include ministries, regulatory bodies, customs authorities, standards and certification bodies as well as think tanks and research institutes. The behind the border agenda, however, will often require lending operations as well as country dialogue. For example, creating efficient and competitive telecommunications, financial and transportation sectors that service foreign trade will often require restructuring and competitive regulatory reforms. These reforms are often most effectively implemented through a Bank lending operation. Trade facilitation, customs reform and standards development may also be most effectively approached through a Bank lending operation. An export diversification project in Bangladesh designed to simplify and modernize customs, improve trade policy analysis, and build capacity for WTO rules is an example. The Bank's project in Russia to establish a WTO Enquiry Point for standards is another example. MENA's work in support of private sector development in Tunisia, its ECAL and Export Development projects,—as well as private sector development/export competitiveness in Egypt, West Bank and Gaza, and Kuwait—are further examples. Interaction with clients will take the form of training and capacity building through WBI programs and sustained involvement by country operations through ESW and lending supervision. The WBI trade course has a significant focus on behind the border issues. The Bank has provided advice on trade facilitation and the operation of customs regimes for exporters, especially in low-income countries and has had a major program that has helped China prepare for WTO accession.

- *Provide advice on policies that affect the investment climate so as to ensure a supply response to trade reform.* The Bank, together with the IMF, is providing a steady stream of policy advice on investment climate issues that will, among other things, help ensure a responsiveness to trade reform initiatives. In addition to advice on macro and structural policies, this includes advice on the financial sector, business regulation, and labor markets. For example, the Private Sector Advisory Service (PSAS), with guidance from regional staff, is conducting corporate governance assessments in several countries under the joint Bank/Fund ROSC program and joint Bank/OECD corporate governance roundtables. To help improve the impact of its work, the corporate governance program uses, among other things, the template and self-assessment tools that it has developed. PSAS intends to address other investment climate issues, including basic entry and exit policies, the institutional underpinning of markets, and the functioning of private firms. This complements ongoing work of the Bank's regional staff in their advice on trade and structural policy and the IMF in its exchange rate and stability advice.

- *Provide advice on policies that encourage efficient trade-promoting FDI.* The Foreign Investment Advisory Service (FIAS), now integrated into PSAS, provides advisory assistance to governments to improve their countries' FDI environment. Over the last 15 years, FIAS has given advice on policies, laws and regulations, investment procedures, and investment promotion strategies and institutions. In addition to its traditional products, FIAS is developing new products to address the competitiveness of the FDI environment in host countries, the diffusion of best practice from foreign investors to the local economy, and corporate responsibility. In addition, FIAS experience will be systematically documented and made available via a website. Tools for assessing the investment climate will be developed, to complement traditional delivery mechanisms. Support to the PSAS work on investment climate would be enhanced by the rapid response system that is being developed. It would provide the platform for dissemination activities, for active marketing and information services, and for rapid response services to internal and external (public sector) client requests. Internal and external training activities would also be managed by the rapid response group. Finally, MIGA has developed a sophisticated set of insurance mechanisms against selected in risks in the political environment that can allay investor concerns, help improve the investment climate, and facilitate additional investment. MIGA provides political risk insurance, legal advice and dispute settlement, and technical assistance.

Endnotes

[1] See the World Bank Board Paper "Integrated Framework for Trade Related Technical Assistance for Least Developed Countries." June 19, 2000, SecM2000-353.

[2] See Barro and Sala-i Martin (1995) for a review of the econometric literature. Sensitivity of results to both variables and specifications are highlighted by Levine and Renelt (1992) and Sala-i Martin (1997a and b).

[3] See, for example, Bhagwati 1978; Little, David, Scitovsky, and Scott 1970; and Papageorgiou, Choksi, and Michaely 1991); for firm-level analyses, see Bigsten, et al. 1997 and Kraay 1997.

[4] Rodrik argues, for example, that most of the explanatory power of the Sachs and Warner index is derived from just two indicators—the black market premium and state monopoly over major exports. These two indicators are

correlated with a wide range of macroeconomic policy and institutional factors other than trade openness, and thus yield an upward bias in the estimation of trade restriction effects. Rodriguez and Rodrik (1999) contended that tariff and nontariff barriers, two variables that directly measure trade openness, have little explanatory power when considered separately in the cross-country regression studies.

[5] The fluctuations in Figure 1 are associated with volatile commodity price movements, especially those of oil; measured in constant price terms, the share of developing countries rose more steadily from 24 percent in 1970–72 to 35 percent 1996–99.

[6] Data on intrafirm trade are replete with gaps. Hipple's 1989 calculation based on 1982 U.S. statistics is the origin of the one-third number, and Casson and Pearce (1988) is the source of the higher propensity to intrafirm trade from developing countries.

[7] As reflected in the proposals of Clare Short, (UK Minister of Development), Mike Moore (Director-General of the WTO), and Joseph Stiglitz (former Chief Economist, World Bank).

[8] Finger and Schuler (2000) estimated that the cost of implementing WTO obligations on 16 important elements of customs reforms standards would surpass $40 million. The costs of SPS-related measures as estimated in supporting World Bank projects in 10 countries ranged from $3.3 million (in Turkey) to $150 million (in Russia), and the costs of IPR projects in three countries ranged from $4.0 million (Brazil) to 32.1 million (Mexico).

[9] *Small States: Meeting Challenges in the Global Economy*, Report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States, April 2000, accessible at www.worldbank.org/smallstates.

[10] The East Asian financial crisis revealed the weaknesses in that region's imperfect liberalization strategy for its capital account, and underscores the importance of strengthening domestic prudential regulation of the financial system precedes full financial opening. See World Bank 2000c, chapter 2.

[11] This is a conservative estimate because dynamic gains that include full services liberalization and productivity responses are undoubtedly much larger. Estimates of gains from full merchandise trade liberalization worldwide typically exceed $100 billion for developing countries. These estimates vary widely depending on methodologies and assumptions: static vs. dynamic analysis, market structure, sectoral and regional coverage, and productivity impacts. For example, at one end of the estimate range, Anderson, et al, 2000, conclude developing countries would receive $108 billion in static income gains from merchandise liberalization; they do not include service liberalization or productivity effects. Dessus, et al, 1999, estimate that developing countries would gain $455 billion from merchandise trade liberalization, assuming dynamic gains and endogenous productivity responses to trade competition. Studies of the Australian government indicate that global gains from service liberalization would more than double the gains from merchandise liberalization (Australia, 1999).

[12] Three items are subject to a transitional period: rice, bananas, and sugar.

[13] See, for example, Finger and Schuler 2000 as well as Maskus and Lahouel 2000.

[14] If they advance successfully, the FTAA negotiations will involve a number of low-income countries in intensive negotiations with the United States. These countries will face significant technical problems, particularly because of the large number of overlapping regional groupings that exist within Latin America. They will need considerable capacity building so that they can avoid potential pitfalls like excessively restrictive rules of origin or the exclusion of products of particular interest. .

[15] Trade openness, while associated with growth, does not have a sustained impact on changes in income inequality; other factors appear to be more important (e.g., education, distribution of land, and the net progressivity of government spending and taxing activities), and the positive growth effects on the incomes of the poor over time swamp any income-dampening effects through any rising inequality associated with openness (see Dollar and Kraay 2001).

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