Inputs, Trends, and Evolution of World Bank Trade Assistance

This chapter reviews the scope, trends, and evolution of World Bank assistance on trade to its client countries from fiscal year 1987 through 2004.

Until the 1980s, the Bank was project-focused, but in the 1980s and 1990s it became increasingly involved in policy reform using noninvestment loans. Lending for trade adjustment through Structural and Sector Adjustment Loans (SALs and SECALs) to address balance of payments problems accounted for 25 percent of all adjustment lending during the 1980s. Bank analytical work was also important in the policy dialogue with client countries.

Lending Inputs to Trade

IEG carried out a comprehensive review of the Bank's portfolio to identify trade-related projects. Bank trade-related support can be classified into six main areas: trade liberalization, institutional trade facilitation (for example, customs), infrastructure-related trade facilitation (for example, air freight, ports), private trade financing, public trade financing, and technical assistance for trade negotiations and the WTO accession processes (Appendix C1).[1]

Magnitude, Relative Importance, and Trends

Bank lending for trade was substantial during the period under review. Between 1987 and 2004, the Bank supported more than 500 lending operations that were partly or fully focused on trade in 117 countries.[2] This assistance of about $38 billion supported free-standing trade loans and loans with trade-related components—about 8.1 percent of total Bank commitments during this period.

Despite the common perception that trade was a large part of the Bank's portfolio, the share of trade-focused lending operations[3] in the Bank's total commitments was comparable to that for the Bank's major sectors of assistance such as education, health, and public governance.

Lending for trade has fluctuated, but shows a long-term decline.

Since reaching just over $3 billion annually in 1993, Bank lending for trade has varied, but continues a long-term pattern of decline (figure 3.1). Several concurrent events may be linked to this trend. To begin with, as discussed in the next chapter, many countries liberalized their trade regimes in the 1980s, so that trade-related lending adjustment became less necessary, and it is not surprising that trade lending would decline. Liberalization was further deepened through regional agreements.

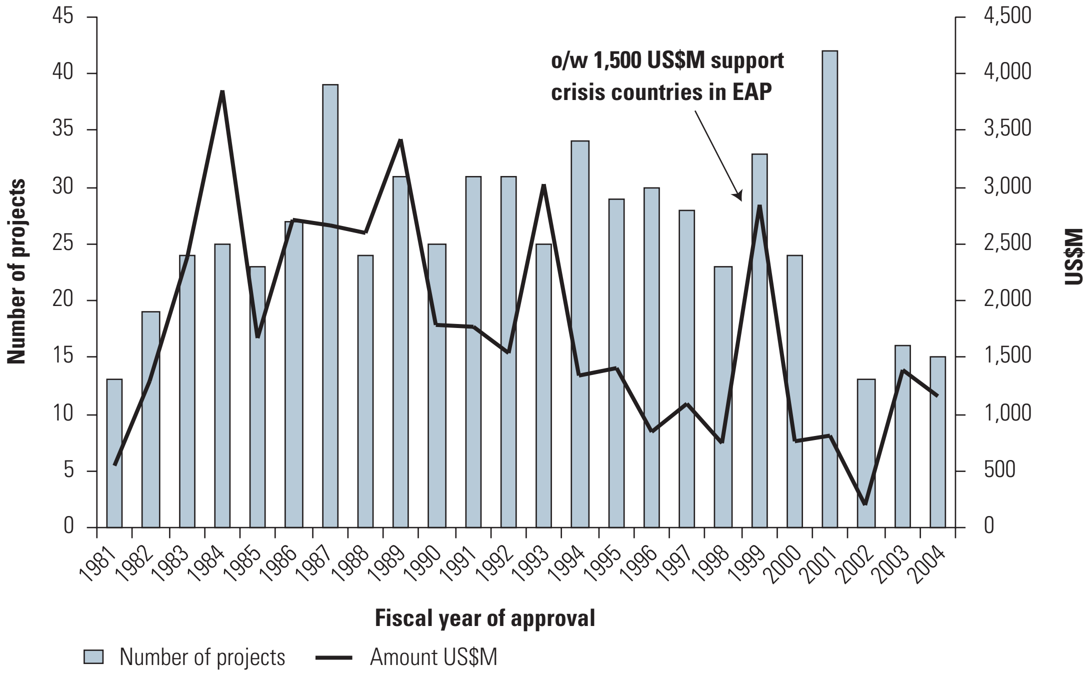
In addition, over this period, the International Monetary Fund (IMF) became more prominent in trade policy advice and incorporated trade conditionality in its stand-by arrangements. The share of Fund programs with formal trade conditionality rose from 55 percent in the years before 1995 to 70 percent between 1998 and 2001, though this has dropped in the four years since (IMF 2005). The decline in Bank lending would have been even more dramatic if not for the East Asia crisis in 1999 and the emergence of new clients in Europe and Central Asia (ECA) during the 1990s. Several of these clients undertook trade-related operations, including a large multi-country trade facilitation project in 2001.

In the past four years, a modest resurgence in trade-related lending has occurred in tandem with renewed interest in trade by the Bank and its clients. This lending is limited to a few countries and focuses on trade facilitation initiatives, which comprise two-thirds of all new lending. Given the significant volume of previous adjustment lending, it is unclear whether that lending will recover to the levels of the early to mid-1990s.

Thematic Focus: From Trade Liberalization to Trade Facilitation

The overall figures conceal a shift in the composition and emphasis of trade lending over the past two decades. While Bank assistance in the early 1980s focused on direct lending to development banks through lines of credit for trade finance, by the beginning of 1987 lending was concentrated on trade liberalization and more direct trade promotion activities, such as supporting trade-related institutions and exporters (figure 3.2). Together these two categories accounted for 70 percent of all lending for trade between 1987 and 1994. In part, this was linked to the export-led growth messages of the *1987 World Development Report*. But it was also attributable to reform-minded policy makers (notably in Latin America) who believed in the benefits of trade liberalization.

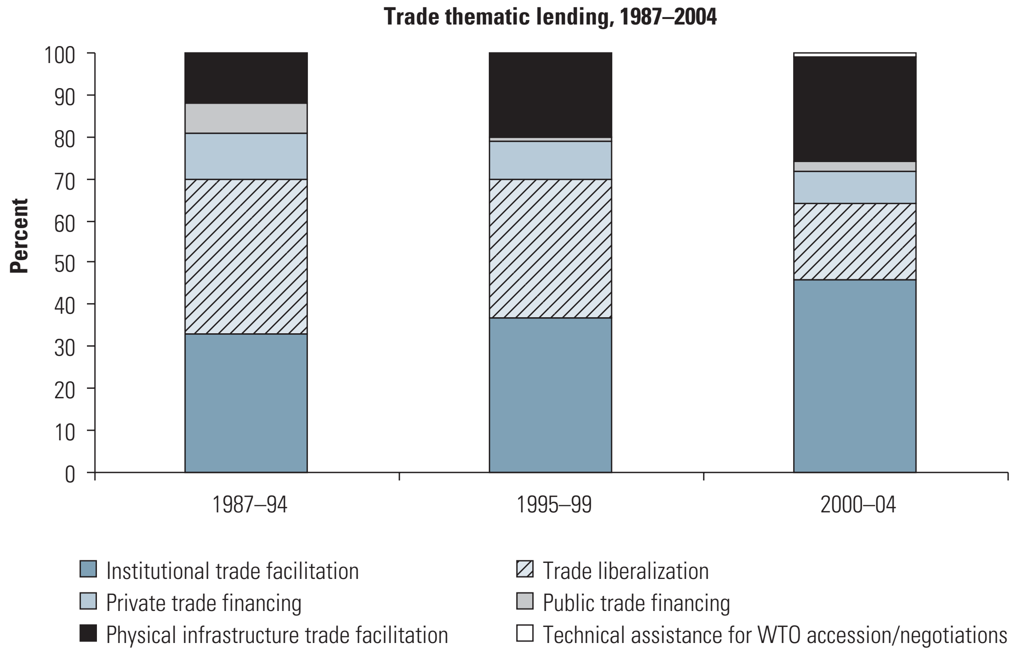
Figure 3.1: Trade-Related Bank Lending Has Varied But Trended Downward Overall



Source: Trade Assistance Evaluation Project Database.

Note: Excludes oil, gas, and electricity export projects. EAP = East Asia and Pacific Region.

Figure 3.2: The Thematic Focus of Bank Lending for Trade: Trade Liberalization and Direct Lending to Exporters Gave Way to Trade Facilitation



Source: Trade Assistance Evaluation Project Database.

Note: Total lending - 1987-94 = $22.1 billion; 1995-99 = $10.2 billion; 2000-04 = $5.1 billion.

During the mid-1990s, while trade liberalization remained an important component of Bank lending for trade (33 percent), the focus on trade facilitation activities intensified as attention shifted to broader investment climate issues such as the importance of trade logistics in competitiveness and the global value supply chain. On the infrastructure side, greater emphasis on the trade benefits from infrastructure improvements was evident in major commitments supporting international road corridors and ports. The number of loans devoted to trade-related institutions (primarily customs) accounted for 37 percent of trade-related lending between 1995 and 1999, making this the single largest thematic area supported.

Lending for trade liberalization has moved in waves across Regions over time, suggesting a "neighborhood" effect. Large amounts initially supported a set of early reforms in the Latin America and Caribbean Region (LAC). The emphasis then shifted to Sub-Saharan Africa. Over time, the Bank moved to support Middle East and North African countries, and then most recently to Eastern Europe and Central Asia (Appendix C2). Lending to East Asia was concentrated during the crises in the late 1990s.

The composition and emphasis of trade lending has shifted over two decades from trade liberalization to trade facilitation.

In the past four years, lending for the institutional and infrastructure aspects of trade facilitation has increased further as a share of trade-related lending. Institutions-related trade facilitation accounted for almost half of all trade-related lending between 2000 and 2004, while lending for trade liberalization declined noticeably.[4] While lending and advice related to the multilateral trading system continues to be minuscule, the number of Bank lending operations including such support during the 3 most recent years was double the number during the preceding 13 years.

Much of the Bank's earlier work on trade-related capacity building was embedded in lending operations and is more properly defined as technical assistance.[5] Between fiscal years 1987 and 2000, there were 29 trade-related technical assistance projects, of which 20 are closed and 9 are still active. The overwhelming majority of these interventions (20 out of 29) focused on support for customs reform and modernization, or on analysis related to trade policy reform.

What Was Recommended? The Design of Trade Adjustment Loans

At the height of adjustment lending in the 1980s, trade policy accounted for a quarter of all structural adjustment conditionality. Trade conditionality offers a useful and systematic way to identify actions that the Bank assumed were most critical. This section draws on a trade conditionality database (built from information in the Bank's Adjustment Lending and Conditionality Implementation Database and an IEG desk review of loan agreements) to analyze the design of trade adjustment loans between fiscal years 1987 and 2004.[6]

The sample characteristics are presented in table 3.1. These 152 loans include all adjustment loans with trade components exceeding 10 percent.[7] The sample constitutes 65 percent of all non-emergency rehabilitation adjustment loans with trade components (regardless of size) that were approved and closed between 1987 and 2004, and 89 percent in value. Of the 65 countries, 25 received three or more trade-related adjustment loans. The average number of trade-related adjustment loans received by the countries was 2.3; the median was 2.

Focus of Lending Conditions

The focus of Bank trade conditionality has varied over time and across Regions, but some general patterns can be discerned. Trade-related conditionality is classified into four areas: import-related, export-related, exchange rate and foreign exchange–related, and industrial or supporting policies (box 3.1).[8]

Trade conditions have focused on imports, exports, exchange rates, and supporting policies.

Between 1987 and 1990, import-related policies comprised almost half of all conditions (or 6.4 conditions on average per loan) in all Regions except South Asia (figure 3.3 and Appendix C3).[9] With the exception of South Asia, the emphasis on industrial policies was greater between 1991 and 1999 compared with the earlier period. Conditionality in this period reflected the importance the Bank placed on increasing enterprise efficiency and the Europe and Central Asia effect, resulting in continuing and expanding privatization.

Very few supporting policy conditions involved labor market and safety net issues or non-customs trade-related institutions. The lack of attention to labor market rigidities was an oversight. While the literature does not yield strong evidence of employment losses from greater openness (see, for example Papageorgiou and others 1991; Revenga 1995 on Mexico; Currie and Harrison 1997 on Morocco; Bourguignon and Goh 2004 on East Asia), distortions in the labor markets can influence the extent to which trade liberalization is associated with gains in employment and lower poverty.

In the five most recent years, trade-related conditions have been quite diverse across Regions. This may be because of the relatively small size of the sample during this period (20 lending operations), which renders Regional breakdowns less informative. Over time, export promotion has risen in importance in almost every Region.

Conditions related to the exchange rate and to foreign exchange rate management were the least frequently represented condition (7 percent) between 1987 and 2004. They were most heavily emphasized at the beginning of reforms, consistent with the advice from the literature, and these conditions were normally met (reflected in reduced black market premiums for the countries with available data). In addition, the "Concordat" with the IMF meant that the latter was more likely to be giving and "conditioning" exchange rate policy advice.[10]

Sequencing of Conditions: Did the Bank Follow a "One-Size-Fits-All" Approach?

A common criticism of the Bank's trade advice

Table 3.1: Trade Adjustment Loans—Sample Characteristics, 1987–2004

	Sample[a]	
	Loans	**Countries**
Geographic Region		
Africa	69	26
East Asia and Pacific	12	6
Europe and Central Asia	13	8
Latin America and the Caribbean	32	15
Middle East and North Africa	14	5
South Asia	12	5
Total	**152**	**65**
By income		
IDA		34
IBRD		31
Time periods (number of loans)		
1987–90	44	
1991–99	88	
2000–04	20	

Sources: Tsikata (2005) based on calculations from the IEG Trade Policy Conditionality Database; Adjustment Lending Conditionality and Implementation Database (ALCID).

Note: Sample also includes 29 loans with trade component < 10%. Of the 29 loans, the following countries have other loans within the larger sample of 152 loans: Bulgaria, Cameroon, Malawi, Mexico, Morocco (2), Mozambique, Niger (2 loans with trade component <10%), Romania, Sierra Leone, Tanzania, Tunisia, Vietnam, and Zambia (4). The remaining 11 loans went to countries that did not have any other loans during the review period and were thus included for completeness.

a. All adjustment loans with ≥10% of trade-related components, excluding Emergency Rehabilitation Loans.

is that it has followed a "one-size-fits-all" approach. This section examines that criticism. In terms of sequencing, on the import side, policies aimed at reducing or eliminating quantitative restrictions (QRs) and other forms of nontariff barriers were typically the starting point, consistent with the literature. In two-thirds of the countries (42 out of 65), QRs were

Box 3.1: Elements of Trade Policy Reform Are Varied and Diverse

Trade reform in developing countries typically involves a range of changes in the use of trade policy instruments on both the export and import sides. The typical trade policy reform package consists of the following four components:

Import-related*:* Policies such as eliminating or reducing quantitative restrictions (and converting them to tariffs) as well as other types of nontariff barriers, reducing import tariff levels and dispersion, making tariff regimes more uniform and transparent, reducing import surcharges, improving import procedures, and eliminating official reference prices.

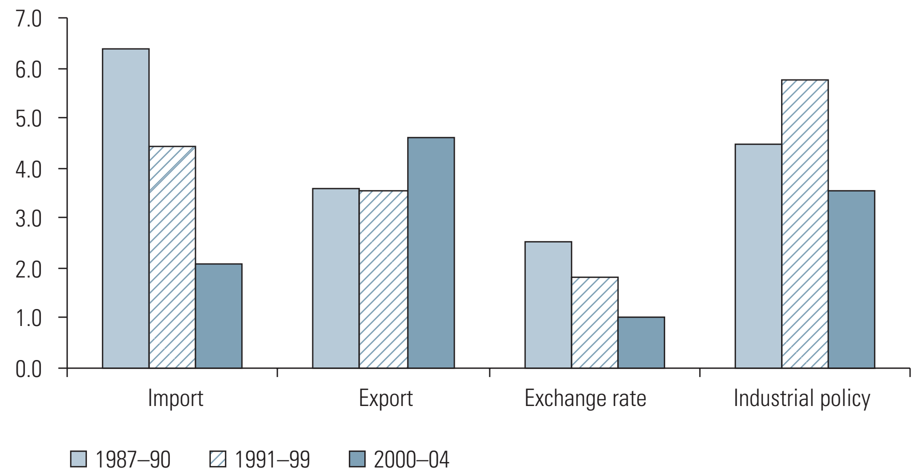
Export-related*:* Policies related to making imports available for export (such as duty drawback and temporary admission schemes), reducing export bans, taxes and licenses, reducing the anti-export bias, export credit and financing, and other export incentives.

Exchange rate and foreign exchange management: Moving toward market-determined exchange rates, exchange rate devaluation or step adjustment, and moving away from the administrative allocation of foreign exchange.

Industrial/supporting policies: Pricing reform, investment promotion, competition policy, marketing, regulatory, privatization, labor markets, and safety nets.

Source: Tsikata (2005).

Figure 3.3: Focus of Trade Conditions in Adjustment Loans Shifted over 1987–2004 (average number of conditions per loan)



Source: IEG Trade Assistance Evaluation Project Database.

a first step of trade reform. Fifteen of the remaining 23 countries had previously reduced such restrictions or had a simultaneous loan that addressed their elimination. Of the remaining eight countries, six had a low incidence of QRs, in some cases having previously reduced them (but without a Bank loan). The QR reforms were often introduced simultaneously with supporting policies aimed at reducing price distortions and at creating a complementary competitive environment.

While the projects described above followed sequencing that was broadly in line with the 1987 WDR and the literature as outlined in Chapter 2, IEG found little evidence of a generic (or "one-size-fits-all") approach to trade reform in the Bank's client countries. Countries varied in the extent of macroeconomic stabilization that they had achieved before the reform was introduced, and in how and when they chose to use export-related policies to stimulate trade promotion. Moreover, countries were heterogeneous in how deeply they reformed and in the range of complementary policies they introduced to support the trade reform.

The actual path of trade reform was less frequently prescriptive than is commonly perceived.

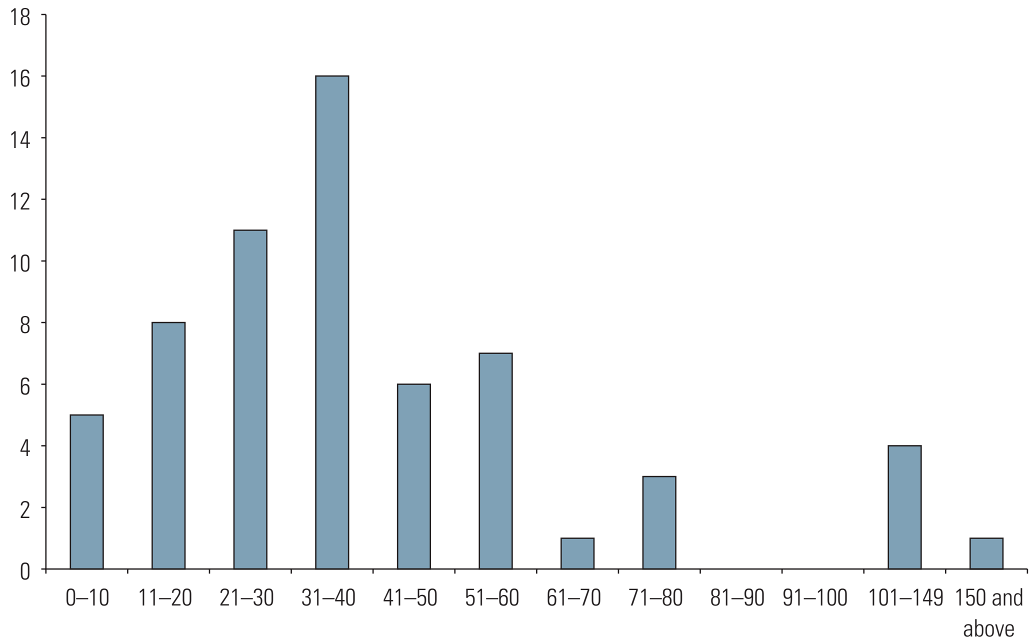
The actual path of trade reform was less frequently prescriptive than is commonly perceived. For example, only about 40 percent of import tariff conditions specifically recommended quantitative targets for tariffs (minimum, maximum, or average levels, ranges) and fewer than 10 percent of conditions gave specific targets for the number of tariff bands.

By contrast, about half of all import tariff conditions provided general guidance (for example, simplify and reform tariff regime, reduce dispersion).[11] The magnitude of tariff reductions also varied widely across countries. Figure 3.4, which shows the distribution of maximum tariffs recommended by the Bank in loan agreements, illustrates a wide range, reflecting the varying initial conditions and the context-specificity of the political economy of trade reform. More generally, it suggests that the tariff guidance in OD 8.60 and Thomas and Nash (1991) were not "hard" targets to be met instantaneously, and that there were several paths to the recommended tariff ranges.

Another criticism of Bank trade advice has been that it has emphasized "import liberalization" over "export promotion," despite the evidence from East Asia that suggests that policies to promote exports in advance of import liberalization may be more effective and

Figure 3.4: Maximum Tariff Recommendations Covered a Wide Range (frequency of tariff ranges recommended)

Distribution of maximum tariff recommendations in trade reforms (%)



Source: Staff calculations from IEG Trade Assistance Evaluation Project Database.

reduce the likelihood of deindustrialization.[12] All 152 trade adjustment loans were reviewed to assess the sequencing and distribution of recommendations. The results presented in table 3.2, summarized by Region, show that in most Regions, loans that had conditions focusing solely on imports exceeded those focusing exclusively on exports. The exception was Europe and Central Asia. However, in all Regions except Europe and Central Asia and the Middle East and North Africa, loans were more likely to feature a combination of import and export actions.

Another way of examining this hypothesis is to analyze the trade reforms supported by the Bank in each country over time, particularly the focus of the conditions. In 51 of the 65 countries where the Bank supported trade reforms, it advised a combination of import liberalization and export promotion (defined as the export-related conditions above), or export promotion first. Of the 65 countries, 5 started out solely with import liberalization before moving on later to export promotion (Honduras, Madagascar, Mexico, Pakistan, and Panama). In another 9 (Armenia, Cape Verde, Congo, Georgia, Guatemala, Mauritania, Niger, Sri Lanka, and Yugoslavia), the focus of conditionality was primarily import liberalization, with no later export promotion. Thus, while the evidence suggests that the Bank largely supported export promotion, in 14 countries that received 55 loans (between a quarter and a third of the sample), the Bank focused only on import-related measures.

Evidence suggests that while the Bank did not follow a "one-size-fits-all" approach for all countries, a sizable number of projects focused on import liberalization over export promotion.

Recommendation Implementation and Outcome

Knowledge of the policies recommended to countries is not sufficient to make a link with outcomes unless one assumes *a priori* that the

Table 3.2: Trade Loan Conditions Most Often Addressed Both Imports and Exports, But a Third of Loans Focused Solely on Imports

		Focus of loan conditions[a]		
	Total loans	Import only	Export promotion only	Both
Africa	69	24	7	29
East Asia and Pacific	12	4	2	6
Europe and Central Asia	13	3	4	2
Latin America and the Caribbean	32	12	5	14
Middle East and North Africa	14	7	2	3
South Asia	12	5	0	5
Total	152	55	20	59

Source: IEG staff calculations.

a. May not add to total because some loans had neither import-related nor export-promoting conditions.

policies were implemented exactly as designed. In this section, compliance with trade conditionality or (in other words) policy reform implementation (PRI) is compared with actual results.[13] The review of the experience with implementing trade conditionality at the level of individual loans draws on project supervision reports, tranche-release reports, project implementation completion reports and their IEG reviews, and (where available) project performance assessment reports.

Countries largely met trade conditions, which were better implemented than other adjustment loans.

Policy implementation was rated from 1 (highest, or strong implementation, with all conditions met on time) to 3 (lowest, or weak implementation, with conditions only partially met and significant delay). Moderate implementation was assigned a 2 and reflected cases in which conditions were largely met, but with delays. An overall index of PRI for each country was calculated as a simple average of all the country's loans (Appendix C4).[14]

The PRI shows that about 73 percent of countries exhibited strong implementation on trade issues. This share is higher than IEG (1997) found for overall adjustment lending, but is in line with that report's specific findings for trade. If moderate implementation is included, the figure rises to 84 percent. Particularly strong compliers on trade included Mexico, Mozambique, Panama, and Pakistan. Papua New Guinea and Venezuela were weak compliers. There did not appear to be a pattern between income or Region and the rate of compliance.

Table 3.3: Trade Adjustment Loans Featured Strong Implementation

	Total loans (US$ billion)	Number of loans	Average number of tranches
Strong compliers (39 countries)	15.1	84	1.7
Moderate compliers (9 countries)	2.2	13	1.7
Poor compliers (9 countries)	3.8	18	2.2
Total (57 countries)	21.1	115	1.8

Source: IEG staff calculations.

Note: Thirty-seven loans (for 8 countries) could not be evaluated either because there were no legally binding conditions (6 loans), or because project documents did not contain enough information to assess compliance (31 loans).

Despite this relatively strong compliance record, economic outcomes were mixed for this group (table 3.4). Countries with a strong compliance record experienced only average improvements in growth (12 out of 26) and investment (14 out of 26), but fewer than half experienced an improvement in exports. This is partly explained by the heterogeneity in initial conditions across countries; it also illustrates that trade liberalization by itself is not sufficient to generate improved economic performance. Some poor compliers had very good outcomes in exports and poor investment outcomes. This seems largely to be the product of unusual circumstances: in two poor compliers (Nigeria and Venezuela), oil-related exports account for the good performance. The existence of oil, however, may have meant less incentive to liberalize.

Specific areas of weak implementation have varied over time. During the late 1980s, countries had greater difficulty in complying with core trade issues. Since the early 1990s, however, this has changed. Recent difficulties with compliance appear to be linked to domestic supporting policies, particularly in privatization and regulatory reform. Waivers of conditionality were sought most frequently in these areas. Fourteen of the 33 waivers for the 93 adjustment loans with trade conditions approved since fiscal year 1992 were sought for privatization-related conditions.

Reflecting the progress with meeting trade conditions, the average number per loan and the percentage of loans with trade conditions have fallen significantly since 1987 (figure 3.5) .[15] This pattern of decline is generally consistent across Regions and also across International Development Association (IDA) and International Bank for Reconstruction and Development (IBRD) countries, except in the Middle East and North Africa Region, where the average of 10 trade-related conditions per loan remains the same as in the 1980s.

Despite above-average project implementation, economic outcomes were mixed.

In addition to the three factors mentioned earlier in the chapter (the move toward more open regimes, a shift in the Bank's focus toward longer-term reforms in institutional and structural policies and a concurrent rise in IMF trade conditionality, and a rise in trade liberalization through regional arrangements such as free trade areas), it is possible that conditionality has declined because of increasing skepticism about the efficacy of conditionality, more generally, in motivating policy reform (box 3.2). However, the causality of these various factors is difficult to disentangle. In more recent years, the shift also likely reflects the evolution of the Bank's approach to conditionality toward greater country-owned

The most difficult recent areas of compliance concern the regulatory framework.

The average number of trade-related conditions per loan and the incidence of trade conditionality have fallen significantly since 1987.

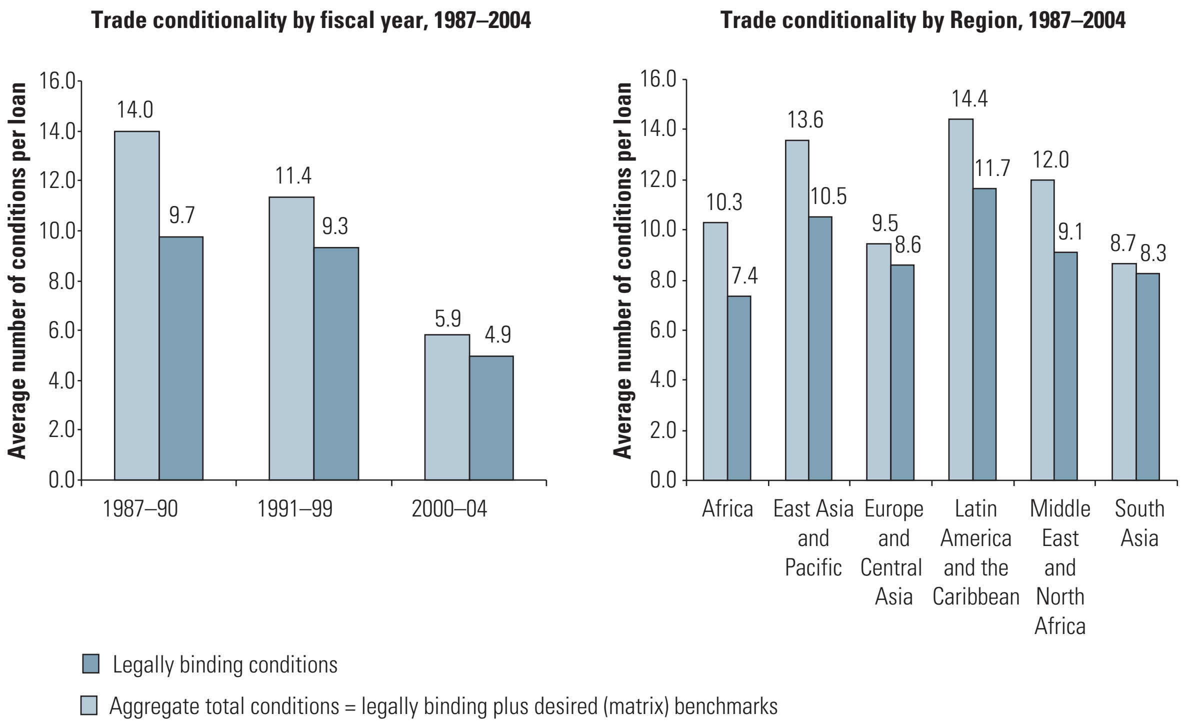
Table 3.4: Meeting Lending Conditions Did Not Necessarily Improve Economic Performance

	Number of countries with data	Number of countries with improvement in		
		Growth rates	Export	Investment
Strong compliers (63 loans)	38 (12)	6	7	10
Moderate compliers (17 loans)	16 (8)	6	3	4
Poor compliers (16 loans)	14 (4)	2	4	2

Source: IEG staff calculations.

Note: Thirty-seven loans could not be evaluated either because there were no legally binding conditions, or because project documents did not contain enough information to assess compliance.

Figure 3.5: Number of Lending Conditions Declined over 1987–2004



Source: Tsikata (2005).

conditionality and less prescriptiveness, as outlined in Operational Policy 8.60 on development policy lending.[16]

Nonlending Inputs

In addition to the substantial lending portfolio, Bank activities in trade have included important nonlending inputs—notably economic and sector work (ESW) carried out in the operational Regions of the Bank.[17] The discussion of nonlending inputs below focuses on ESW; Chapter 5 analyzes the Bank's trade-related activities, advocacy, research, and trade-related capacity building, mainly focusing on the period since 2001.

Early ESW focused on incentives and trade performance; less attention was paid to politics, institutions, and welfare outcomes.

The focus of trade-related ESW has broadened over time, but insufficient attention is given to the political, institutional, and welfare dimensions. Between 1987 and 2001, ESW focused on the change in incentives, and on general trade performance. The next-most important areas of focus, though far less frequently addressed, were assessing the regulatory framework and the impact of the external environment.

Since 2002, while trade-related ESW continues to review progress in trade performance and incentives, more reports now focus on a broader definition of competitiveness (labor costs, infrastructure), include external environment considerations (such as the impact of regional arrangements or market access issues), and analyze microeconomic issues. In both periods, however, reports have only rarely presented an in-depth analysis of the welfare implications of trade policies, analyzed the institutional framework for trade, or incorporated political economy factors that could influence trade reform and outcomes. Also largely missing is microeconomic analysis on the response of firms (exit/entry) to changes in incentives.

Evidence from the country case studies suggests that high-quality analytical work can

Box 3.2: Conditionality May Be Neither Necessary nor Sufficient

The record of the appropriateness of Bank conditionality on core trade issues is mixed. In some cases, the conditionality was light, flexible, and adaptable. For example, in **India**, conditionality was light, except for the 1991 Structural Adjustment Loan. Yet even then, the authorities had some leeway, as noted earlier.

In a few other cases, the country failed to meet the condition—in part because it felt it could not act because of political constraints—and received a waiver. In **Indonesia**, four trade policy loans implemented between 1987 and 1996 were devoid of legally binding conditionality. They were given by the Bank in general support of Indonesia's ongoing trade and investment reform program, reflected the Bank's confidence in the credibility of the authorities, and were informal precursors of what is now known as "ex-post conditionality."

In other cases the Bank continued to introduce conditionality even when it was ineffective or when the authorities had serious concerns. In **Zambia**, despite conditions repeated in three successive loans, the government procrastinated on the privatization of the mining parastatal, the Zambia Consolidated Copper Mines (ZCCM), because of political concerns. The phenomenon of Zambia continuing to receive high levels of assistance in the absence of reform has been dubbed "the nonreform" paradox: more and more conditions lead to less and less effective conditionality (Rakner and others 1999).[a] First highlighted as an agricultural structural adjustment condition in 1995, the privatization of SONACOS was a key performance indicator in the Private Investment Promotion Project (fiscal 2003) almost a decade later.

In **Indonesia**, the 1997 financial crisis was associated with diminished credibility of the authorities, and the Bank introduced conditions that had been on its agenda for several years. Notwithstanding the relatively small role of trade issues in the crisis, the Bank introduced legally binding trade-related conditionality.[b] These conditions, related to export taxes and controls and regulatory issues, were eventually satisfied. As noted in the case study, however, it is difficult to argue that any of these issues were critical to resolving Indonesia's financial crisis. They appear to have been at best excessive, and possibly inappropriate.[c] At the same time, two reasons could explain the decision to include them. First, by taking on some of the core interests of the president and his associates, the conditions were intended to send a strong signal to investors about the government's commitment to reform.[d] Second, the World Bank (and IMF) used the opportunity of the crisis to include the most critical trade-related reforms. Regardless of the reason they were introduced, the resulting strained relationship with the Indonesian authorities suggests that in countries where the Bank may not ordinarily have much leverage, the institution needs to be careful to attach only critical conditions during times of crisis.

Sources: Country Case Studies for IEG Trade Assistance Evaluation.

a. The authors argue that that the underlying problem was a defensive government agenda to maximize donor inflows, rather than a properly articulated strategy for medium-term growth and development. Rakner argues that one of the key elements of the defensive agenda is in "in the area of trade reforms, the Movement for Multiparty Democracy (MMD) government is seen as having overcommitted and carried out reforms too rapidly" (p. 574). Given the government's willingness, it perhaps is not surprising that the Bank undertook so little analytical work—there was less need to convince than in other cases. However, this does not excuse the need for the Bank to have identified the implications of such reforms to the authorities.

b. The three trade-related conditions in the First Policy Reform Support (PRS) 1 were: (i) replace all existing quantitative export controls on crude and processed palm oil, olein, and stearin with an export tax not exceeding 40 percent ad valorem; (ii) introduce a system of resource use royalties for forestry, reduce export taxes on logs, sawn timber, and rattan to a maximum of 30 percent ad valorem, and adopt and announce a program for lowering this progressively over time; and (iii) ensure that all traders, including foreign direct investors, continue to be free to compete with Bulog (the government-owned rice procurement agency) by importing, wholesaling, or retailing any commodity other than rice, and ensure that private traders and Bulog have access to foreign exchange at the same rate when importing goods other than rice. PRS 2 reiterated the condition on maximum export tax rates on logs, rattan, and minerals (Indonesia Project Performance Assessment Report for PRS1 & PRS2).

c. Feldstein 1998 as cited in the Indonesia Country Case Study for IEG Trade Evaluation.

d. Hofman and others (2004) as cited in the Indonesia Country Case Study for IEG Trade Evaluation.

improve policy dialogue and the quality of lending (box 3.3 and Appendix D7). But the case studies also highlight that these benefits may sometimes emerge only in the medium term, years after the research was first carried out (India, Morocco). By contrast, disputed technical analysis (Mozambique) or the absence of sustained analytical work underpinning trade reforms, as in Zambia, can strengthen the perception of a Bank caught up in dogmatic prescriptions.

In terms of trends, after sustained decline from the mid-1990s following the

Evidence from country studies suggests high-quality analytical work can significantly improve policy dialogue and quality of lending.

Box 3.3: High-Quality ESW Supports Policy Dialogue

The Bank's trade-related analytic work in **Senegal** has supported the development of adjustment lending over a long period. In the early 1990s, Bank studies of industrial and agricultural prices and incentives identified state interventions and the associated economic costs. These analyses helped prioritize sector adjustment reforms.

While the Bank was precluded from active and open involvement in the devaluation debate in the early 1990s, it worked behind the scenes with a small group of policy makers on macroeconomic and competitiveness issues. Simulation of the fiscal impacts of devaluation-cum-tariff reform were undertaken by the Ministry of Finance's Policy Options Group in 1994 with Bank guidance, and was acknowledged by Senegalese policy makers to have been crucial in convincing them that the risks of the devaluation could be managed.

In **Morocco**, a major contribution of trade ESW has been the quantification of the costs and benefits of freer trade and a generally high emphasis on empirical analysis. During the 1980s, Bank research focused on the potential aggregate gains from trade. The Bank also seconded an economist to the Ministry of Commerce and Industry who, working with staff, helped provide real-time analyses of potential trade policy effects and became a trusted interlocutor for those interested in pursuing trade reform.

By the time the authorities decided to reform in response to crisis in the mid-1980s, the government technocrats were convinced of the value of reform and had a blueprint for its introduction. The benefits of the ESW and advice were not limited to the earlier period. While the pace of reform slowed in the second half of the 1980s, the consistent proponents of reform include those staff first convinced in the early 1980s. Alavi (1993) is another example of analytical work making an impact on policy dialogue and reform.

Source: Country Case Studies prepared for the Trade Assistance Evaluation.

ESW on trade issues has risen in recent years, catalyzed by donor support.

conclusion of the Uruguay Round, ESW on trade issues has risen in recent years.[18] Underpinning this reversal is greater interest in trade issues by client countries as they grapple with more complex integration into the global economy, greater commitment and interest by donors leading to additional trust fund resources, and development of a new trade-focused economic report—the Diagnostic Trade Integration Study (DTIS), which was an important initial catalyst (figure 3.6).[19] Whether funded though the multi-agency Integrated Framework initiative (for the least-developed countries) or bilateral donors (for other developing countries), the DTIS spurred analytical work in trade within the Bank.

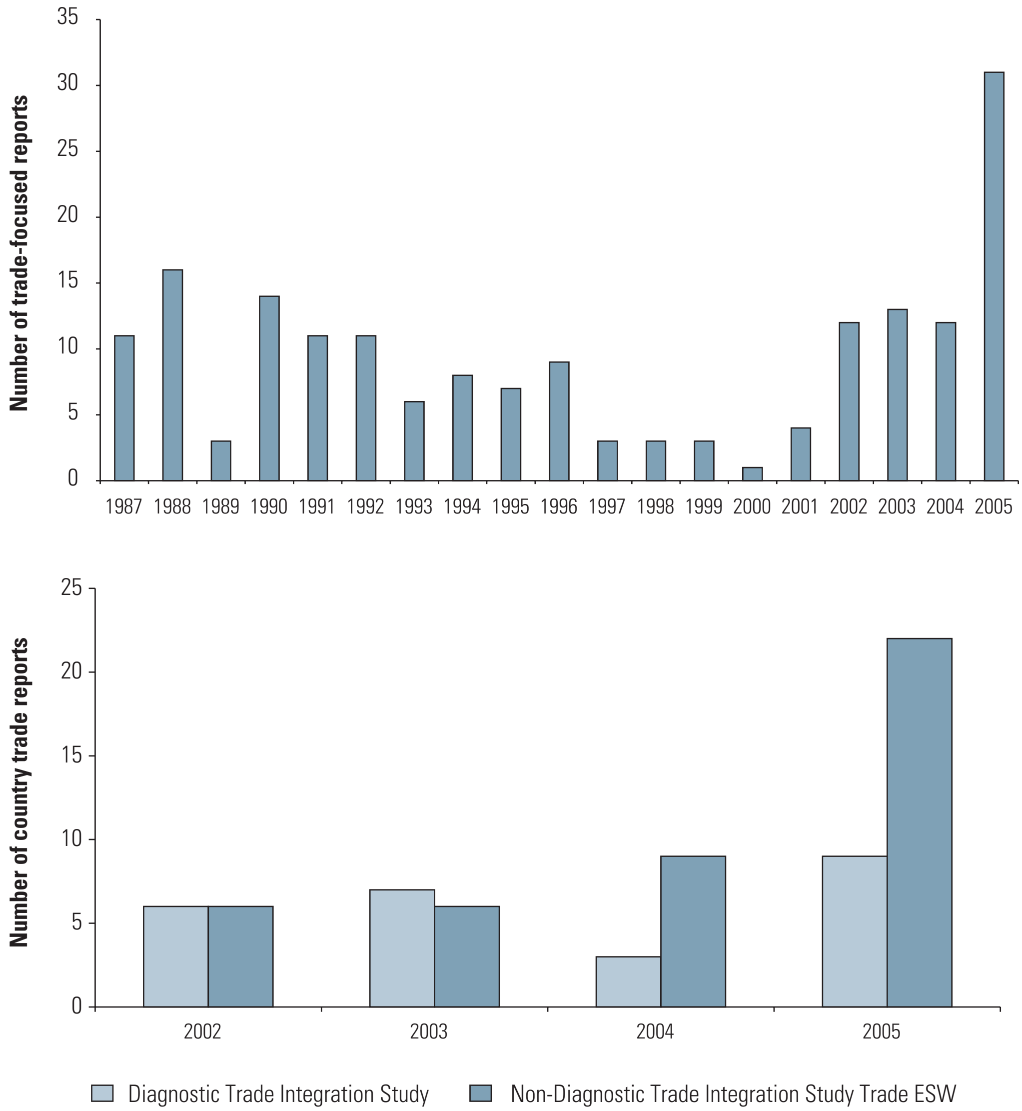
While it is too soon to tell with the more recent analytical work, early trade-related ESW was associated with trade-related lending. Between 1987 and 1990, 65 percent of trade ESW was followed by trade-related lending within two years. This figure has fallen slightly since then—between 1990 and 2001, 60 percent of trade ESW was followed by lending. The discussion of the links between ESW and project outcomes is taken up in Chapter 4.

But it is too early to tell its impact on lending.

The share of countries in which trade-related ESW has been conducted has risen in each Region since 1994, except Latin America and the Caribbean, which started at a high level. The most dramatic rise occurred in the Africa and South Asia Regions. In Latin America, trade-focused ESW at the country level has declined, but a number of major trade-related Regional studies have been done, and given the stock of existing trade research on those countries, they do not appear to have been underserved. More generally, in the past three years, strategic Regional trade studies have been done in every Region except Africa and have been well focused on the particular concerns of the Regions they cover (box 3.4).[20]

To place the analysis on Regional trade issues in perspective, the Bank has carried out much research and analytical work on regionalism. Research has been published in established journals. Among the contributions, several deal with the political economy aspects of regional trading arrangements (RTAs) (Cadot, de Melo, and Olarreaga 2003;

Figure 3.6: New Diagnostic Studies and Trust Funds Catalyzed Increased Economic and Sector Work (number of trade-focused reports)



Source: IEG Trade Assistance Evaluation Database.

Note: Trade-related ESW was selected using two approaches. For 1987–2001, trade-related ESW was identified by searching the ESW database for key trade words, followed by manually checking the depth and relevance of the trade content of the report in question. For 2002–05, the study benefited from the OPCS revamping of sector and thematic codes. The relevant list was obtained by selecting sector codes (45-50 in the OPCS coding system) that correspond to trade and integration. Code 48 (technology diffusion) was excluded because, while trade-related, it is beyond the scope of this study. A number of trade-related studies identified by the Regions were still not captured by the OPCS classification, including most of the trade diagnostic studies. Diagnostic Trade Integration Studies (DTIS)=Trade Study that follows specific template and funded by one of the following: (a) Integrated Framework Initiative; (b) U.K. DFID trust funds; (c) Dutch trust funds.

Olarreaga, Soloaga, and Winters 1999). Among the issues explored is why it is easier to 'exchange market access' by reducing trade barriers bilaterally than to reduce trade barriers unilaterally, even though most of the efficiency gains from trade reforms come from unilateral reduction in trade barriers. The research shows that bilateral rather than multilateral (or unilateral) trade liberalization is most likely to occur if negotiators reflect mostly producers' preferences. The research also established systemic externality effects of RTAs through terms-of-

Box 3.4: Regional Reports on Trade—Strategic and Nontraditional

In De Ferranti and others (2002), the Latin America and the Caribbean Region's experience is used to argue that a substantial natural resource base is not necessarily detrimental to economic growth and income equality. Econometric analysis is used to argue that comparative advantage in the Region has been as variable as in countries and Regions with a weaker natural resource base; thus, policy makers have greater control over outcomes.

Drawing on the Chilean success with rapid agricultural productivity growth following trade reforms in the late 1970s, the report shows that similar trends in labor productivity growth have been achieved in countries following a similar path. Case studies of successful export processing zones in Central America (Costa Rica and El Salvador) are developed to show that policy incentives can generate rewards. The report is complemented by insightful historical lessons from nineteenth century industrialization patterns in natural resource–based economies.

The Middle East and North Africa Region offers an interesting contrast as the only Region that failed to reduce its protection during the 1990s. It is also notable as the Region with countries that are the furthest away from predicted trade volumes. With a labor force growing at twice the average of other countries, the Region faces a significant job-creation challenge.

Dasgupta and Nabli (2003) review the Region's disappointing performance and use comparative analysis to highlight— based on country characteristics—that the Region holds the possibility for accelerated growth through faster trade and investment integration. The report emphasizes that both the resource-rich and resource-poor countries in the Region face poorly functioning labor markets (wage rigidities, skill mismatches, and institutional factors such as expatriate worker quotas that raise employment costs for expatriates). The report argues that incentives to liberalize trade have been weak economically and politically because a coalition of powerful constituents benefits from rents (such as public sector agencies, public sector enterprises, and private enterprises in import-substituting activities) that would be lost under a more liberal trade and investment regime.

Both of these reports are well-focused and draw on research conducted within the Bank as well as externally. While they draw on research themes emphasized by the Trade Department, they also develop areas that have not figured prominently in the research at the center. Examples include the role of labor markets (including education policies and technological absorption through trade) in Latin America and the Caribbean and on labor market institutions and adjustment costs to trade reforms in the Middle East and North Africa. More extensive empirical work on the political economy of reform, emphasizing the differences between resource-rich and resource-poor countries, would have been welcome for both reports.

Source: De Melo (2005).

trade effects on third countries (Winters and Chang 2000, 2002), giving support to the concerns of excluded countries facing such trade arrangements.

The research on regionalism has been forward-looking (starting early on) and consequential in its impact in refereed journals and in the overall debate on the relation between regionalism and multilateralism. At the same time, countries enter into regional agreements for many reasons (politics, security, insurance, and so on) that are often beyond the scope of reasonable quantification by economists. Thus, for much of the 1980s and 1990s, the Bank focused on the suboptimality of RTAs.

After highlighting the second-best nature of preferential trading arrangements during much of the 1990s (in favor of unilateral or multilateral trade liberalization), reflecting some ambivalence toward RTAs, the Bank has taken a pragmatic approach in recent years, and has had an active dialogue with regional trade institutions in some Regions. This is especially notable in the Africa Region, where analysis has been conducted on the common external tariff for several RTAs (EAC, ECOWAS, UMOEA),[21] revenue implications and possible trade diversion, the Environmental Protection Agencies (EPAs) with the European Union (Hinkle and Schiff 2004), and Latin America (work on CAFTA and the Free Trade Area of the Americas [FTAA]). The Europe and Central Asia Region, which has always conducted Regional trade analysis, has continued to do so.