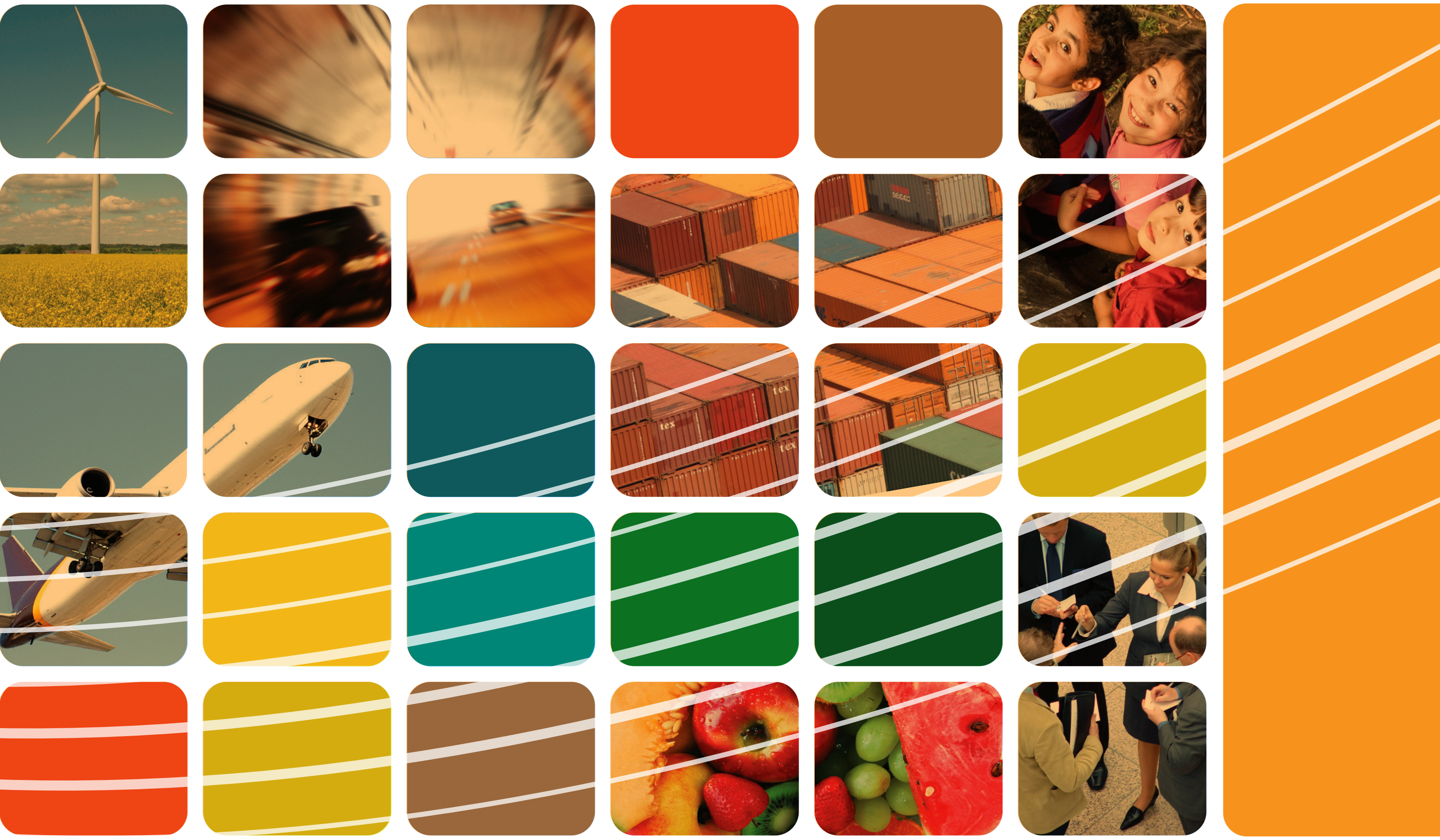
INTER-AMERICAN DEVELOPMENT BANK

Sector Strategy to Support Competitive Global and Regional Integration



IDB

Inter-American Development Bank
Vice-Presidency for Sectors and Knowledge
Integration and Trade Sector

Sector Strategy to Support Competitive Global and Regional Integration

March 22, 2011

This document was prepared by VPS/INT under the supervision of Antoni Estevadeordal (Manager) and coordination of Paolo Giordano and Joaquim Tres (INT/INT). The document benefited from inputs provided by several Bank units represented by: Carlos Hurtado (VPC/CSC), Alexandre Meira Rosa (VPS/INE), Hans Schultz (VPP/SCF) (Managers), Morgan Doyle (VPS/VPS), Ricardo Carciofi (VPC/INTAL), Janine Ferretti (VPS/ESG), Rodolfo Huici and Luis Alfredo Uechi (INE/TSP), Gastón Astesiano, Jorge Enrique Mercado and Emilio Sawada (INE/ENE), Mario Sanginés (SCF/SCF), Rafael Anta and Juan José Llisterri (SCL/SCT), Claudia Piras (SCL/GDI), Fazia Pusterla (SPD/SDV), José Seligmann-Silva and Belinda Fonseca (VPC/CSC), Osmel Manzano and Ennio Rodriguez (VPC/CID) and Casey Silva (SCF/FMKT). Luciana García, Matthew Shearer and Kea Wollrad (VPS/INT) provided background material. Cristóbal Vásquez, Martha Skinner and Mariana Sobral de Elía assisted in the preparation and publication of the document.

Table of Contents

Figures

Tables

Boxes

Abbreviations and Acronyms

ARPEL	Asociación Regional de Empresas de Petróleo y Gas en Latino América y Caribe
ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
ALADI	Latin American Integration Association
ALIDE	Latin American Association of Financial Institutions
AMI	Mesoamerican Information Highway
CARICOM	Caribbean Community and Common Market
CIER	Comisión de Integración Eléctrica Regional
COMALEP	Multilateral Agreement on Cooperation and Mutual Assistance between the Customs Office in Latin America, Spain and Portugal
COSEFIN	Consejo Centroamericano de Ministros de Finanzas
ERM	Eligibility Review meeting
EU	European Union
FDI	Foreign Direct Investment
FELABAN	Latin American Bank Federation
FIRII	Infrastructure Integration Fund
FSO	Fund for Special Operations-IDB
FTA	Free Trade Agreement
GCI	General Capital Increase
GDP	Gross Domestic Product
G20	Group of Twenty
IDB	Inter-American Development Bank
ICT	Information and Communication Technologies
INE	IDB Infrastructure and Environment Sector
INT	IDB Integration and Trade Sector
INTAL	Institute for the Integration of Latin America and the Caribbean
IIC	Inter-American Investment Corporation
IIRSA	Initiative for the Integration of Regional Infrastructure in South America
IOM	International Organization for Migration
LAC	Latin America and the Caribbean
MCCA	Central American Common Market
MERCOSUR	Southern Common Market
MIF	Multilateral Investment Fund
NAFTA	North American Free Trade Agreement
NSG	Non-Sovereign Guarantee
OC	Ordinary Capital-IDB
OECD	Organization for Economic Co-operation and Development
OLADE	Latin American Energy Organization
OPC	Operations and Policy Committee
OVE	Office of Oversight and Evaluation-IDB
PBL	Policy Based Loans-IDB
PIFCARD	Investment and Funding Plan for Central America and the Dominican Republic

PM	Mesoamerican Project
QRR	Quality and Risk Review
RICAM	The Central American Roads Network
RoO	Rules of Origin
RPG	Regional Public Goods
RTA	Regional Trade Agreement
RTC	Regional Technical Cooperation
SAFE	Secure and Facilitate Global Trade
SIEPAC	System of Electrical Interconnection of Central America
SME	Small and Medium Enterprise
SSC	South-South Cooperation
TC	Technical Cooperation
TEN	Trans European Networks
TFFP	Trade Finance Facilitation Program
TIM	International Transit of Merchandise
TPO	Trade Promotion Organization
TRTA	Trade-related Technical Assistance
UN	United Nations
UNASUR	Union of South American Nations
WCO	World Customs Organization
WTO	World Trade Organization

INTRODUCTION

As part of the Ninth General Capital Increase of the Bank, our Governors established regional and global integration as one of Bank's priorities. Governors also requested the Bank to develop an integration strategy to provide an operational framework for the 15 per cent of annual lending that will be devoted to integration from 2015. The purpose of this strategy is to guide the implementation to the IDB Governors' GCI-9 new mandate on integration, while its goal is to increase and sharpen the Bank's contribution to competitive Latin American and Caribbean global and regional integration.

The central message of the strategy is that the Bank needs to act simultaneously on the *software* (policy and regulatory frameworks) and the *hardware* (physical integration) of integration, ensuring coherence between national and regional interventions. Though *software* investments require fewer resources, they can make integration infrastructure more efficient and unlock investments. Focusing on the *software-hardware continuum* and strengthening the production of regional public goods will be crucial to retain the historical Bank's comparative advantage as the region's integration Bank.

To support regional and global integration and create the necessary incentives for this process, this strategy proposes to deploy a smart-mix of financial (loans, grants and guarantees) and non-financial instruments (research, capacity building, policy dialogue).

To obtain this final version of the strategy approved by the Bank's Board of Executive Directors on March 22nd 2011, the ideas and preliminary drafts were submitted to a process of formal public consultation that engaged in intense dialogue with key integration actors, from civil society, specialists, governments, international organizations and sub regional organizations and the private sector.

The public consultation process was launched and divided into two phases of thirty days each: the first phase on the profile of the strategy and the second on the final draft of the document, which included contributions received during the first phase. During the consultation process, meetings were held in twelve countries, as well as videoconferences and meetings in Central America and the Caribbean, with experts and leading specialists of international organizations and other development banks, with a total of approximately five hundred participants for both phases. We would like to thank all those both outside and inside the Bank for their contribution that allowed the Bank to respond to the Governors´ mandate.

The present publication has the same content to the document approved by the Board of Executive Directors of the Bank, though some formatting changes have been introduced.

Antoni Estevadeordal　　　　March 22nd 2011
Manager
Integration and Trade Sector
Vice Presidency of Sectors and Knowledge

I

Executive Summary

I. EXECUTIVE SUMMARY

The purpose of this strategy is to guide the implementation to the IDB Governors' GCI-9 new mandate on integration, while its goal is to increase and sharpen the Bank's contribution to a competitive LAC global and regional integration.

The specific objectives of the strategy are to: (i) consolidate the Bank's knowledge basis of the integration agenda; (ii) strengthen the regional capacity to manage modern integration initiatives; (iii) build additionality into operations in key sovereign and non-sovereign sectors; and (iv) mainstream integration into the Bank's operational program. The document details the thematic areas of Bank's integration interventions.

The strategy provides the framework for the Bank to reach the 15 per cent target of annual lending by the end of 2015, and to contribute to all dimensions of the regional development goals related to integration established in this document and the other GCI-9 strategies, all contributing to the Bank's New Institutional Strategy (AB-2764) to reduce poverty and inequality and contribute to sustainable growth.

This strategy supersedes the institutional strategy on regional integration adopted in 2003 in that: i) it broadens the focus of Bank's interventions as it supports global integration in addition to regional integration; iii) shifts the focus of Bank interventions from advocacy and technical cooperation to lending; and iii) places emphasis on national interventions in addition to regional ones.

The central tenet of the strategy is that the Bank needs to act simultaneously on the *software* (policy and regulatory frameworks) and the *hardware* (physical integration) of integration, ensuring coherence between national and regional interventions. Though *software* investments require fewer resources, they can make integration infrastructure more efficient and unlock investments in *hardware*. Focusing on the *software-hardware continuum* and strengthening the production of regional public goods will be crucial to retain the historical comparative advantage of the IDB as LAC's integration Bank.

The document summarizes and builds upon an extensive body of policy research, which documents the need for LAC to embrace a third-generation integration strategy. It concludes that the region needs to bridge two intertwined global and regional integration gaps: (i) seizing a fair share of global trade; and (ii) deepening regional markets and functional policy cooperation. It needs to do so by focusing on: (a) an unfinished trade agenda that still requires expansion, perfection and convergence of existing agreements; (b) reducing logistics costs related to underinvestment in transport infrastructure, an inadequate transport mode mix, uneven regulatory frameworks, lack of trade facilitation at border crossings, all complemented by competitive integration of energy markets and reduction of the digital divide; and (c) expanding the provision of regional public goods, harnessing the potential of South-South cooperation.

The strategy incorporates lessons learned under GCI-8 when the Bank stepped-up its support to integration and built a distinctive comparative advantage acting as an honest integration broker. To support global and regional integration, the strategy sets a framework under which the Bank will: (i) offer a wider range of financial and non-financial sovereign and non-sovereign instruments; (ii) blend them more efficiently as to provide greater incentives for collective action; (iii) engage client countries' on integration at the highest executive level, particularly but not exclusively the Bank's governors, and foster enhanced policy coordination; and (iv) improve internal Bank coordination.

The strategy sets the framework to develop integration operations aligned with four general strategic criteria. Priority and incentives will be granted to operations that incorporate: (i) a cross-country focus; (ii) regional additionality; (iii) national subsidiarity; and (iv) compensation of coordination failures. The document details such principles, maps potential clients of integration operations and specifies the potential thematic areas of intervention. The strategy will be implemented with a balanced combination of policy-based lending, regional and national investment operations, NSG operations, non-reimbursable technical cooperation and knowledge and capacity-building products. By deploying a *smart-mix* of instruments, the Bank will create the necessary incentives to promote integration in client countries.

II

Objectives

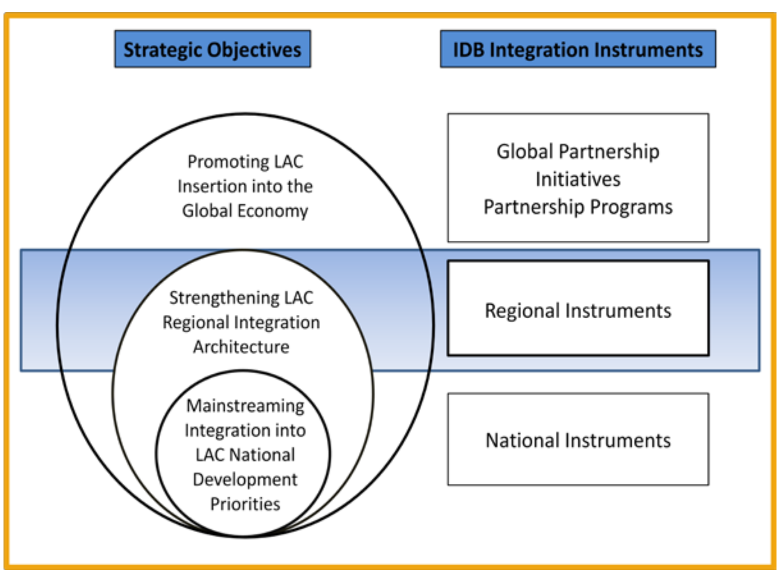
II. Objectives

The Ninth General Capital Increase (GCI-9) document (AB-2764) establishes competitive global and regional integration as one of the five institutional strategic priorities to achieve the Bank's overarching objectives of reducing poverty and inequality and promoting sustainable growth. The GCI-9 also sets an annual lending target of 15 per cent to support integration and regional cooperation in Latin American and the Caribbean (LAC) by the end of 2015.

The goal of this strategy is to increase and sharpen the Bank's contribution to a competitive LAC global and regional integration. More specifically, the document offers a rationale for a new generation of integration projects, summarizes a diagnosis of LAC integration challenges, and reviews the Bank's track record in this field to derive lessons learned for future action. It also sets operational objectives, delineates thematic areas and modalities of Bank intervention that will guide the implementation of this strategy and establishes links with other GCI-9 sector strategies.

Competing in the global economy requires actions on three complementary levels: (i) mainstreaming global and regional integration objectives into **national** development strategies; (ii) building competitive institutional and operational platforms at the **regional** level; and (iii) pursuing an active **global** integration strategy. Figure 1 shows the three complementary strategic objectives for LAC with the corresponding levels of Bank interventions, highlighting the focus of this strategy on the inter-connected dimension of the challenge: strengthening LAC global and regional integration architecture through **"integration instruments"**. This strategy highlights the necessity for countries to tackle the three levels simultaneously, all of which can benefit from Bank support through a variety of financial and non-financial instruments.

Figure 1. IDB Support to LAC Countries' Strategic Objectives of Global and Regional integration



III

The Rationale for Global and Regional Integration

III. THE RATIONALE FOR GLOBAL AND REGIONAL INTEGRATION

A. Global and regional integration as an engine for growth and development

Integration as a strategic additional development policy tool. Integration is not an end in itself, but a strategic platform to maximize the benefits of globalization and harness functional cooperation for growth and development. In LAC, the policy framework for integration has shifted radically from the *Old Regionalism* of the 1950-60s that supported state-led import-substitution strategies within regional blocks, to the *New Regionalism* of the 1990-2000s meant to promote market scale and efficiency through global and regional trade liberalization[1]. As the drivers of global competition changed dramatically, joining together regionally to better navigate the world economy is more necessary than ever.

Integration as an engine for growth and development. Global and regional integration help countries to: (i) overcome the disadvantages of small market size. In a world economy where economies of scale are critical, a larger integrated market provides not only an adequate efficiency scale for local firms' production, but also supports the development of regional production networks and more efficient technology development and absorption; (ii) attract foreign direct investment (FDI). The free circulation of goods, services, and factors of production is key to attract market- and efficiency-seeking FDI promoting forward and backward linkages with domestic firms, in addition to investments into the region's large natural resources endowments; and (iii) access the global marketplace at a faster pace. Bilateral and regional trade integration permits more rapid advances to freer trade than complex multilateral negotiations, which have proven significantly slower to negotiate.

Integration as a platform for functional cooperation. Regional integration allows countries to pursue more effective collective policies beyond trade integration, in particular: (i) a greater voice in global *fora*. Regional integration magnifies countries' bargaining power in *fora* such as the G20 or global negotiations for the provision of global public goods such as a balanced global financial architecture, a rules-based multilateral trading system, or a sustainable framework on climate change; (ii) a platform for the provision of regional public goods (RPGs). Regional integration provides incentives for cooperation in the provision of regional public goods and regional cooperation, ranging from macroeconomic stabilization, political cooperation to planning and financing of infrastructure initiatives[2]; and (iii) a natural space to address asymmetries and promote cohesion. As global and regional integration may produce social and regional disparities, regional policy coordination is crucial in promoting balanced regional development and preserving consensus for global and regional integration in the long run[3].

B. The necessary requisites for sustainable integration initiatives

Sustaining forward-looking political will. There is a direct relationship between the depth, breadth, and ultimately the effectiveness and relevance of an integration initiative, and the political will that underpins it. Regional collective action requires a forward-looking sustained political vision, a high-level determination to strengthen the capacities of regional and subsidiary national institutions, and the allocation of sufficient and predictable flows of political capital and financial resources to the design, implementation, and enforcement of integration policies. The capacity of an integration initiative to deliver on its development promises ultimately depends also on

[1] See IDB (2002), Devlin, R. and Estevadeordal, A. (2004) and Devlin, R. and Giordano, P. (2004).

[2] See Estevadeordal, A., Frank, B., Nguyen, T. (2004).

[3] See Sapir, A. et al. 2004 on the European experience.

the existence of champions - be they individuals, governments or regional institutions - able to provide leadership to the integration club. While the emergence of individual leaders with vision and dedication is often the result of historical fate, it is certain that the governments of relatively larger and wealthier countries need to be willing to bear the brunt of integration costs, and that the action of an external trusted honest broker and proactive promoter like the Bank can be catalytic for collective action.

Targeting an optimal economic scale. The optimal economic size of an integration initiative deserves the utmost consideration. Integration is seen as a tool to overcome the disadvantages of small size. But given the small economic and geographical size of most LAC countries, not every integration scheme can deliver effective results[4]. The similarity of countries' factor endowments and technology also impose limitations on the traditional gains of trade and raise considerable risks, particularly for smaller countries. Similar endowments and technologies imply that countries' comparative advantages tend to overlap, and that a large share of their trade is bound to originate from outside the region. This, in turn, increases the risks that regional integration generates trade diversion and the agglomeration of economic activity in the larger regional countries. The geometry of modern integration must therefore consider other factors beyond the underlying political logic of some traditional integration blocs and should take into account elements such as building institutions and promoting policies to connect with the global economy, promoting sustainable trans-national transportation corridors, facilitating the integration of cross-border production networks, and promote inclusive initiatives bearing in mind social and gender differences in the access of assets and services, among others.

Building an efficient institutional architecture. The costs and benefits of integration arise with asymmetric temporalities. Adjustment costs materialize in the short-term while benefits are reaped in the longer run, when integration completes the process of structural transformation and regulatory upgrade. Trans-national institutions and their national counterparts are therefore required to promote the long-term regional collective interest, ensuring that integration is not reversed by short-term political economy considerations. At the same time, integration initiatives must be based on a stable and predictable system of common rules, rights and obligations and on enforcement mechanisms that guarantee the certain and prompt settlement of disputes.

[4] As of 2008, only a region-wide LAC integration scheme would lead to a US$ 4.2 trillion market comparable to that of China.

IV

Diagnosis: Towards an Effective Third Generation Integration in LAC

IV. DIAGNOSIS: TOWARDS AN EFFECTIVE THIRD GENERATION INTEGRATION IN LAC

A renewed integration strategy for the region is a key ingredient for a wider competitiveness agenda. To compete successfully in global markets, the countries of the region need not only to redefine their integration strategies, but also undertake reforms and investments in other determinants of long-run productivity growth, some of which lie outside the scope of this strategy[5]. However, it is clear that as globalization unfolds it is increasingly essential to mainstream a renewed integration strategy at the center of the national development strategies of LAC countries. These are not isolated and independent goals, but closely intertwined propositions. This section of the document focuses on the integration dimension of this challenge, but also highlights the need of a wider approach.

A. The status of global and regional integration in LAC

The *New Regionalism* was a break with history. The integration model of the late 20th century represented a major structural break from the past: (i) the import-substitution model was replaced by a market-oriented one; (ii) trade policy instruments expanded in depth and complexity (e.g. universal automatic tariff liberalization, rules of origin, etc.), coverage (services, investment, competition, government procurement, intellectual property, etc.) and enforceability (incipient dispute settlement mechanisms); (iii) the geometry of integration expanded, with an increasing focus on North-South and a new generation of South-South agreements; (iv) regional institutions were reformed and modernized; and (v) functional cooperation became part of the integration agenda, particularly in the area of regional infrastructure[6].

***Tariffs* were dramatically reduced while trade agreements flourished.** Since the late 1980s tariffs in the region have come down drastically, with most favored nation (MFN) tariffs falling from an average of more than 40 percent to close to 10 percent in the late 1990s, and with preferential tariffs declining even further. In fact, LAC is rapidly reaching the point where the largest bilateral trading relationships are covered by preferential trade agreements. There are now 42 free trade agreements (FTAs) in force, covering 237 bilateral relationships (of a possible 496), which represent 89 percent of intra-LAC trade[7]. Of these agreements, 24 eliminate tariffs on at least 80 percent of products[8]. Despite these impressive achievements, the region has still a long way to go before traditional trade costs cease to be a barrier to intra-regional trade[9].

Most of the “missing links” have relatively little trade. The majority of bilateral relations not covered by FTAs are between the countries of Central America or the Caribbean, on one hand, and South America on the other (except for Chile and Colombia, each of which have agreements

[5] Complementary actions will be undertaken under the framework of Bank’s policies and other sector strategies being developed simultaneously in the GCI-9 context, particularly the Private Sector Development Strategy, the Institutions for Growth and Welfare Strategy, Social Policy for Equity and Productivity and the Climate Change Strategy, where there is a large potential for cross-fertilization in areas in which the Bank has comparative advantages.

[6] Under the *New Regionalism* the growth benefits were somehow slow to come, but have become unmistakable in the last decade. Between 2003 and 2008, the region’s GDP grew at an annual average of 5 percent, driven by a 17 percent annual growth of its exports and record influx of foreign investment, which topped 90 billion in 2008. The 2008-2009 crises hit the region hard, causing sharp drops in exports (29 percent) and GDP (2.5 percent). But unlike past experiences, recovery has been relatively swift and most countries in the region resumed growth in 2010.

[7] Based on 2008 figures, excluding exports from Antigua and Barbuda and Haiti, for which 2008 figures are not yet available. All figures cited are sourced from INTradeBID (www.iadb.org/int/intradebid).

[8] Measured as more than 4,000 of the 5,000+ subheadings of the Harmonized System. All figures cited sourced from INTradeBID (www.iadb.org/int/intradebid).

[9] See Estevadeordal et al. (2009).

with some or all Central American countries). The big "missing links" within LAC FTAs are the bilateral relationships of Mexico with Brazil, Venezuela, Panama, and the Dominican Republic, and those between Brazil and the Caribbean Basin, including Central America. These alone represent nearly half of the intra-LAC trade that is not between countries with an FTA in place. Furthermore, although Mexico has a series of partial-scope agreements with the Mercosur countries, only the agreement with Uruguay has a broad coverage of products, thus leaving significant sectors out of the agreements.

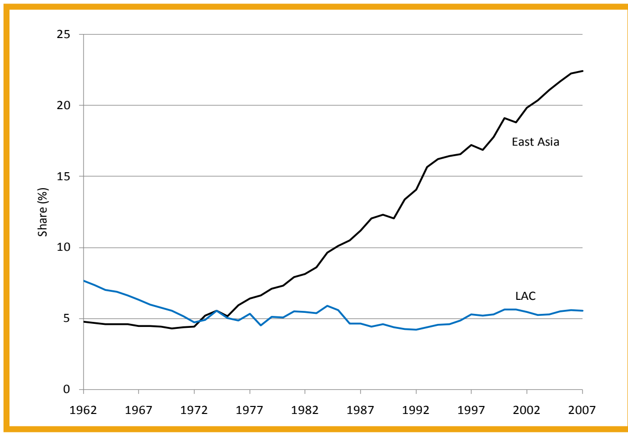
Rules of origin are of particular importance. A major consequence of defining rules of origin agreement-by-agreement is that preferential treatment can be jeopardized when production processes are carried out in countries that are not members of the same agreement. In these cases, parts or components that are not sourced within a single FTA can cause the final good to be disqualified from originating status, even if the exporting country and the importing country both have FTAs with the country in which the part or component was produced. This lack of cumulation mechanisms hinders the integration of supply chains.

The drivers of regional integration have changed once again. The region must once again adapt its integration model to a new environment where: (i) the logic behind private sector-driven integration requires the adaptation of traditional state-led initiatives shaped by geopolitical considerations; (ii) the emergence of major competitors and markets in the developing world is revealing the limits of inward-looking integration initiatives; (iii) global competitiveness is increasingly determined by non-traditional factors, such as transport and logistics costs, private standards for market access or connectivity and interoperability of telecommunications networks; (iv) the asymmetric distribution of benefits and costs jeopardizes the consensus for deeper economic integration; (v) regional institutions face the challenge to support overlapping agendas, a variable geometry of stakeholders, and multiple speeds determined by an uneven capacity and interests of individual countries.

The region has key assets to face the new integration challenges. The *New Regionalism* in LAC left a legacy of assets that may be drawn on to address the new challenges: (i) a shared long-term strategic vision of an integrated LAC continent; (ii) an extensive web of free trade agreements that will mature into substantial intra- and extra-regional trade liberalization; (iii) a set of regional institutions that have undergone a process of modernization and technical upgrade; (iv) a global architecture of multilateral rules that prevents radical backtracking; (v) a level of interdependence that has reached a critical threshold to support a growing demand for regional public goods. However, it would be unwarranted to conclude that LAC is in a comfortable position in the world economy or that its trade-led growth has achieved a sustainable path. The region has still sizeable global and regional integration gaps to fill, and national platforms to build before it can meet its elusive ambition to catch-up with developed and developing competitors in the globalization race.

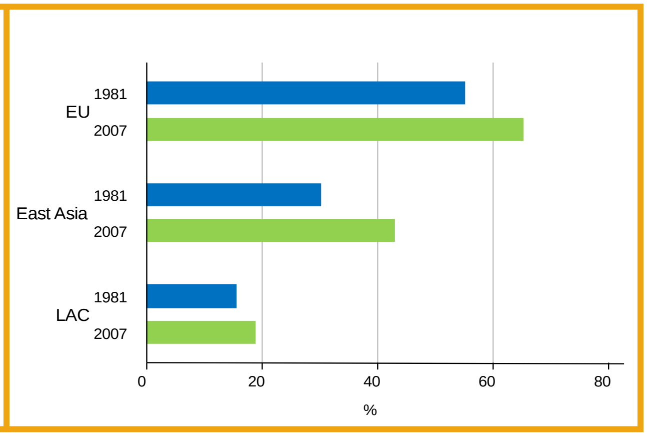
The global and regional integration gaps. The region has yet to reap the full growth benefits of trade and integration measured in quantitative or qualitative terms. LAC's trade volumes are still relatively small, and a lot of ground needs to be covered to reach the world market share it had in the early 1960s before the full impact of the import substitution policies was felt (Figure 2). Moreover, LAC exports are concentrated in a small number of goods and services, particularly in price-volatile basic natural resources. With the exception of Brazil and Mexico, most countries in the region have export concentration levels well above the norm in terms of their levels of per capita income. Additionally, although intra-regional tariffs fell sharply and intra-regional trade expanded faster than extra-regional trade in most countries, intra-regional trade integration remains well below the levels observed elsewhere (Figure 3).

Figure 2. LAC and East Asia Share of World Exports (1962-2007)



Source: VPS/INT based on UN COMTRADE

Figure 3. Share of Intra-regional Trade over Total Foreign Trade (1981 and 2007)



Source: VPS/INT based on UN COMTRADE and *World Development Indicators* Note: Developing East Asia includes China, Indonesia, Korea, Malaysia, Singapore and Thailand.

The need for national platforms to support an ambitious integration agenda. LAC countries have made progress in the regional harmonization of some border integration measures and in the regulation of behind-border disciplines. However, as global competition and regional integration grow in complexity and generate a deeper impact on national development, the need to further align national policies and to modernize national institutions required for the implementation of integration policies has increased dramatically.

B. Closing the global integration gap: a competitive region in global markets

Complement multilateral liberalization with regional integration. Keeping protection low against the rest of the world is crucial and the region is clearly lagging behind any OECD or East Asian comparator. Low tariffs at home should be complemented by low-cost access to main world markets. Countries such as Chile, Mexico, Peru, or those of Central America are leading the way in terms of signing free trade agreements with the most important global markets. While global traders like Brazil or Argentina need a wide web of trade rules that facilitate access to protected international markets. The slow progress being made in the Doha Round makes it clear that a market access strategy based only on multilateral negotiations, albeit desirable, is not sufficient. Agreements with other countries and regions have to be part of the menu if LAC countries want to reap the benefits of regional integration sooner rather than later[10]. Despite substantial progress made in reducing external tariffs, most sub-regional agreements still apply high and dispersed tariffs, particularly in South America and in the Caribbean.

C. Closing the regional integration gap: a fully connected market

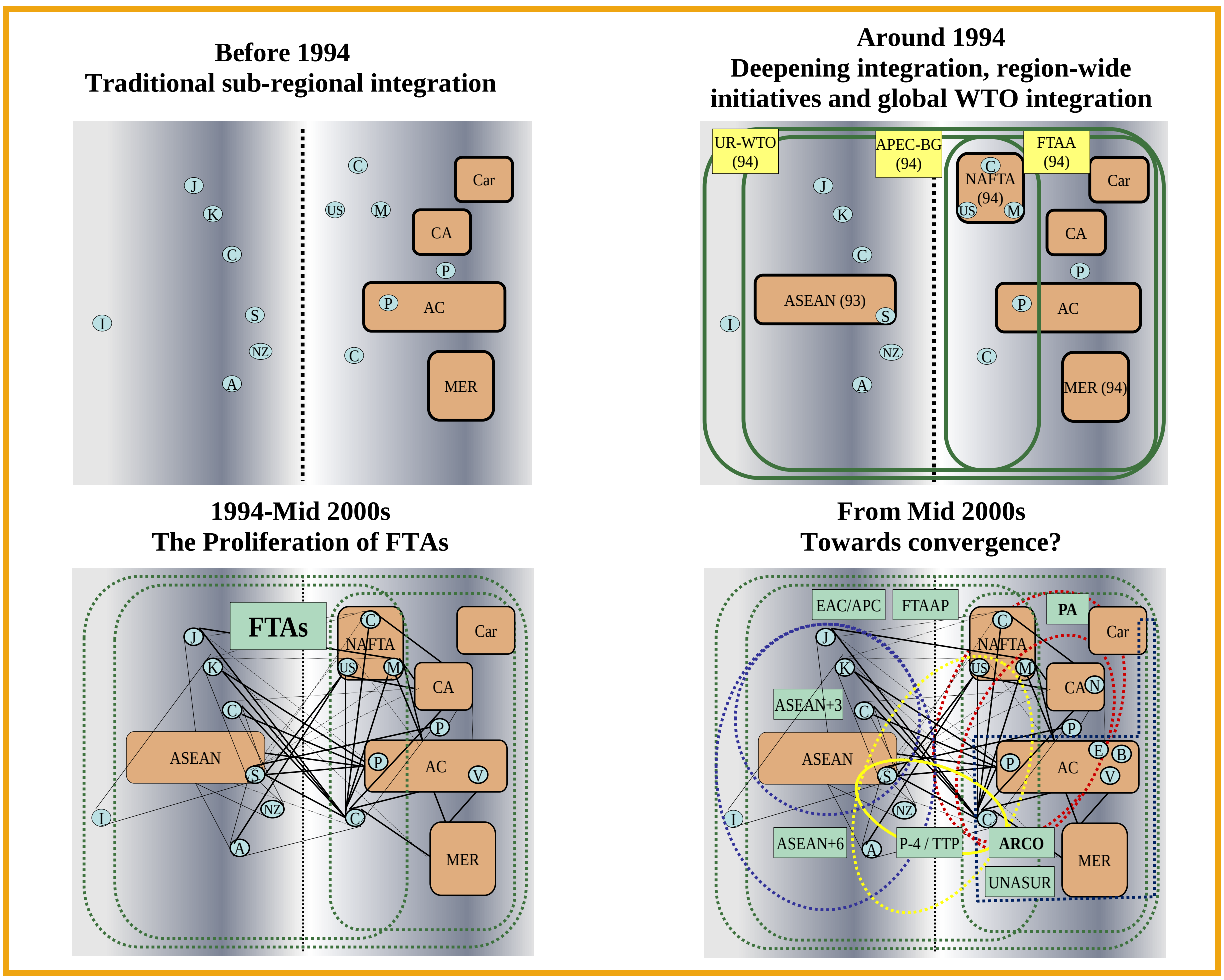
Connecting the *software* and *hardware* of integration. Competing on an equal footing with advanced and other emerging economies requires a renewed third generation integration strategy. Its components can be visualized on a *continuum* ranging from *hardware* to **software** development, with the former referring to investments in regional infrastructure and the latter to the implementation of collective policies and regulatory frameworks. There is an urgent need to redouble investments in both the *hardware* and *software* of integration and, to connect them in an all-encompassing policy agenda of *cooperation* on integration.

[10] See Estevadeordal, A., Freund, C, Ornelas, E. (2008) regarding the complementarity between multilateral and regional liberalization.

Upgrading the software: free circulation from goods to factors of production

Facilitating rules convergence and the free circulation of goods. Policy and regulatory measures - or *software* - reforms aimed at facilitating the free circulation of goods will push the region towards more efficiency and wider markets. The proliferation of bilateral free trade agreements in the last decade adds to the complexity of harmonizing the integration *software*, as trade rules have been developed into a fragmented institutional setting (Figure 4). The agenda is not new and involves: (i) removal of residual intra-zone tariffs and non-tariff barriers; (ii) completion of custom unions; (iii) harmonization and simplification of rules of origin regimes; (iv) harmonization and/or mutual recognition of customs procedures, sanitary, and technical standards; (v) development and harmonization of investment regimes and antitrust legislations; (vi) establishment of well-functioning institutionalized dispute settlement mechanisms; (vii) negotiations to achieve trade convergence among existing agreements; (viii) cooperation to promote cross-border investments; and (ix) coordination in the areas of logistics and trade facilitation.

Figure 4. Trade Integration in the Americas, Asia and Asia-Pacific (1990-2010)



Source: VPS/INT based on IDB INTRADE information system

Developing regional platforms for services and factor markets integration. While the liberalization of goods markets is a long-overdue necessary condition to achieve a competitive global size, it is far from being sufficient, as shown by the thriving integration of productive networks in Asia and elsewhere. Global competition, particularly in manufactures, increasingly requires access to intermediate goods, energy, technology, skills, and capital. The region has advanced at the national level in liberalizing some key services markets, but has fallen short in providing the conditions for productive integration. This brings the integration agenda to a new level, which includes the need to: (i) regulate inter-regional labor migration in order to facilitate the movement of labor and professional services providers while protecting the rights of the migrants; (ii) develop and deepen regional financial markets in order to reduce the cost of capital especially for SMEs and promote cross-border investments; (iii) harmonize direct and indirect taxation and incentives regimes in order to avoid distortions in the optimal localization of business; and (iv) build infrastructure and a regulatory environment suitable for the development of modern services industries.

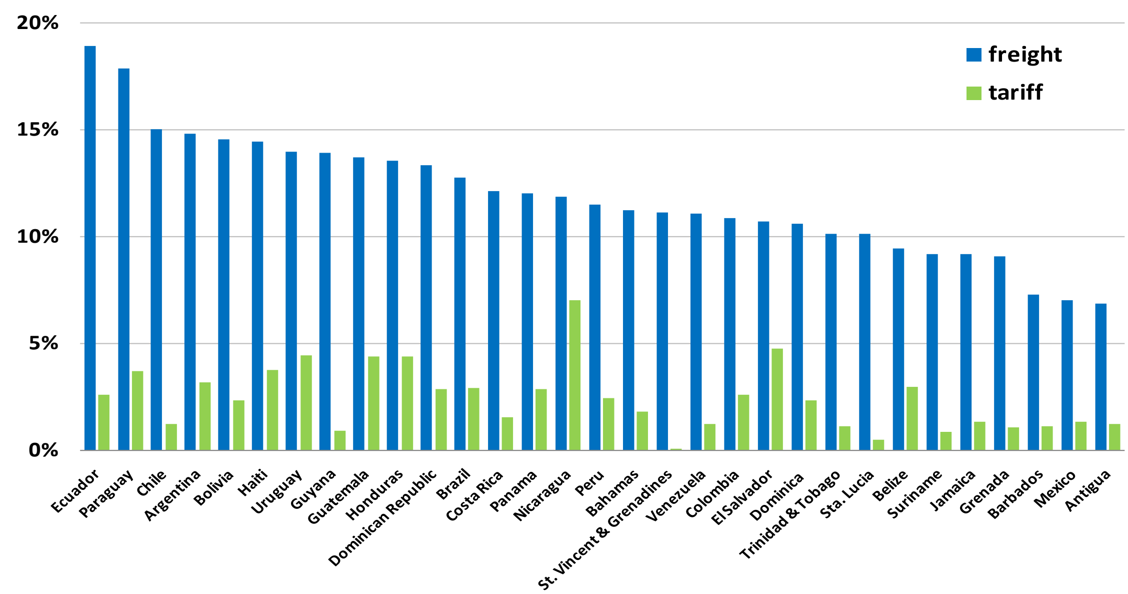
Competing with world-class institutions. Public, private, and public-private institutions promote, regulate, and ultimately embody the intangible assets crucial for competing in the global knowledge-based economy. The region has already recognized that some top-heavy regional institutions shaped under the *Old Regionalism* have nearly exhausted their historical function and under the *new regionalism* LAC has relied on scaled-down institutions or on simple inter-governmental cooperation frameworks. Nevertheless, there is a need to upgrade the institutional architecture, including through: (i) streamlining regional integration institutions, assigning clear jurisdictions to overlapping bodies and initiatives; (ii) enforcing common rules and developing effective dispute settlement bodies; (iii) upgrading the technical capacity of regional and, most importantly, subsidiary national institutions and investing in capacity building in all areas of the wider integration agenda; (iv) developing trans-national private networks and public-private partnerships and expanding the critical mass of relevant actors associated with the integration process and (v) strengthening their governance and transparency.

Scaling-up the hardware: physical integration to reduce non-policy trade costs

Focusing on the reduction of transport costs. The non-policy components of trade costs - such as those incurred to acquire economic information on foreign markets, obtain timely customs clearance, and comply with security, safety, and technical standards or ship goods internationally - are increasingly critical for global competitiveness. Transport costs today constitute one of the most important obstacles to trade integration[11]. They are not only much higher than tariffs, but they are also significantly higher than those observed in the developed world as a consequence of the region's limited and relatively inefficient regional infrastructure (Figure 5).

[11] See Moreira M., Volpe, C. and Blyde, J. (2008).

Figure 5. Freight Costs and Tariffs on Intraregional Exports 2005



Source: VPS/INT based on ALADI

Acting in all segments of the logistics and supply chains. International transport costs fail to capture all impediments to external competitiveness. At least two other components tend to play a major role: (i) domestic freight expenditures, which can account for as much as 30 percent of the price of mining and agricultural exports at the port of departure; and (b) the time costs of border clearance associated with depreciation and inventories. It is therefore necessary to act on all cost components, such as port inefficiencies, warehousing, and customs costs, the latter of which often represents the most important component in a logistics chain. For the poor, who often spend more on food than on anything else, the cumulative effects of logistics inefficiencies result in a prohibitive "tax"[12], which may represent the largest share of a good's final price to consumers[13] (see Box 1 below). **Transforming the unbalanced modal composition of the transport network**. LAC transport costs are high not only because of the inefficiencies of each of the transport modes, but also because the modes are not integrated in a way that minimizes costs. Modal composition reflects policy decisions and not only exogenous factors such as geography, which can ultimately facilitate or hamper the choice of a transport mix that minimizes freight costs. Analysts argue that LAC policy choices in transport policies have been more a hindrance than help: in emphasizing roads over rail, river and coastal logistics systems, the region has selected the most expensive as well as the least environmentally friendly option for its infrastructure system[14].

[12] See Dessus *et al.* (2008) and Giordano and Watanuki (2010).

[13] See Schwartz *et al.,* (2009).

[14] See Batista da Silva (1996).

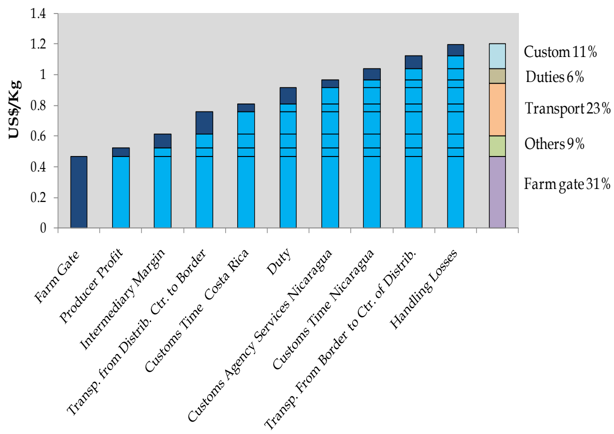
Box 1. Logistics Bottlenecks: Supply Chain Analysis of Tomatoes in Central America

The importance of logistics costs can be illustrated by the example of tomato exports from Costa Rica to Nicaragua, as this product features an unusual sensitivity to time and damage related to efficient logistics movements.

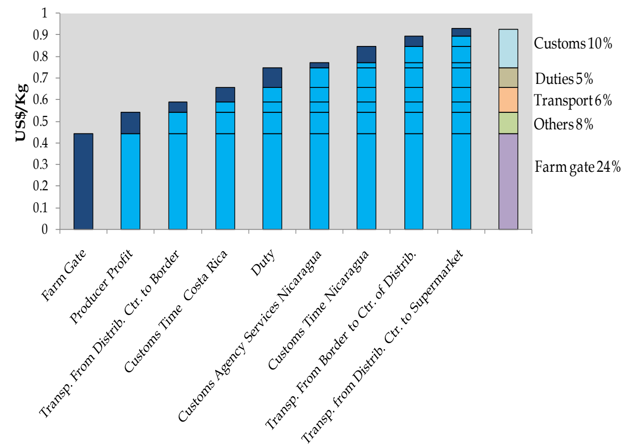
The analysis captures the cost structures involved in transporting a kilogram of tomatoes from the farm gate in Costa Rica to the final sale point in Nicaragua. Cost components are decomposed along the value chain. Results indicate that the biggest burdens for both small and large exporters are: (i) high domestic transportation costs and (ii) bottlenecks at the region's border crossings, mostly attributed to customs delays, which are particularly relevant in the trade of perishable goods.

As shown in the figures below, the largest cost component as a percentage of the final price of a kilogram of tomatoes for the small exporter is transport (23 percent), followed by customs (11 percent), and duties (6 percent). Outside of trade and logistics costs, the farm gate price represents the largest cost component. Similarly, for the large exporter, the two most important trade and logistics costs remain customs (10 percent) and transport (6 percent), while duties represent a similar share at 5 percent. When comparing the small exporter to the large exporter, it is observed that the small exporter has the equivalent of a 27.5 cent extra cost per kilogram of tomatoes due to logistics inefficiencies.

Small Tomato Exporter



Large Tomato Exporter



Note: The cost decomposition does not add up to 100 percent because the graphs do not include retailer's operating and administrative costs and profits.

Source: IDB, World Bank, ECLAC (2010)

Investing in transport connectivity. Spatial coverage of the road network in the region is below the world average, despite the key role of road transport in LAC. Indicators show a world average of 241 km of road network per 1,000 km^2 of surface, whereas in LAC the coverage is about 156 km[15]. The quality of the existing network is also subpar when compared to other regions, and there is a pronounced deficit of interfaces between railways and ports. With the exception of a few specialized terminals, most of the ports do not adequately connect with railways[16]. A similar problem is related to the interface between ports and the road network. Many ports in the region must be accessed by narrow and often congested roads, very few of which were designed to provide connection with the interior. Interfaces between railways and road networks are equally deficient.

Reforming regulatory frameworks. Under-investment is compounded by regulatory inefficiencies. For example, managing separate transport contracts for each mode of transportation can be very cumbersome for an exporter and a unified document could facilitate bank transactions and speed up trade credit. However, a unified multimodal transport contract might not be possible without enacting proper legislation first.

15 See Barbero (2010).
16 See Sgut (2003).

Focusing on the development of sustainable trade and investment integration corridors. In order to address all these issues simultaneously the region needs to take on new challenges including: (i) elevate the political profile of infrastructure integration initiatives, securing continuous support for long-term investment[17]; (ii) promote integral and balanced territorial development, taking into consideration socio-economic developmental priorities; (iii) align regional corridors infrastructure planning to active trade routes, evaluating the return on investment on emerging intra- and extra-regional trade; (iv) secure adequate funding for priority projects, identifying key cross-border bottlenecks; and (v) apply adequate sustainable infrastructure standards throughout the project cycle by ensuring enhanced social and environment safeguards.

Digital wiring is a key ingredient of modern integration strategies. International estimates suggest that for every 10 per cent increase in broadband penetration, one can expect a 1.3 percentage point of additional growth[18]. Broadband access has also profound implications for the achievement of the Millennium Development Goals and for enhancing business productivity and global integration. LAC countries are facing a growing digital divide due to a very low access to broadband, measured by low availability and high costs, which leaves individuals and firms disconnected from external markets. Two main indicators illustrate the LAC digital divide: in 2009 digital penetration stood at 5.4 broadband subscriptions per 100 inhabitants, compared to 26 in OECD countries; a fixed broadband subscription costs about ten times more in real terms in LAC than in the OECD[19].

[17] For example, under UNASUR/IIRSA in South America or COSEFIN/PIFCARD in Central America. The Caribbean sub-region however critically lacks an initiative focused on infrastructure integration.

[18] See World Bank (2009) and Crandall *et al.* (2007).

[19] See IDB (2010).

Connecting hardware and software: a seamless region competing globally

Connecting *hardware* and *software* yields high returns. Connecting the investments made in the *hardware* and *software* of integration and consolidating them into a third generation comprehensive integration strategy may prove to be the key to creating a seamless competitive region[20]. This strategy should include actions such as: (i) mainstreaming infrastructure initiatives into an overall regional strategy, linking regional infrastructure initiatives to regional regulatory and policy cooperation frameworks; (ii) promoting the provision of critical regional public goods, supporting the growing interdependence among countries and cross-border externalities and other neighborhood issues.

D. Bridging national policy platforms: sharing the costs and benefits equitably

An asymmetric distribution of cost and benefits can jeopardize integration. There is a legitimate and growing demand in the region that the costs and benefits of economic integration be fairly distributed among member countries and within countries to increase economic and social opportunities for the excluded. To ignore this demand is to put the consensus for the whole integration process in peril[21]. Trade policies can be the source of these asymmetries, but there are also other sources such as macro (e.g. exchange rate regimes) and microeconomic policies (e.g. subsidies and fiscal incentives). The agenda is as complex as it is urgent, and includes: (i) advancing towards the establishment of cohesion policies through transfers between members of an integrating region that compensate regional, social and gender inequalities[22]; and (ii)

[20] See examples of this strategic approach in Europe (EC, 2006) and Asia in (ADB-ADBI, 2009).

[21] Support for economic integration has declined steadily in LAC since the late-nineties (Latinobarometro, 2009). See also Blyde, J., Fernández-Arias, E. and Giordano, P. (2008)

[22] Cohesion or structural convergence funds are an indirect instrument to promote balanced integration and preserve regional political cohesion (Giordano, P., Moreira, M. and Quevedo, F., 2004).

strengthening domestic institutions and policies, complementing and supporting regional initiatives: a point too often neglected which contributes to turning integration into the scapegoat for national idleness.

E. Regional public goods: a new platform for multi-sector cooperation

Regional public goods are key for integration processes. The progressive integration of goods, services and factor markets generates growing interdependence and naturally creates externalities that lead to an increasing demand for regional public goods (RPG) and functional cooperation, which in turn reinforce integration processes.

The drive towards greater integration seen in the region in the last two decades has created opportunities to intensify cross-border cooperation. However, much still remains to be done to support growing interdependence with a more strategic approach, despite the existence of some pilot initiatives pioneered by the IDB[23].

South-South Cooperation is intensifying. The growing interdependence and intensifying integration in LAC are having a positive impact on the generation of South-South Cooperation (SSC) initiatives both regionally and globally, as countries exchange experiences, good practices and engage in policy coordination. LAC countries are also benefiting from the active role of regional development banks in the facilitation of SSC.

[23] The Bank together with the Asian Development Bank jointly developed the policy application of the concept of regional public goods (Estevadeordal A., Frank B., Nguyen T., 2004), which led to the creation of the Regional Public Goods Program at the IDB.

V

Lessons Learned from the Bank´s Support to Integration

V. LESSONS LEARNED FROM THE BANK´S SUPPORT TO INTEGRATION

A. Supporting integration: a core Bank development mandate

Supporting integration is part of the Bank's institutional identity. Support for global and regional integration lies at the heart of the development mandate of the Bank. Article I of the IDB Charter states that the purpose of the Bank is to *"contribute to the acceleration of the process of economic and social development […] individually and collectively*". Throughout its history the Bank has built a distinctive comparative advantage in this area that is widely acknowledged by client countries, LAC constituencies and other multilateral, regional and extra-regional institutions.

A new focus on quantity and quality of integration projects. The past IDB strategy focused on the creation of Regional Public Goods, particularly Regional Integration and Regional Cooperation[24]. The GCI-9 renewed and strengthened the Bank's integration mandate to upscale the Bank's interventions, and calls for three major changes in focus: (i) broaden the scope of integration interventions, supplementing the support to regional integration with actions that facilitate integration into the global economy; (ii) mainstream integration into the lending activity of the Bank; and (iii) achieve greater coordination among Bank's sector strategies of all units that hold the potential to contribute to integration outcomes. This section takes stock of previous Bank's actions and lessons learned in order to respond to the ambitious GCI-9 mandate.

B. Lessons learned from IDB support to the integration *software*

Advocating new ideas to expand the integration frontier. The Bank consolidated its intellectual leadership, served as the primary integration brain trust for the region, and helped to raise the profile of LAC integration by promoting innovative research, supporting research networks and developing outreach initiatives with extra-regional partners. Additionally, the Bank maintained cutting-edge information systems and modeling tools on trade and integration[25], and developed methodologies and training in **rapid** strategic environmental assessment for national planning agencies. The Bank learned that investing in integration cutting-edge knowledge is key to engage client countries and earn their trust to become a preferred integration partner.

Leading in trade-related technical assistance (TRTA). Technical assistance and advisory services of the Bank proved to be invaluable during the complex integration agenda of the 1990s-mid 2000s, including multilateral, sub-regional, hemispheric and extra-regional negotiations[26]. This agenda is now growing in complexity due to **simultaneous** negotiations across overlapping agreements (Figure 4) and, more importantly, the challenges associated with implementation. The Bank responded by scaling-up TRTA resources with a *Special Initiative on Trade and Integration*, mainstreaming trade into country strategies and programming, mobilizing lending resources through a new *Trade Lending Facility*, and promoting innovative approaches, particularly in the area of customs modernization where the Bank has developed strategic alliances with the World Customs Organization (WCO) and the Customs Offices' Multilateral Agreement on Cooperation and Mutual Assistance (COMALEP). The Bank is now urged to expand its capacity to assist client countries beyond trade matters in a wider range of integration-related

[24] See IDB 2003 for the past institutional strategy on Regional Integration and IDB 2006 and 2007 for a review of the Bank's action and strategy to support the trade-related *software* components of the integration agenda through national interventions.

[25] The Bank developed INTRADE, the most comprehensive resource center on trade agreements available for LAC (www.iadb.org/int/intradebid).

[26] For LAC, 1994 marked a milestone in the area of trade integration (see Figure 4). As a response, the Bank created and endowed with new resources the Trade, Integration and Hemispheric Issues Division, within the former Integration and Regional Programs Department.

technical areas and issues that contribute to economic growth and reduce poverty and social and gender inequalities.

Facilitating private sector integration. The Bank has been a pioneer in the development of integration programs for the private sector. The Trade Finance Facilitation Program (TFFP) is part of a global architecture and includes a network of over 200 international and local banks that have signed agreements with **the** Bank, having issued more than 500 guarantees over the past five years. The Program is widely recognized as an essential part of trade facilitation and a catalytic instrument that helps the region to face the financing challenges that come along with further integration. In addition, the Bank has successfully pursued several loans to specialized trade finance funds (several of which have won recognition awards in the international markets), loans to individual banks for trade finance and loans to regional funds specializing in infrastructure investments. It also progressively mobilized resources of the Multilateral Investment Fund (MIF) and the Inter-American Investment Corporation (IIC) to assist the internationalization of SMEs.

Serving as an honest broker in integration initiatives. The Bank served as an honest broker and active promoter in flagship integration initiatives, particularly at their inception stages. Recent examples include the *Arco del Pacífico Latinoamericano,* the *Annual Meeting of the Ministers of Finance of the Americas and the Caribbean*, and the *Pathways to Prosperity in the Americas*. The Bank has learnt that: (i) mobilizing Ministers of Finance is key to bring the integration agenda from the negotiation stages to the implementation phases in which programming public investment is crucial. Therefore, the Bank needs to support the emerging institutional coordination challenges posed by this negotiation-implementation continuum involving several ministries and subnational entities; (ii) the convening power of the Bank is crucial to raise awareness in clients on the multi-sectoral challenges and social related issues of modern integration.

Mobilizing the donor **community for trade-related support to LAC.** The Bank played a catalytic role in mobilizing and coordinating external donors´ support, the most recent and notable effort being perhaps the leadership in the regional implementation of the WTO-led *Aid for Trade* initiative and the creation of the Bank's *Aid for Trade Thematic Fund*. The Bank has learnt that: (i) Bank initiatives in the area of integration may generate interest in external donors; (ii) these initiatives are a suitable platform to start addressing new issues such as trade and gender and trade and climate change[27]; (iii) there is a need to assign dedicated resources to their development; and (iv) commitment of Senior Management and a critical mass of donors are key at the inception stage.

Promoting policy dialogue on a long-term regional vision. The Bank instituted in 2000 a *Regional Policy Dialogue* with the objective to create a network of senior officials to share best practices and explore long-term opportunities for regional cooperation. The *Trade and Integration Network*, one of the current twelve active networks, has been effective in supporting high-level dialogue on trade integration matters and has generated opportunities for the provision of technical and financial support to client countries. The Bank has learned that: (i) the joint operation of the Trade and Integration network and other sector networks (e.g. transport, science and technology, etc.) is a valuable instrument to support the emerging multi-faceted integration agenda; (ii) the Bank would benefit from a dedicated policy dialogue instrument focused on reaching out to the expanding constituency of stakeholders relevant for today's integration agenda (such as trade, transport, communications, foreign affairs, and finance ministries as well as private sector organizations) and on advancing a Bank-wide integration agenda.

Building capacity for a critical mass of integration agents. The Bank carries out a comprehensive capacity-building program and developed partnerships with international

[27] The Aid for Trade Strategic Thematic Fund includes gender and environment as the two horizontal priorities for its 2010-2013 Operational Plan.

institutions, in particular, a pioneering *IDB-WTO Capacity Building Program*. Its traditional trade-related thematic focus has been recently broadened to include new issues (e.g. migration, physical integration, etc.). From this experience, the Bank has learned that: (i) the allocation of adequate resources to an ambitious capacity building program on integration is a contribution to the development goals of the region valued by clients; participants; (ii) capacity-building is needed not only on a growing list of integration-related thematic topics but, going forward, to nurture the capacity of government officials and private sector representatives to originate, design and execute integration projects, with the goal to unlock the latent demand for regional programs; and (iii) enhanced coordinated action of INT and the Institute for the Integration of Latin America and the Caribbean (INTAL) is a key asset for the Bank as it allows to combine the technical expertise of the former with the convening and logistical capacity, and historical trajectory of the latter, all of which signal the distinctive commitment of the Bank to LAC integration.

C. Lessons learned from IDB support to the integration *hardware*

A progressive regionalization of infrastructure investment. The regional approach to investment in regional *hardware* emerged later in response to a growing demand in the region. It took the form of technical and logistical support to official initiatives; an increase in regional infrastructure lending; and an incipient support to the development of cross-border regulations.

The Integration of Regional Infrastructure in South America (IIRSA). The Bank launched in 2000 an initiative to support IIRSA, which seeks to develop and integrate regional infrastructure and to facilitate physical integration and equitable and sustainable territorial development among twelve South American countries. The Bank supports the Secretariat of the Technical Coordination Committee through INTAL, and played a critical role in building consensus on 524 potential projects worth a US$96 billion pipeline of which 40 per cent have been either concluded or in their construction phase. The Bank stepped up its funding to IIRSA in 2005 with the creation of the Regional Fund for Infrastructure Integration (FIRII, in Spanish) that met the demand for a dedicated mechanism (US$13.6 million in 16 operations approved for IIRSA projects out of a total of US$25.6 million and 27 operations). The Bank subsequently provided lending resources for investments in priority IIRSA projects mobilizing US$ 8,871 million in 28 projects. Flagship operations include sectors such as energy (*Argentina: Electric interconnection Northwest – Northeast*) and transport (*Argentina: Duplication of Road N° 14, between Paso de los Libres and Gualeguaychú*). As the IIRSA initiative transitions into a new institutional setting under the guidance of UNASUR, the Bank may need to retool its support to promoting cross-border investments between countries with asymmetric benefits more effectively and to connect *hardware* and *software* investments, particularly in training, good practice dissemination, and regional regulatory reforms.

The *Proyecto Mesoamerica* (PM). The Bank launched in 2001 an initiative to support PM (previously known as *Plan Puebla-Panamá*), which has the goal of facilitating funding and implementation of regional integration projects through infrastructure, connectivity, and social development. The Bank was assigned the mandate to: (i) facilitate consensus for the design and implementation of regional projects, (ii) provide technical support; and (iii) channel funding through grants and loans. The Bank responded by creating a multi-sector Technical Support Group and mobilizing sizeable resources for the PM initiative, leading to an overall Bank's portfolio of US$ 1,775 million (38 operations) in lending, and US$ 53 million (70 operations) in non-reimbursable technical cooperation. Flagship operations include sectors such as energy (*System of Electrical Interconnection of Central America-SIEPAC*), transport (*The Central American Roads Network-RICAM*),

communication (*Mesoamerican Information Highway-AMI*) and trade facilitation (*International Transit of Merchandise-TIM*).

Lessons learned from IIRSA and PM. The Bank support to the two main formal *hardware* integration initiatives has been the object of evaluations by OVE[28], from which the Bank learned that: (i) the technical and logistical support provided by the Bank to the integration initiatives is highly valued by clients; (ii) the Bank needs to provide support to the integration *hardware* and *software* in an integrated manner, leveraging and providing incentives to coordinate the expertise of different units; (iii) there is a need to design innovative processes, including national and regional programming, aimed at repositioning the countries' portfolio of integration infrastructure; (iv) there is a need to develop new operational approaches suited to the specificity of integration projects; (v) interventions targeted to address key integration bottlenecks, such as border-crossings, ports, and logistics services, may yield high developmental returns; (vi) there is a need to refine project evaluation methodologies, particularly those related to the asymmetric distribution of costs and benefits and the sustainability impact of integration infrastructure; and (vii) the support with non-financial instruments is imperative to underpin consensus among countries, finance pre-investment and elevate the institutional profile of *hardware* integration initiatives.

D. Lessons learned from the Bank support to regional public goods

Innovating to finance regional public goods. As regional integration deepened, the demand to address cross-border externalities and neighborhood issues grew. The Bank responded in 2005 by creating a specific instrument. With an annual endowment of US$10 million, the RPG Program allocates resources on a competitive basis to project proposals generated in the region in all sectors, provided that they contribute to regional policymaking[29]. The Bank learnt that: (i) the demand for RPG significantly exceeded the availability of funding[30]; (ii) the RPG program could be scaled-up to provide greater incentives for regional cooperation; (iii) effectiveness may be enhanced by reducing the dispersion of projects across sectors and increasing their average size; (iv) the demand-driven focus and innovative proposals of the program may be complemented with proactive support of functional cooperation in areas where the Bank has comparative advantages; (v) a better alignment of the program with the new GCI-9 priorities may generate opportunities to scale-up RPG projects with Bank's lending operations.

[28] See RE-338 and RE-350, respectively, for a detailed evaluation assessment and recommendations.

[29] To date, 74 projects have been approved in a wide array of sectors.

[30] The Bank received a total of 323 project proposals totaling approximately US$ 393 million.

VI

Areas of Bank Intervention: A Renewed Integration Compact

VI. AREAS OF BANK INTERVENTION: A RENEWED INTEGRATION COMPACT

Implementing an ambitious strategic framework. The diagnosis of LAC's integration and of the lessons learned supports the notion that, to retain its position of a privileged integration partner, the Bank needs to use existing instruments more effectively. The GCI-9 mandated the Bank to upscale its support to integration, as is the case of comparator institutions that are upgrading their tools to face these challenges. It sets an ambitious lending target of 15 per cent by the end of 2015, and highlights five key dimensions through which integration outputs should contribute to regional development goals, signaling the wide qualitative scope of the new Bank mandate on integration[31]. The remainder of this section details the objectives, thematic areas, target counterparts, identification criteria of specific integration-oriented activities and modalities of intervention proposed to meet the spirit and the letter of the GCI-9.

A. Objectives of the Bank's Integration Strategy

The Bank's actions to support integration will be organized according to the following priorities:

(i) Consolidate the knowledge foundations of the integration agenda. The Bank will expand the frontier of knowledge on regional integration, in order to retain intellectual leadership and serve as a regional brain trust;

(ii) Strengthen the regional capacity to manage modern integration initiatives. The Bank will leverage its expertise and unique position as an honest broker and active promoter to support the institutional architecture needed for deeper integration;

(iii) Build regional additionality into the Bank's operations in key sovereign and non-sovereign sectors. The Bank will operate to meet the 15% GCI-9 lending target to support regional cooperation and integration, while promoting high-quality projects and balanced interventions along the regional *software-hardware continuum*; and

(iv) Mainstream integration into the Bank's operational program. The Bank will implement innovative approaches to mainstream the support to integration in the operational program; it will explicitly consider the potential contribution of a wide range of non-financial and financial activities to integration objectives.

B. Thematic Areas of Bank Intervention

The thematic focus areas of the strategy were selected and validated by means of an open consultation process, which included focused exchanges with high-level regional senior officials, Bank senior staff in headquarters and country offices, executive representatives of comparator regional development banks and institutions, and experts and representatives of the civil society. The process was complemented with a thorough assessment of comparative advantages based on the Bank's track record and OVE evaluations. This process resulted in the following list of thematic areas that will become the backbone of the strategy during its implementation:

[31] The GCI-9 document (AB-2764, Annex 1) instructs the Bank to contribute to three main regional development goals, measured in terms of: trade openness; share of FDI in national economies; and incidence of intra-regional trade transactions. It envisions the concentration of lending in five areas: infrastructure (*hardware*); institutional strengthening and capacity development (*software*), regional initiatives and regional public goods (functional cooperation). The integration project outputs signal the need to include a wide range of actions.

The *software-hardware continuum*. Activities that support global and regional integration and cooperation can be classified in three broad thematic areas consistent with the five GCI-9 lending program priority targets on integration (see Box 2 below for a specific example):

(i) ***software*:** activities that support policy reforms, regulatory upgrade, institutional strengthening and capacity development needed to facilitate the movement of goods, services, capital, people and technology across borders, with the goal of promoting a better integration of country systems and private operators into the global economy;

(ii) ***hardware*:** activities that enhance the connectivity of national infrastructure investments (in transport, energy and communications) and associated regulatory frameworks to sustainable trade and investment integration corridors, with the goal of reducing cross-border transaction costs, boosting external competitiveness through productive integration, and promoting balanced territorial development.

(iii) functional cooperation and regional public goods: activities that sustain formal regional initiatives and foster regional cooperation practices in areas in which collective action at the regional level adds value to national interventions, such as institutions and capacity building, standards and regulatory harmonization, social protection and health, climate change and natural disasters, science and technology, and others.

Software priorities. The diagnosis section illustrated that despite the radical transformation of the trade and integration architecture that occurred in the last two decades, LAC still does not capture a fair share of global trade and investment, is missing the opportunity to harness regional markets for market and product diversification, pays excessive transaction costs when doing business across borders and fails to distribute the gains from integration into the global marketplace equitably. The reasons for these mixed results are many, some of which are related to factor endowments and their distribution that can only change in the long run. However, there is significant scope for action related to the integration *software* in five clusters of IDB projects that can enable the region to achieve better outcomes:

(i) negotiation and implementation of trade and investment agreements. LAC countries have negotiated ambitious second-generation FTAs that level the playing field across-the-board with highly competitive partners. Going forward the challenge is to adopt comprehensive policy reforms and multi-sector complementary investments to take advantage of market access opportunities. The Bank will support the region by: (a) strengthening institutional capacity to negotiate new agreements with emerging dynamic partners, particularly in Asia; (b) brokering consensus and building capacity to negotiate the convergence of overlapping agreements to reduce transaction costs to the private sector; (c) strengthening inter-sectoral coordination to implement reforms agreed upon, in order to avoid the cost of retaliation for non-compliance and unlock structural transformation and efficient specialization; (d) contributing to improved regulatory standards (eg. sanitary, quality, security, etc.) to avoid rejection of shipments at the border; (e) promoting trade-adjustment programs that facilitate the transition of declining firms and labor into new flourishing export activities; (f) generating cutting-edge technical knowledge currently scarce in the region, particularly in less developed countries (eg. rules of origin, sanitary standards, trade dispute settlement, etc.); (g) directing lending to reforms needed to comply with FTA commitments (eg. trade facilitation, trade-induced fiscal adjustment, intellectual property, labor and environment regulations, etc.); and (h) scaling-up and generalizing multi-sectoral investment in institutional modernization projects that allow governments to tackle in a comprehensive fashion modern internationalization strategies.

(ii) export promotion and investment attraction. Governments' failures to remove market distortions that prevent internationalization and insufficient provision of public goods and services to business operate as a disincentive to compete in the global marketplace, particularly for small and medium firms. The Bank will contribute to improve the global stance of LAC countries by: (a) supporting inter-sectoral and inter-government coordination of export promotion activities; (b) financing institutional reengineering of Trade Promotion Organizations (TPOs); (c) promoting the use of new instruments for export promotion and investment attraction (export single windows, online promotion services, e-commerce and e-marketplaces, regional, country and sector image promotion strategies, investment after care units, etc.); (d) providing incentives to complement export promotion activities with investment attraction plans; (e) financing matching-grants export development projects in sectors with high potential (quality certification, associative projects, business plans for internationalization, etc.); (f) promoting specific sectors with high value-added, export and investment potential (e. g. attraction of global off-shoring in services); and (g) investing in physical and regulatory infrastructure needed to compete in external markets (e.g. information technology platforms for services delivery).

(iii) trade facilitation and customs modernization. As noted in the diagnosis section, transaction costs related to bottlenecks along the trade logistics chain, particularly at the border, account for a disproportionate share of the final price of goods exported by the region and impinge on its capacity to compete in destination markets. The region can substantially boost its competitiveness by focusing on the neglected area of customs modernization and placing emphasis on a modern trade facilitation approach. The Bank will assist the region in: (a) complementing the focus of customs on collection of trade taxes with trade facilitation initiatives; (b) financing the modernization of customs with investments in automation, new scanners and innovative digital-based management models to enhance security and speed such as the Central American International Transport of Goods (TIM in Spanish); (c) aligning security standards to the Secure and Facilitate Global Trade (SAFE) framework promoted by the World Customs Organization (WCO), particularly by implementing risk profiles and selective categorization of goods for verification and fast cargo clearance; (d) integrating customs, immigration, security and quarantine border management procedures among agencies (within and between countries) to facilitate trade while enhancing security; (e) promoting public-private partnerships aimed at improving efficiency across the logistics and supply chains; (f) developing and financing the implementation of national and regional logistics plans, taking into account the specific needs of SMEs; (g) supporting policy reforms and financing investment in infrastructure and information technology needed to develop multi- and inter-modal logistics platforms; and (h) jumpstarting national and regional logistic observatories by gathering methodologies, data and indicators needed to address obstacles to the fluidity of national or regional supply chains (Box 2 below on *Sustainable Trade and Investment Integration Corridors* provides a graphic example of the interplay among *software* project clusters i), ii), iii) and the *hardware*).

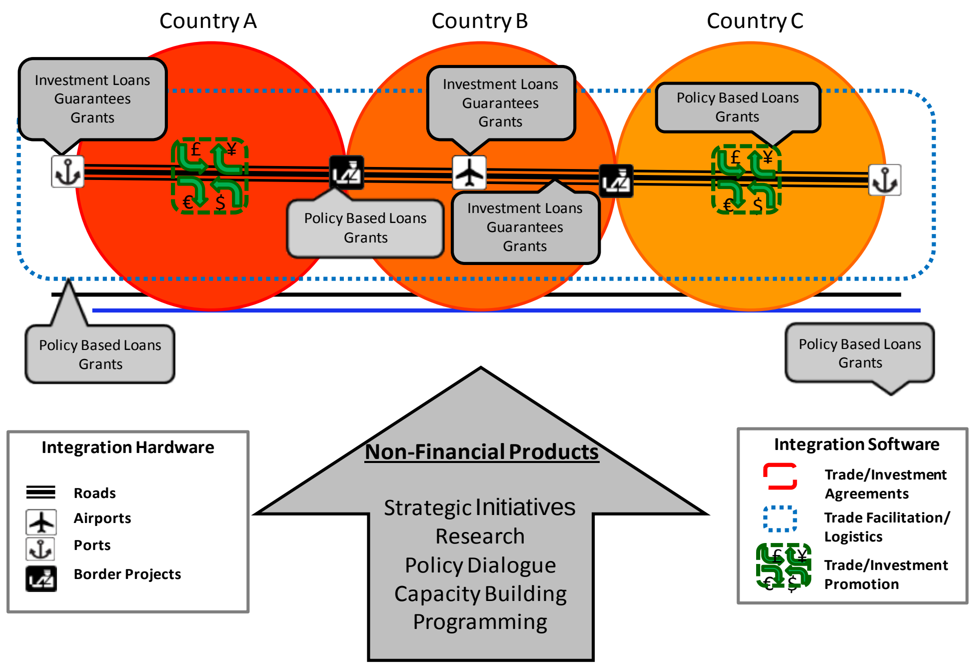
(iv) expansion of the depth and coverage of private finance. The global financial crisis has painstakingly revealed the vulnerability of the LAC trading sector to sudden stops in trade finance. Likewise, the development of large-scale infrastructure projects needed to enhance the connectivity of the region is often constrained by the lack of private investment. The region would benefit from initiatives aimed at expanding the depth and coverage of trade and integration-related private sector financial support. The Bank will support the region by: (a) mobilizing governments, trade and banking associations and public and private financial institutions to provide support to trade finance operations; (b) partnering with regional entities such as FELABAN, ALIDE and other financial institutions to widen the dissemination of trade finance training tools; (c) explore with governments opportunities to incorporate the private sector in the development of sustainable integration infrastructure corridors through loans and guarantees; (d) promote knowledge and exchange of information on ongoing initiatives in the areas of trade and integration finance in order to identify new business opportunities; (e) mobilize resources for feasibility studies related to trade finance and integration infrastructure projects; (f) enhance communication and engage multi-stakeholders networks to secure political will, identify good practices and scale-up successful pilot projects.

(v) development of an enabling environment for sustainable and inclusive integration. Upgrading the integration *software* does not fall within the jurisdiction of a single government agency and requires multi-sector alignment under the guidance of an executive decision-making authority. As the LAC integration agenda shifts progressively from the negotiation of FTAs to the implementation and adjustment stages, three major changes are needed: raise the awareness of the Finance Ministers of the integration agendas to include the financing of integration-related reforms and investment in countries' national development plans; improve multi-sector coordination to address all determinants of successful integration; provide incentives for cross-border coordination, focusing on border regions and most vulnerable social groups, including the rural poor and women. In this context, the Bank will support the region by: (a) engaging Finance Ministers in strategic planning of integration-oriented investments and enabling coordination mechanisms of diverse public and private sector stakeholders; (b) promoting cross-sector dialogues with the goal of raising awareness of integration-related challenges in a wide range of government bodies and prop their inclusion in investment projects; (c) prioritizing components related to international financial integration in activities aiming at reforming financial regulations; (d) promoting international fiscal harmonization and regulation of transfer prices in national activities; (e) explicitly promoting the internationalization of small and medium enterprises in finance and productivity-enhancing development projects; (f) designing interventions in the agriculture sector that take into account the potential benefits of integration into global value chains for smallholders and the challenges generated by greater market openness for net food importers/buyers; (g) promoting "Regional Research and Innovation Areas" to overcome the fragmentation of regional research and development (R+D) and enhance cooperation among firms and R+D centers, while supporting regulatory harmonization and regional institutions strengthening; (h) assigning priority to technical assistance and lending in border-related projects (eg. in the areas of citizen security, territorial/sub-national development, migration and labor market integration, etc.); (i) develop knowledge and innovative approaches to assist countries in dealing with migration flows and progressive integration of labor-markets; (j) deepening knowledge and building capacity and incentives with the goal of spreading the benefits of deeper integration to the most vulnerable groups, taking into account gender and minority gaps as well as sub-national disparities; and (k) enhancing the sustainability of integration by promoting the application of strategic environment assessments, capacity building initiatives, networks of information sharing and policy dialogues on international environment negotiations.

Box 2: Example of Sustainable Integration Corridors

Creating corridors to promote intraregional trade, services and investment will be key to increasing competitiveness, productivity and jobs. These projects will (a) enhance connectivity across countries by reducing cross-border transactions and transportation costs; (b) increase competitiveness in regional and global markets through economies of scale offered by cross-border investments based on value-added production processes; (c) promote private sector activity by supporting joint financial, technological, production, distribution and other collaborations along the corridors; and (d) promote the provision of other regional public goods associated with these corridors to reduce poverty and support social development.

The overarching objective is to transform classic "transportation" corridors into effective "trade and investment" sustainable corridors, combining "*software*-type" interventions with "*hardware*-type" projects. The figure below shows an example of complementary national interventions in three countries, under a regional and global integration perspective. The graph also shows the strategic proposition of associating complementary Bank instruments, not only among participating countries, but between integration *hardware* and *software* interventions.



Other regions have already begun to implement this concept of sustainable regional economic corridors. The Trans-European Networks Program (TEN) in the European Union is a good example on how the EU shifted from a "patchwork to a network" in the words of former EU Commissioner Sir Neil Kinnock. The objectives of the TEN are to promote and improve the interoperability and interconnection of the transport, energy and telecommunications networks within the EU territory, eliminating bottlenecks (Schrlif, 2010). More recent similar efforts can be found in East and South East Asia, especially the Greater Mekong Subregion (ADB-ADBI, 2009).

***Hardware* priorities.** As discussed in the diagnosis and lessons learned sections, the region has advanced remarkably not only in the integration *software* but also in the *hardware*, particularly by setting in motion two far-reaching sub-regional initiatives aiming at prioritizing investment in transport, energy and **communication** in a regional coherent frame-work (i.e. IIRSA and PM). Going forward, the region is facing four main challenges: (i) the sheer size and the asymmetries of investments related to the regional integration agenda reduced the speed of implementation of planned investments which have not met original expectations; (ii) the *software* and *hardware* segments of the agenda have grown somewhat apart and missed the opportunity to reinforce each other; (iii) regional initiatives need to be progressively aligned to global integration which will be a major driving force for countries' integration strategies; and (iv) the Caribbean sub-region does not have a *hardware* integration initiative anchored by regional planning of integration infrastructure. In order to reduce trade and integration costs and face mounting external competition, LAC countries are now urged to enhance the connectivity of the region. Focusing on the development of *Sustainable Trade and Investment Integration Corridors* will allow the Bank to support the region in building the physical and regulatory infrastructure that lies at the heart of a third generation integration strategy (see Box 2). Investment priorities will be concentrated in the areas of transport, energy and communications[32]:

(i) connecting the transport network. Transport and logistics costs weigh excessively on the regional capacity to compete globally due to the insufficient coverage and quality of physical infrastructure and to the lack of regulatory harmonization. The Bank will help the region to: (i) upgrade the quality and expand the coverage of national transport routes, connecting them to the main trade hubs; (ii) enhance the efficiency of the combination of transport modes, particularly by promoting more efficient inter- and multi-modality; (iii) address issues related to accessibility, congestion, urban conflicts, under-investment and outdated regulation of ports and maritime services, considering the need to adapt to a post-Panamax regime; (iv) promote competitive market structures in air cargo and regional freight and logistics services that prevent an optimal operational scale as well as modernization and expansion of existing systems and facilities; all in tandem with: (v) *software* reforms in the areas of transport regulations, customs, trade facilitation and private sector services provision (see page 21 "trade facilitation and customs modernization"); (vi) continuous and sustainable efforts to improve border-crossing infrastructure and services, balancing the needs of users, SMEs and local communities in general; (vii) policy dialogue on transport integration crucial to generate technical consensus on project development and prioritization by governments; and (viii) strengthening of regional institutions and support to multi-country initiatives (see in Box 2).

(ii) supporting cost-reducing energy integration. For many countries in the region the high cost of energy is not only an onerous tax on final consumers but also an impediment to business development and international competitiveness. The physical integration of power grids, the regulatory harmonization of energy markets and the development of regional generation capacity hold the potential to contribute to greater efficiency and energy security. Despite their technical and legal complexity, political sensitivity and the long periods needed for their development, energy integration projects may be key for the Bank to reach the integration lending target. The Bank will provide support to: (i) the interconnection of national electric systems; (ii) the development of regional gas pipelines; (iii) the joint planning and financing of bi-national and/or regional energy projects, particularly in crude oil refineries and hydroelectric power generation; while on the *software* side, it can: (iv) support policy dialogue on energy matters, crucial to buttress energy security; (v) promote regulatory modernization to facilitate transactions in energy goods and services; (vi) build new and strengthen existing partnerships with regional institutions, particularly ARPEL, CIER and OLADE.

(iii) bridging the digital divide. The development of information technologies is prompting the emergence of new development strategies and business models. The digital connection of governments, firms and individuals holds the potential to reshuffle the comparative advantages of the region and to contribute to the better integration of the region with itself and the global economy. The Bank will support the region with: (a) capacity building and policy research for the generation and implementation of comprehensive ICT policies (infrastructure, services, applications, access and literacy); (b) lending to reform telecommunications policies and regulation (i.e., convergence, spectrum policy and management, interconnection, universal access, universal service, licensing, digital TV,

[32] This section of the strategy only deals with the cross-border aspects of infrastructure development and, as such, is not meant to guide other aspects of the infrastructure activity of the Bank.

etc.); and (c) infrastructure financing for broadband and other ICT infrastructures that can support innovation and improve business productivity and the access and delivery of social services (i.e. backbone and last mile networks, hosting centers, telecenters, etc.).

Priorities in functional cooperation and regional public goods. To produce an optimal level of regional public goods, countries need to address market and coordination failures. Moreover, they need incentives to prioritize regional activities over national investments. Despite these challenges, LAC countries are increasingly demanding support for the provision of RPG. In turn, the support to RPG is crucial to implement the Bank strategy as it allows sustaining the consensus needed to develop *software* and *hardware* integration projects. The Bank will focus the support to RPG projects that focus on areas of intervention where regional collective action adds value to national interventions and where the Bank has a comparative advantage.

C. Identification of Integration Activities

The complex nature of integration activities. Programming, designing, executing and evaluating integration operations involve uncertainties generally related to the cross-border nature of development interventions, and more specifically to a number of factors, such as: (i) integration interventions include both operations that facilitate the integration of one single country into the global economy and operations that support multi-country cooperation for the same purpose; (ii) integration operations often yield benefits that span beyond the border and there is uncertainty on the distribution of costs and benefits for individual countries and/or groups of beneficiaries; (iii) there is often a lack of clear institutional counterpart in charge of integration operations, both at the national and/or regional level; (iv) even in the case of clearly identified counterpart(s) and prioritized integration projects, financial investment needs to be channeled by means of national operations for lack of regional institutions that can provide sovereign guarantees, while there is a need to ensure cross-border coordination during execution; for all these reasons, (v) integration operations are characterized by coordination failures among potential counterparts, which need to be compensated with adequate incentives.

Mapping the counterparts of integration activities. An illustrative typology of integration operations is provided in Table 1, which shows how interventions in the *software*, *hardware* and functional cooperation can involve different configurations of clients: (i) national: operations that typically support unilateral actions aiming at securing a better integration into the global or regional economy; (ii) cross-border: operations that involve two neighboring countries and/or sub-national regions; (iii) trans-national: operations that involve several contiguous countries; (iv) inter-regional: operations that involve two or more non-necessarily contiguous countries that cooperate for a common development goal.

Table 1. Illustrative typology of integration activity

	SOFTWARE	*HARDWARE*	COOPERATION
National	Export & Investment Promotion/Customs Modernization	Ports and Airports Modernization	-------
Cross-border	Trade Facilitation and Customs/Labor markets and migrations	Transport Infrastructure/ Border-crossing Infrastructure	Protected areas/Water/Coastal Management/Natural Parks
Trans-national	Strengthening of Integration Institutions/Private Sector Development	Regional Transportation Corridors	Natural Disaster Management/Health and Epidemiology
Inter-regional	Trade and Investment Agreements/Financial Integration	Integration Corridors in Satellite Communications	Regulatory Frameworks/Regional Standards

Identification criteria of integration activities. The multi-sector thematic scope and operational complexity of integration projects coupled with the dispersion of potential clients requires the definition of clear and simple identification criteria, which need to be adjusted over time. The Bank will identify integration operations according to four non mutually exclusive indicative criteria (see specific thematic areas in pages 23-25):

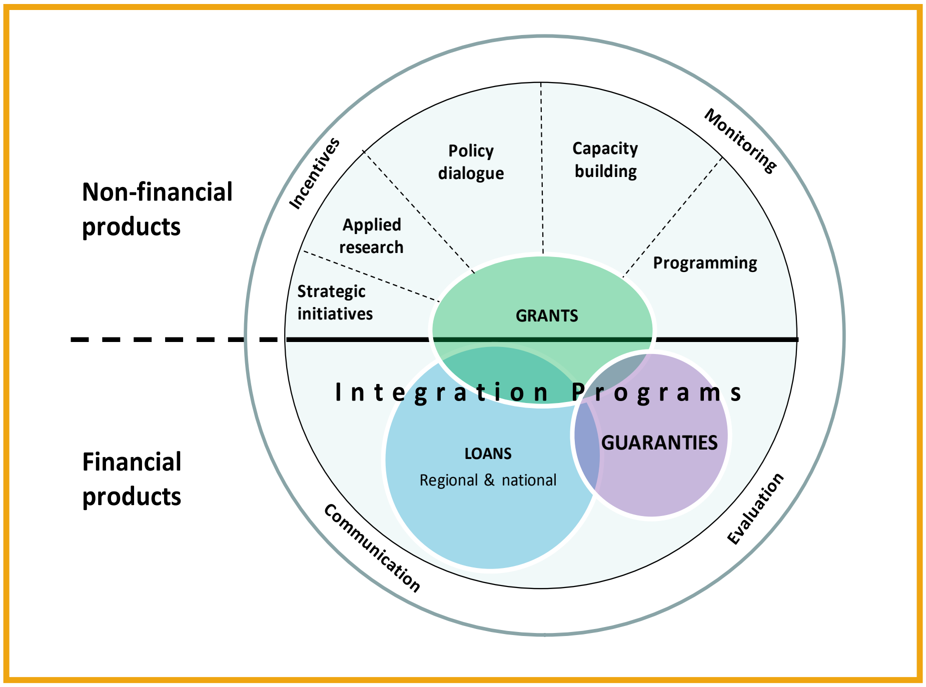
(i) Cross-country focus – projects that contribute directly or indirectly to a greater regional or global insertion of LAC countries and/or to promote regional collective action and cooperation;
(ii) Regional additionality – projects that generate additional value added through the incorporation of objectives of internationalization and/or regional cooperation;
(iii) National subsidiarity – projects that contribute to the alignment of domestic policy reforms and of national/sub-national investments with cross-border objectives;
(iv) Compensation of coordination failures – projects that generate incentives that compensate market failures (cross-border externalities), coordination failures (costs of collective action) and other costs related with the complex execution of regional collective initiatives.

D. Modalities of Bank Intervention

A new integration compact based on a *smart-mix* of instruments. To support its clients' efforts to achieve competitive global and regional integration, the strategy proposes a renewed instrument compact based on financial and non-financial components (Figure 6). Instead of focusing on the development of new instruments, the proposed integration compact is based on the notion that the Bank should meet the lending target and development goals mandated by the GCI-9 by means of deploying a *smart-mix* of existing instruments. Accordingly, the Bank will support integration with a balanced combination of policy-based lending, regional and national investment operations, NSG operations, nonreimbursable technical cooperation and knowledge and capacity-building products.[33]

[33] This approach supersedes the existing strategy on regional integration approved in 2003 and widens it in that: i) it broadens the focus of Bank's interventions as it supports global integration in addition to regional integration; iii) shifts the focus of Bank interventions from advocacy and technical cooperation to lending; and iii) places emphasis on national interventions in addition to regional ones.

Figure 6. An Enhanced Strategic Compact to Support Integration



Strategic initiatives. In the absence of centralized supranational bodies that express political will and drive for integration, inter-governmental platforms are the only source of integration mandates. The Bank will contribute to the region's long-term integration vision providing analytical contributions, building regional and national capacities and increasing the capacity to react to operational demands. The strategy will ultimately allow the Bank to respond effectively and in a coordinated manner to emerging integration initiatives.

Policy research. Cutting-edge applied research is crucial to retain intellectual leadership, contribute to a long-term vision, enhance the quality of policy dialogue and support an innovative operational program. The Bank has a solid policy research record, maintains unique information systems, and has in-house capacities to provide expert policy advice. The Bank will strengthen and expand the Bank's research agenda and information systems to the emerging components of the new integration agenda in order to serve clients with the highest standards.

Policy dialogue. Policy dialogue on regional issues has grown in complexity due to a new multi-level institutional architecture. In order to foster regional collective action, the Bank needs to engage policy makers both at the sector and at the executive-financial level, particularly Ministers of Finance and address the new coordination needs. In the past the Bank has reacted to regional demands on an *ad-hoc* basis. Although the Bank's Regional Policy Dialogue addresses some regional priorities, it was not designed to promote a broad regional integration strategy[34]. The Bank will promote a more coordinated approach to supporting scattered but complementary integration initiatives and will expand the support to high-level policy dialogues on existing or emerging regional integration initiatives to ensure coherence, sustainability and development impact.

Capacity building. Capacity building is crucial to create and sustain a long-term and multi-sector critical mass of national expertise on regional

[34] The recent support to the Annual Meeting of the Finance Ministers of the Americas and the Caribbean and COSEFIN in Central America are important steps towards creating new and broader effective platforms.

integration. It must include high-level executive training, short-term policy advisory services, and support to project identification, design, monitoring and evaluation. Through extensive capacity building programs, the Bank had a crucial impact on the development of the current trade architecture. The challenge is now to build on this credibility and to expand its reach to the new issues of the integration agenda and be more proactive in the inclusion of sub-national stakeholders. The strategy will facilitate the development of integration capacity building initiatives with high-profile institutional strategic alliances that have a long-term impact on a critical mass of integration constituencies throughout the region.

Programming. The process with which countries assign priority to integration operations differs in several ways from traditional programming. In the case of cross-border, international and trans-national operations, it: (i) requires an alignment of various regional, national, and sector constituencies in the absence of a clearly defined "regional counterpart"; (ii) faces multiple overlapping thematic agendas; (iii) must combine a definition of priorities at the regional level (top-down approach) and revealing and aggregating national preferences (bottom-up approach); and (iv) often requires an external honest broker to mainstream the integration vision into an effective operational business plan. In the case of national integration operations the main challenge is the existence of cross-border spillovers that generate uncertainty on the distribution of costs and benefits and may result in lower prioritization. The strategy will provide the foundation for the Bank to support regional collective action and program integration operations, taking into consideration the need to adapt to the abovementioned challenges. In the context of the preparation of country and regional strategies and of programming dialogue, the Bank will systematically engage public and private sector counterparts in areas related to the implementation of the strategy.

Incentives for the development of integration programs. Integration operations face intertwined institutional and operational challenges, as they need to: (i) promote policy cooperation and cross-border investments; (ii) incorporate incentives to compensate for countries' coordination failures; (iii) be executed with a combination of financial and non-financial instruments at the regional and national level simultaneously; (iv) be supported with resources that offset the additional costs they command; and (v) be monitored and evaluated with specific methods not yet adequately developed. The Bank will support new approaches to develop integration programs by providing adequate incentives that lead to the mobilization of a smart-mix of non-financial products, regional grants, and regional and national policy-based and investment lending, as exemplified by the concept of integration corridors (see Box 2). In the design of integration operations, due consideration will be given to the application of adequate environmental assessments, including strategic assessments if appropriate, and the symmetric distribution of costs and benefits among countries, regions and social groups.

Financial instruments. In order to meet the integration lending target agreed in the GCI-9, the Bank will need to provide financial and non-financial incentives to clients to better coordinate national integration operations and to stimulate both the demand and supply of cross-border integration programs. The Bank also provides non-sovereign loans and guarantees to private sector projects that have regional scale and integration objectives which may need to be developed further. The Bank will redouble its efforts to critically review the existing resources and will align them to better implement the strategy, considering the need to provide incentives for the design and implementation of integration projects. As part of this effort, the Bank will strengthen its outreach work and consider the establishment of new platforms such as a Strategic Thematic Fund on Integration or other mechanisms, as most appropriate and efficient, that allow to attract like-minded donors and scale up the availability of grant resources, in order to reduce the relative effective costs of integration projects and unlock their profitability, for both public and private Bank's clients.

E. Risks

Risks. The GCI-9 mandate on integration is ambitious and presents challenges related to the existence of cross-country externalities that affect the effective demand of regional countries for integration operations and the capacity of the Bank to stimulate and respond to such demand simultaneously. Integration operations often compete with national investments that may be perceived as having higher returns, particularly in the short-term. Likewise, integration projects, particularly those related to hardware development, are highly complex and usually entail long origination processes, often spanning several decades (e.g. bi-national energy integration). These specific characteristics of integration projects present two risks: i) an insufficient demand from client countries; and ii) the timeframe to assess the effectiveness of the strategy may be too short, even in presence of progress. The strategy proposes to mitigate these risks with proactive programming and a more efficient mix of available instruments. However, the lack of political will among potentially integrating countries may render Bank's incentives ineffective altogether.

VII

Results Framework

VII. Results Framework

In the context of the GCI-9, regional development goals and expected output contributions were identified in the IDB Results Framework 2012-2015 for the area of competitive regional and global integration (see table 3 in Annex 1 of document AB-2764). This strategy will contribute both to the goals and to the expected outputs shown in Table 2:

Table 2. GCI-9 Regional Development Goals and Expected Output Contribution 2012-2015

Regional Development Goals		Expected Output Contributions to Regional Development Goals 2012-2015	
Goal	**Baseline**	**Results**	**Estimated output**
Trade Openness (trade as a percent of GDP)	84.9% (2004-2007)	# of public trade officials and private entrepreneurs trained in trade and investment	65000 (baseline: n/a)
Intraregional trade in LAC as a percent of total merchandise trade	24.2% exports 33.1% imports (2004-2007)	Regional and sub-regional integration agreements and cooperation initiatives supported	10 (baseline: n/a)
FDI net inflows as a percent of GDP	4.2% (2004-2007)	# of cross border and transnational projects supported	22 (baseline: 26, 2005-2008)
		Number of International trade transactions financed	1000 (baseline: 561)
		Mobilization volume by NSG financed project/companies	$ 31.2 billion (baseline: S 25.3 billion, 2005-2008)

VIII

References

VIII. References

ADB-ADBI (2009) *Infrastructure for a Seamless Asia* (Tokio: Asian Development Bank Institute).

Barbero, José A. (2010). "La logística de cargas en América Latina y el Caribe: una agenda para mejorar su desempeño" Notas Técnicas No. IDB-TN-103. Departamento de Infraestructura y Medio Ambiente. Inter-American Development, Washington, D.C.

Blyde, J., Fernández-Arias, E. and Giordano, P. (2008) *Deepening Integration in Mercosur. Dealing with Disparities* (Washington DC: IDB).

Crandall, R.; Lehr, W. and Litan, R. (2007) The Effects of Broadband Deployment on Output and Employment (Washington DC: Brooking Institutions).

Dessus, Sebastián; Herrera, Santiago and de Hoyos, Rafael (2008). "The Impact of Food Inflation on Urban Poverty and its Monetary Costs: Some Back of the Envelope Calculations." World Bank Policy Research Working Papers No. 4666, Washington, D.C.

Devlin, Robert and Antoni Estevadeordal (2004) "Trade and Cooperation: A Regional Public Goods Approach", in Antoni Estevadeordal, Brian Frantz and Tam Robert Nguyen (eds.) *Regional Public Goods*, Washington DC: Inter-American Development Bank and ADB.

Devlin, R. and Giordano, P. (2004) "The Old and New Regionalism: Benefits, Costs, and Implications for the FTAA in Estevadeordal, A., Rodrik, D., Taylor A.M., Velasco, A. *Integrating the Americas. FTAA and Beyond* (Cambridge: Harvard University-David Rockefeller Center for Latin American Studies).

Estevadeordal E., Frank B., Nguyen T. (eds.) (2004), *Regional Public Goods. From Theory to Practice)* (Washington DC: IDB-Asian Development Bank).

Estevadeordal, A., Freund C, Ornelas, E. 2008), *Quarterly Journal of Economics* 123(4), 1531-1575 (Cambridge, USA: MIT).

Estevadeordal, A. et al (2009) *The Origins of Goods* (Oxford: Oxford University Press).

Estevadeordal, A., Suominen, K. with J.T. Harris and Shearer, M. (2009), *Bridging Regional Trade Agreements in the Americas*, IDB Special Report on Integration and Trade (Washington DC: IDB).

European Commission (2006), *Global Europe: Competing with the World. A Contribution to the EU's Growth and Jobs Strategy*, (Brussels: European Commission - DG Trade).

Giordano P., Moreira, M. and Quevedo, F. (2004) "El Tratamiento de las Asimetrías en los Acuerdos de Integración Regional" *Documento de Divulgación 26 (BID INTAL-ITD).*

Giordano, P. Lanzafame, J. and Meyer-Stamer, J. (eds.) (2005) *Asymmetries in Regional and Local Development* (Washington DC: IDB).

Giordano, Paolo and Watanuki, Masakazu (2010). "Rising Food Prices for Central America: Are they a Boon or Calamity for the Poor?". Inter-American Development, Washington, D.C. (forthcoming).

IDB (2002) *Beyond Borders: New Regionalism in Latin America. Economic and Social Progress in Latin America. Report 2002* (Washington DC: IDB).

IDB (2003) Regional integration strategy. Revised version (GN-2245-1).

IDB (2006) *Aid for Trade. The Inter-American Development Bank's Experience in Latin America and the Caribbean* (Washington DC: IDB).

IDB (2007) *Aid for Trade. Movilizing Aid for Trade in Latin America and the Caribbean* (Washington DC: IDB).

IDB (2008) Evaluation of the IDB action in the Initiative for Integration of Regional Infrastructure in South America (IIRSA) RE-338.

IDB (2009) Evaluation of IDB's support to the Plan Puebla Panama Initiative RE-350.

IDB (2010) *Science, Technology, and Innovation in Latin America and the Caribbean* (Washington DC: IDB).

IMF (various years) *Direction of Trade Statistics* (Washington DC: IMF).

Latinobarometro (various years) www.latinobarometro.org (Santiago de Chile).

Moreira, M. Volpe, C. and Blyde, J. (2008), *Unclogging the Arteries. The Impact of Transport costs on Latin American and Caribbean Trade*, IDB Special Report on Integration and Trade (Washington DC: IDB).

Sapir, A. et al. (2004), *An Agenda for a Growing Europe* The Sapir Report (Oxford: Oxford University Press).

Sgut, Martin (2003). "Transporte multimodal en Sudamérica: hacia una articulación normativa de carácter regional," Fonplata, IIRSA.

Schwartz, Jordan; Guasch, José Luis.; Wilmsmeir, Gordon and Stokenberga, Aiga (2009). "Logistics, Transport and Food Prices in LAC: Policy Guidance for Improving Efficiency and Reducing Costs," Sustainable Development Occasional Paper Series, No. 2, World Bank, Washington D.C.

World Bank (2009) *Information and Communication for Development: Extending Reach and Increasing Access* (Washington DC: WB).

World Bank-Independent Evaluation Group (2007a) *The Development Potential of Regional Programs: An Evaluation of World Bank Support of Multi-country Operations* (Washington DC: The World Bank).

World Bank-Independent Evaluation Group (2007b) *Sourcebook for Evaluating Global and Regional Partnerships Programs. Indicative Principles and Standards* (Washington DC: The World Bank).