

INTER-AMERICAN DEVELOPMENT BANK
OFFICE OF THE VICE PRESIDENT FOR SECTORS AND KNOWLEDGE
INTEGRATION AND TRADE SECTOR

IDB SUPPORT TO COMPETITIVE GLOBAL AND REGIONAL
INTEGRATION

Profile for a Strategy¹

¹ This strategy profile is based on the Background Paper “IDB Support to Competitive Global and Regional Integration” (GN-2565).

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ABBREVIATIONS

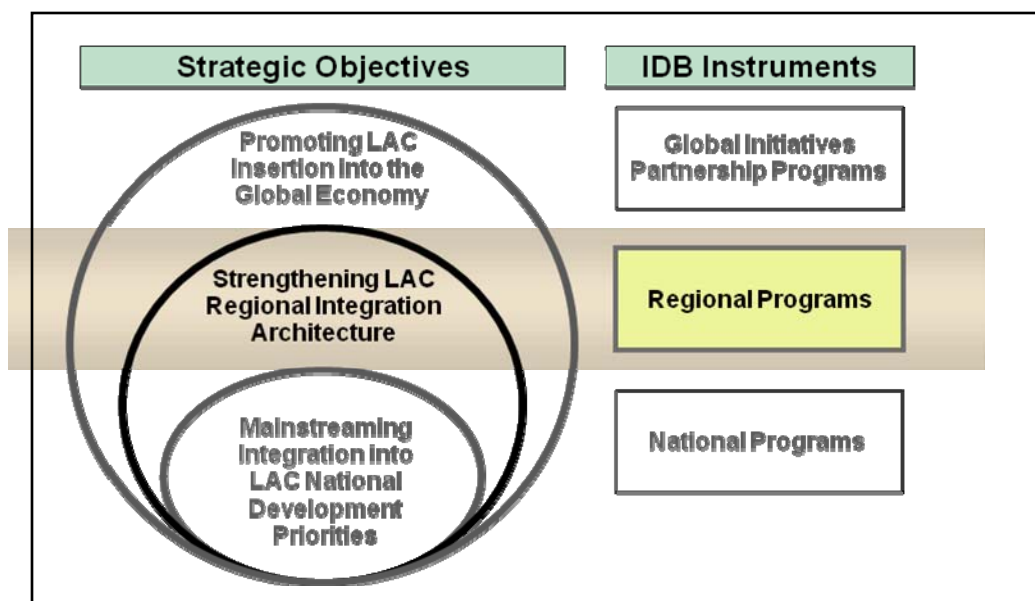
ADB	Asian Development Bank
AMI	Mesoamerican Information Highway
CARICOM	Caribbean Community and Common Market
COSEFIN	Consejo Centroamericano de Ministros de Finanzas
EU	European Union
FDI	Foreign Direct Investment
FIRII	Infrastructure Integration Fund
FSO	Fund for Special Operations-IDB
FTA	Free Trade Agreement
FTAA	Free Trade Area of the Americas
GCI	General Capital Increase
G20	Group of Twenty
IDB	Inter-American Development Bank
IIRSA	Initiative for the Integration of Regional Infrastructure in South America
IOM	International Organization for Migration
LAC	Latin America and the Caribbean
MERCOSUR	Southern Common Market
NAFTA	North American Free Trade Agreement
OC	Ordinary Capital-IDB
OECD	Organization for Economic Co-operation and Development
OVE	Office of Oversight and Evaluation-IDB
PBL	Policy Based Loans-IDB
PM	Mesoamerican Project
RICAM	The Central American Roads Network
RPG	Regional Public Goods
RTA	Regional Trade Agreement
RTC	Regional Technical Cooperation
SIEPAC	System of Electrical Interconnection of Central America
TC	Technical Cooperation
TIM	International Transit of Merchandise
TRTA	Trade-related Technical Assistance
UN	United Nations
UNASUR	Union of South American Nations
WTO	World Trade Organization

I. OBJECTIVES

- 1.1 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 regional cooperation and integration in Latin American and Caribbean (LAC) by the end of 2015.
- 1.2 The purpose of this strategy profile is to offer a preliminary proposal to increase and sharpen the Bank's contribution to LAC global and regional integration. In particular, this profile offers a rationale for integration, a diagnosis, background information, and lessons learned from the Bank support to integration. It also provides a preliminary list of areas and modalities of intervention to support the implementation of the future integration strategy. This profile will be open to public consultation with governments, civil society and experts.
- 1.3 Competing in the global economy requires actions on three complementary levels: (i) mainstreaming global and regional integration objectives into **national** development strategies; (ii) building a competitive **regional** integration platform; 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 document on the regional dimension of this challenge: strengthening LAC regional integration architecture through integration programs. This document highlights the necessity for the Bank to adopt a comprehensive strategy that tackles the three levels simultaneously.

Figure 1

**IDB Support to Competitive global and regional integration
Towards a new regional instruments compact**



II. THE RATIONALE FOR GLOBAL AND REGIONAL INTEGRATION

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

2.1 Regional integration as a strategic additional development policy tool.

Regional 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 Latin America and the Caribbean, the policy framework for regional 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 (IDB, 2002). As the drivers of global competition change dramatically, joining together to better navigate the world economy is more necessary than ever.

2.2 Regional 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 allows to support 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 a key factor in attracting 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. Regional trade integration permits more rapid advances to freer trade than under complex multilateral negotiations.

- 2.3 **Regional 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. Regional integration provides incentives for cooperation in the provision of regional public goods and regional cooperation, ranging from macroeconomic stabilization to planning and financing of infrastructure initiatives¹; 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 run².

B. The necessary requisites for regional integration

- 2.4 **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 regional integration policies. The capacity of an integration initiative to deliver on its development promises ultimately depends also on 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 more advanced countries need to be willing to bear the brunt of integration cost, and that the action of an external trusted honest broker can be catalytic for collective action
- 2.5 **Targeting an optimal economic scale.** The optimal economic size of an integration initiative deserves the utmost consideration. Regional 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 results³. The geometry of integration must consider other factors beyond the underlying political logic of some traditional blocs and

should take into account factors such as optimal transportation corridors or cross-border production networks. 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.

- 2.6 **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. Regional institutions, and 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.

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

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

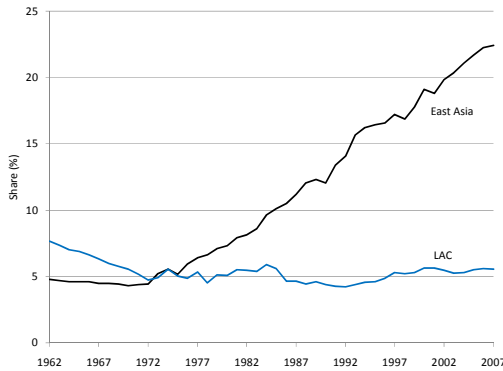
A. The status of global and regional integration in LAC

- 3.2 **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 model; (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 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 initiatives^{4,5}.

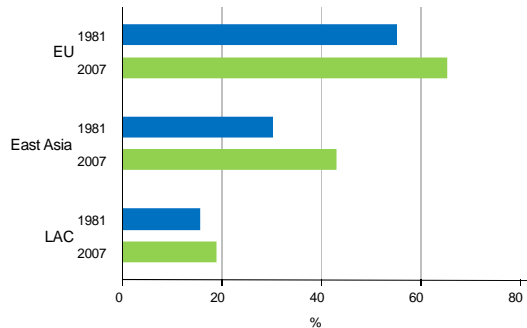
- 3.3 **The drivers of regional integration have changed once again.** The region must once again adapt its integration model to a new environment where: (i) the logic behind private sector-driven integration requires the adaptation of traditional state-led initiatives shaped by geopolitical considerations; (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 costs or private standards for market access; (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.
- 3.4 **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.
- 3.5 **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 sixties 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.

- 3.6 **The need for effective 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 local institutions required for the implementation of integration policies has increased dramatically.

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

- 3.7 **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. 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 later⁶. 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. Apart from trade diversion effects, high tariffs also complicate the objective of unifying markets due to the perforation of the

common external tariff, costly origin regimes and customs procedures, and other red tape costs.

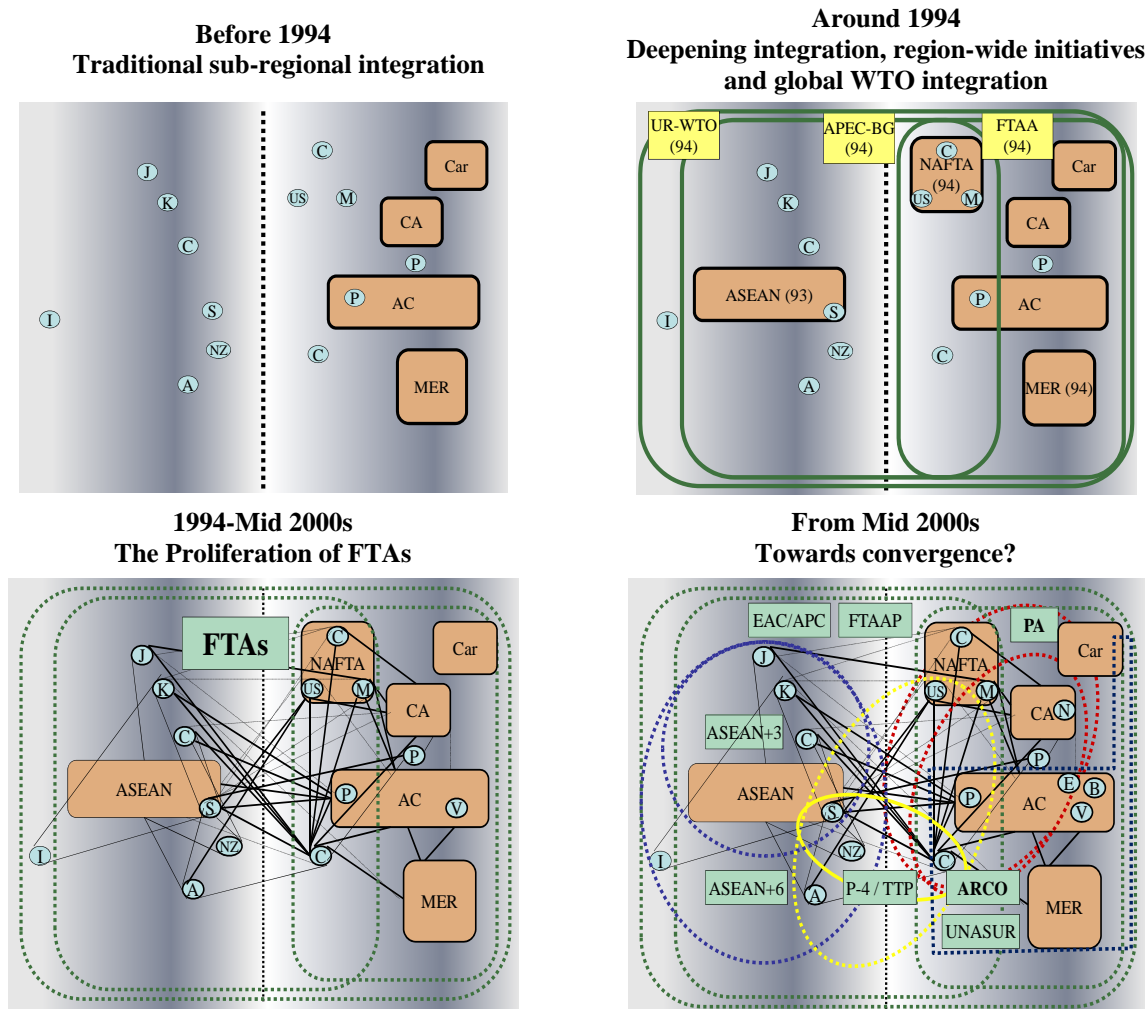
C. Closing the regional integration gap: a fully unified market

- 3.8 **Connecting the *software* and *hardware* of integration.** Competing on an equal footing with advanced and 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, perhaps more importantly, to connect them in an all-encompassing policy agenda.

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

- 3.9 **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 a more unified market. 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)⁷. 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
Regional Integration in the Americas, Asia and Asia-Pacific (1990-2010)



Source: VPS/INT based on IDB INTRADE information system

3.10 Developing regional platforms for services and factor markets integration.

While the unification 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 regional 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 and promote cross-border investments; and (iii) harmonize direct and

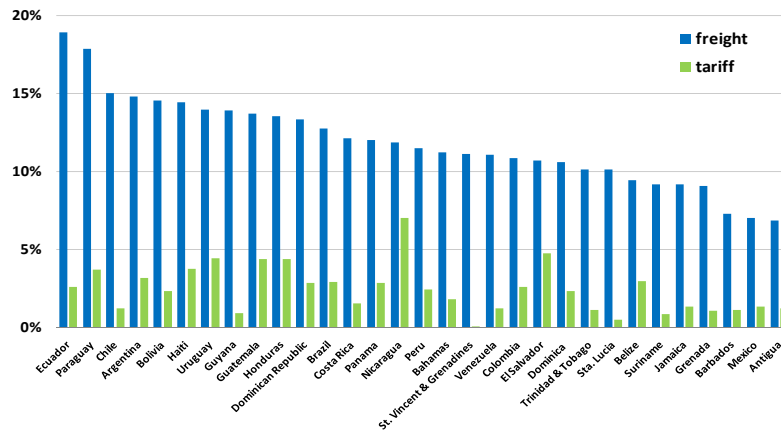
indirect taxation and incentives regimes in order to avoid distortions in the optimal localization of business.

- 3.11 **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 infrastructure, 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 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.

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

- 3.12 **Focusing on non-traditional integration 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. For one, transport costs today constitute the most important obstacle to inter-regional trade⁸. They not only are 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). Some pioneering initiatives have been functional to the coordination of national sector ministries and to jumpstart investment in a number of key integration corridors⁹. However, after a decade of progress this agenda needs to take on new challenges, including: (i) elevate the political profile of these initiatives, securing continuous support for long-term investment; (ii) promote integral and balanced territorial development, taking into consideration socio-economic developmental priorities; (iii) align 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) develop and apply new sustainable infrastructure standards throughout the project cycle by introducing enhanced social and environment safeguards.

Figure 5
Weighted Average *Ad Valorem* Freight Costs and Tariffs on Intra-regional Exports
(2005)



Source: VPS/INT based on ALADI

Connecting hardware and software: a seamless region competing globally

- 3.13 **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 region¹⁰. 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

- 3.14 **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 ignore this demand is to put the consensus for the whole integration process in peril¹¹. 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 urgent, and includes: (i) advancing towards the establishment of cohesion policies through transfers between members of an integrating region¹²; and (ii) 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.

IV. LESSONS LEARNED FROM THE BANK'S SUPPORT TO INTEGRATION

A. Supporting integration: a core Bank development mandate

- 4.1 **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. This section focuses on the Bank's responses to this mandate, in particular in support to regional integration¹³. 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.*” The GCI-9 has renewed and strengthened the Bank's integration mandate to upscale the Bank's intervention. This offers an opportunity to take stock of previous Bank's actions and lessons learned. A preliminary overview is offered below for the public consultation purpose and will be developed more fully in the future integration strategy.

B. The modalities of IDB support to integration

- 4.2 **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 integration¹⁴, and developed a methodology and training in rapid strategic environmental assessment for national planning agencies.
- 4.3 **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 negotiations¹⁵. 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, and mobilizing lending resources through a new *Trade Lending Facility*¹⁶.
- 4.4 **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.

- 4.5 **Innovating to finance regional public goods (RPG).** The Bank also addressed the emerging demand for RPG finance creating in 2005 an innovative instrument to address cross-border externalities and neighborhood issues. With an annual endowment of US\$10 million, the RPG Program allocates regional resources on a competitive basis.
- 4.6 **Serving as an honest broker in integration initiatives.** The Bank served as an honest broker in flagship integration initiatives, particularly at their inception stages. Examples are the technical, logistical, and financial support to the FTAA process, sub-regional integration schemes, and more recently, initiatives such as *Arco del Pacífico Latinoamericano*, *Pathways to Prosperity in the Americas*, and the *Annual Meeting of the Ministers of Finance of the Americas and the Caribbean*.
- 4.7 **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*.
- 4.8 **Promoting policy dialogue on a long-term regional vision.** The Bank instituted in 2000 a *Regional Policy Dialogue on Trade and Integration* with the objective to create a network of senior officials to share best-practices and explore long term opportunities for regional cooperation.
- 4.9 **Building capacity for a critical mass of integration agents.** The Bank carries out a comprehensive capacity-building program and developed partnerships with international 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.).
- 4.10 **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.
- 4.11 **The Integration of Regional Infrastructure in South America (IIRSA).** The Bank launched in 2000 an initiative to support IIRSA, which has the goal to develop and integrate regional infrastructure and to facilitate physical integration

and equitable and sustainable territorial development. The Bank contributes to support the Secretariat of the Technical Coordination Committee, and played a critical role in building consensus on a US\$74 billion pipeline (RE-338, RE-338-2). 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. The Bank subsequently provided lending resources for investments in priority projects in IIRSA and elsewhere. As the IIRSA initiative transitions into a new institutional setting under the guidance of UNASUR, the Bank may need to retool its support to promote cross-border investments between countries with asymmetric benefits more effectively and to connect *hardware* and *software* investments, particularly in training, best-practice dissemination, and regional regulatory reforms.

- 4.12 **The Proyecto Mesoamerica (PM).** The Bank launched in 2001 an initiative to support PM (previously known as *Plan Puebla-Panamá*), which has the goal to facilitate funding and implementation of regional integration projects through infrastructure, connectivity, and social development (see Electronic link 7). 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 creating a multi-sector Technical Support Group and mobilizing sizeable resources for the PM initiative, leading to an overall Bank's portfolio of \$US1,775 million (38 operations) in lending, and \$US53 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*).

C. Lessons learned, current gaps and areas for improvement

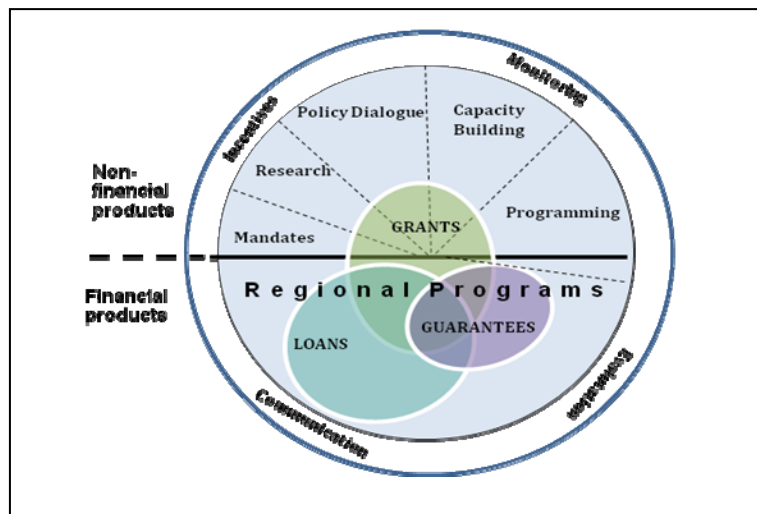
- 4.13 **The need to adapt the Bank to the new integration outlook.** Despite ongoing Bank efforts aimed at supporting LAC's integration agenda with the highest quality standards, a number of gaps will have to be bridged in order for the Bank to scale up its historic integration role and achieve the lending target established by GCI-9. The Bank will propose a new strategic framework that will take into account these lessons learned as well as the feedback received during the public consultation process.
- 4.14 **The knowledge and capacity-building gap.** The Bank needs to maintain intellectual leadership in emerging topics, contribute to the region's long-term vision, and broaden the critical mass of integration constituencies in the region to unlock the latent demand for regional programs.
- 4.15 **The policy dialogue gap.** The Bank needs to engage key policy makers - particularly Ministers of Finance - and reach out to the expanding constituency of stakeholders relevant for today's integration agenda.

- 4.16 **The mainstreaming gap.** The Bank needs to help client countries to mainstream integration-related issues into their national investment strategies, in order to strengthen the strategic framework under which it supports integration.

V. AREAS OF BANK INTERVENTION: A RENEWED INTEGRATION COMPACT

- 5.1 **Implementing an ambitious strategic framework.** The challenges of today's complex global and regional integration agenda cannot be met with old approaches. IDB Governors have mandated the Bank to upscale its support to integration, as it is the case of comparator institutions that are also upgrading their tools to face these challenges. To retain its privileged integration partner position, the Bank proposes to define new areas and modalities of intervention and a renewed instrument compact that will be fully developed in the strategy and its implementation. Figure 6 illustrates the different components of a proposed compact that may be instrumental to upgrade Bank support.

Figure 6
An Enhanced Strategic Compact to Support Integration



A. Objectives of the Bank's Integration Strategy

- 5.2 The strategy should allow the Bank to:
- i) **Consolidate the knowledge foundations of the integration agenda.** The strategy will allow the Bank to 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 strategy will allow the Bank to leverage its expertise and

unique position as an honest broker 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 strategy will undergird the Bank's efforts to meet the 15% GCI-9 integration lending target, 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 strategy will detail approaches to mainstreaming integration into the Bank's operational program and will define criteria for integration interventions.

B. Areas of Bank Intervention

5.3 Defining the areas of focus of the strategy cannot be done in isolation. In addition to an open consultation process, there will be a focused exchange with a group of regional experts and Bank staff to validate the dimension of priorities for development. The process will be matched with a thorough assessment of comparative advantages based on the Bank's track record, resources, yielding the final set of focus areas of the strategy.

5.4 In the meantime, the Bank offers a preliminary list of topics that are believed to have a strong potential of becoming the backbone of the strategy. These are areas where there has been a long-standing partnership with the region with a potential for further growth, as well as emerging areas whose effect on development is now being better understood or where the Bank is building a more robust response capacity.

5.5 The proposed priority topics are: (i) **software:** trade and investment facilitation, financial integration, productive integration, migrations and labor market integration; (ii) **hardware:** transport infrastructure, energy and telecommunications; and (iii) **functional cooperation:** standards and regulatory harmonization, social protection and health, climate change and natural disasters, science and technology and other areas in which collective action at the regional level may add value to national interventions.

C. Modalities of Bank Intervention

5.6 **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 regional integration mandates. The Bank can contribute to the region's long-term integration vision providing analytical contributions, building regional and national capacities and reacting to operational demands. The strategy will ultimately allow the Bank to respond effectively to emerging regional initiatives.

- 5.7 **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 advice. The strategy will seek to strengthen and expand the Bank's research agenda and information systems to the emerging components of the new integration agenda.
- 5.8 **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. At the national level, the Bank will seek to further mainstream the integration agenda into national development strategies. 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 strategy¹⁷. The strategy will seek to promote a more coordinated approach to supporting scattered but complementary integration initiatives and to expand the support to high-level policy dialogues on existing or emerging regional integration initiatives to ensure coherence, sustainability and development impact.
- 5.9 **Capacity building.** Capacity building is crucial to create and sustain a long-term and multi-sector critical mass of national expertise on regional integration. It must include high-level executive training, short-term policy advisory services, and support to project identification, preparation, 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. The strategy should aim at facilitating the development of regional 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.
- 5.10 **Prioritization of integration projects.** The regional process with which countries assign priority to integration operations differs in several ways from national programming: (i) it requires an alignment of various regional, national, and sector constituencies in the absence of a clearly defined "regional counterpart"; (ii) it faces multiple overlapping thematic agendas; (iii) it must combine a definition of priorities at the regional level (top-down approach) and revealing and aggregating national preferences (bottom-up approach); (iv) it often requires an external honest broker to mainstream the integration vision into an effective operational business plan. The strategy will provide the foundation for the Bank to support regional collective action and program integration operations, taking into consideration: (i) the variable geometry of the integration agendas and constituencies; (ii) the need to blend top-down and bottom-up approaches; (iii) the crucial function of the regional dialogue processes; (iii) the need to build into programming financial and non-financial

incentives for implementation; and (iv) the necessary link between country and regional strategies.

5.11 **Regional programs.** Regional programs 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 strategy will seek to strengthen the Bank's capacity to design and implement integration programs, and will consider the need to: (i) develop criteria to define integration programs, taking into account cross-border, trans-national, inter-regional operations and national integration-oriented operations; (ii) develop criteria to evaluate the development effectiveness impact of regional programs; (iii) structure new integrated regional programs, designing new combinations of non-financial products, regional grants, and regional and national lending; and (iv) establish incentives to support identification, preparation and execution of regional programs, mitigating their higher transaction costs; and (v) integrate sustainability considerations into regional infrastructure development.

5.12 **Financial instruments.** In order to meet a higher integration lending target agreed in the GCI-9, the Bank may 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 regional programs. Additionally, the Bank provides non-sovereign loans and guarantees to private sector projects that have regional scale and objectives, which may need to be developed further. During the preparation of the strategy the Bank will assess: (i) the possible need to scale up the availability of grant funding to provide incentives for the design and implementation of regional programs and coordinated national sovereign investment operations featuring cross-border externalities, including through the establishment of a Strategic Thematic Fund for Regional Integration, to be developed as part of other ongoing initiatives; and (ii) the viability of developing a regional non-sovereign facility.

D. Risks, Monitoring and Evaluation

5.13 **Risks.** An adequate incentive structure may help the Bank to promote regional integration more effectively and allow the proposed strategy to meet expectations. The Bank has the potential to increase the number and scale of integration operations if it is able to compensate their coordination needs and higher transaction costs. The objective is to remove the bias against the preparation, supervision, and evaluation of regional projects. The strategy will

consider the need to set up incentives to prioritize regional operations and assess the risk of implementing the strategy in absence of an adequate incentive structure that stimulate both the demand of integration operations of the region and the capacity of the Bank to meet such demand.

- 5.14 **Monitoring and evaluation.** The instruments of the proposed compact need to be effectively monitored and evaluated, and their results effectively communicated to relevant stakeholders, to ensure that their development impact is clearly understood. While this is necessary in general, it is even more relevant in the case of integration programs since they often compete with national investments that may be perceived as having higher returns in the short-term. The Strategy will include specific indicators to monitor and evaluate regional interventions, starting from the definition of a development effectiveness matrix for regional project preparation, to the establishment of modalities aimed at strengthening the communication strategies of regional project outcomes.

VI. ROADMAP FOR IMPLEMENTATION OF THE STRATEGY

- 6.1 The next step in the preparation of the Bank's strategy will be to open a formal public consultation period of 30 days on this profile to receive suggestions that can enhance the strategy. The strategy document will also be submitted to internal consultation within the Bank. The table below provides a tentative calendar until the approval of the strategy by the Board, as mandated by the Governors.

Phase	2010			2011		
	October	November	December	January	February	March
Policy and Evaluation Committee (for consideration)	28					
Board (For Consultation Plan approval)		3				
Consultation 1		4				
Consultation IADB Webpage		4				
Presentation to 10 th IADB-Civil Society Annual Meeting in Quito		4-5				
Special Consultation with regional experts, key stakeholders and representatives		4-30	1-6			
Internal Bank consultations		4-30	1-14			

Consultation 1 results on the IDB webpage			10			
Preparation first draft final document			2			
Management's Operation Policy Committee (OPC)				7		
Consultation 2 (if substantive changes introduced, OPC will review a revised strategy)				12-31	1-12	
PEC						4

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Annex 1
Consultation Plan of the Strategy Profile
Competitive Regional and Global Integration Strategy

I. Background

1. This strategy profile is based on the Background Paper “IDB Support to Competitive Global and Regional Integration” (GN-2565). It has been edited to increase consistency with other strategy profiles prepared by the Bank as mandated by IDB Governors in the context of the 9th capital increase (GCI) (AB-2764) and facilitate the public consultation process.

II. Objectives

2. The general objective of the public consultation for the integration strategy is to promote civil and institutional participation to improve the Bank’s vision on integration.
3. The specific objective is to improve the content of the strategy paper by offering the possibility of interaction among key stakeholders of integration processes, gathering contributions from technical and academic specialists, governments, civil society and sub-regional integration institutions and the private sector.

III. Methodology

4. Management requests opening up a period of formal public consultation that could provide inputs to the Bank’s own contribution and those gathered in eleven meetings and seminars with civil society and with governments, where the contents of the Background Paper “IDB Support to Competitive Global and Regional Integration” were presented and discussed. The formal public consultation process for the integration strategy would involve two phases:
 - 4.1. The first phase is focused on a strategy profile document and would be carried out mainly by digital media during 30 (thirty) days, starting the day following authorization by the Board of Executive Directors. Face to face meetings would be also held during this phase. The profile will be presented at the 10th IDB-Civil Society Annual Meeting.
 - 4.2. The second phase is focused on the development of the strategy document, which needs to be approved by the end of March 2011. The consultation period will be of 30 (thirty) days from the public circulation date of the strategy document.

5. The consultation process (the two phases) will be open to every interested party -even though key players participation will be sought by the Bank, such as academics, specialists, civil society organizations among others- so they can provide their inputs.
6. The Integration and Trade Sector of the Vice-presidency for Sectors and Knowledge (INT/VPS) will lead the consultation process in coordination with the Office of External Relations (EXR) and the Vice-presidency for Countries (VPC).
7. Public electronic pages will be available to the public, so that comments can be made during the two phases of the consultation process.
8. The following table summarizes the objectives, duration, type of participation, activities and indicators for both phases. This document will be updated with additional details about the activities carried out in the second phase.

		Phase I Strategy Profile	Phase II Strategy document
1.	Objective	Gather contributions from the general public by digital media, which could serve as inputs to the development of the strategy document.	Carry out a participatory and inclusive consultation process to improve the strategy document through digital media and face to face meetings.
2.	Duration	30 days from the Board authorization date.	30 days from the public circulation of the draft strategy document.
3.	Type of participation	Virtual Gather online comments. Face to face Meetings will be used in order to present the ideas of this Strategy Profile document. Gather comments during formal and informal consultation meetings.	Virtual Gather online comments. Face to face Gather comments during formal and informal consultation meetings.
4.	Activities	1. Develop dedicated pages on the Bank's external website for the public consultation process. 2. Publication of the Strategy Profile. 3. First phase of consultation is announced on the IDB website (main site, civil society pages and relevant pages such as INT). Alerts will be sent to civil society contacts and civil society groups located in our IDB country offices (ConSOC). 4. Publication of comments on the	1. Draft strategy document publication on the IDB website. 2. Second phase of Consultation is announced. 3. Structured face to face consultation meetings, which would allow video- and teleconference participation from different countries. 4. Offer information in the IDB

		Phase I Strategy Profile	Phase II Strategy document
		IDB site.	website about the consultation process.
5.	Indicators	Virtual 1. Number of site visits to the relevant consultation pages. 2. Number of comments received on line. Face to Face 1. Number of meetings 2. Number of comments received in the process.	Virtual 1. Number of site visits to the relevant consultation pages. 2. Number of comments received on line. Face to Face 1. Number of meetings. 2. Number of participants in the face to face meetings. 3. Number of participants via video-/teleconferences. 4. Additional comments received during the process.

IV. Consultation chronology

FACE TO FACE CONSULTATION

Event name	Place	Date	Local Time	Tentative Participation INT	Tentative Participation EXR/VPC
Meeting with Caribbean Finance Ministers with the IDB	The Bahamas	October 1-2 2010	9:00	Antoni Estevadeordal, Paolo Giordano	CCB Manager Country representatives
X IDB-Civil Society Annual Meeting	Quito	November 4-5 2010	9:00	Antoni Estevadeordal, Paolo Giordano Joaquim Tres	John Ferriter Rosanna Gómez
Meeting with Trade vice ministers and Customs directors from Central America and the Dominican Republic (CAFTA)	IDB HQ Washington DC	November 18-19 2010	9:00	Antoni Estevadeordal, Paolo Giordano, Carolyn Robert, Joaquim Tres	TDB

V. Audience

- Participants in X IDB Civil Society Annual Meeting
- Civil society organizations interested in participating in the consultation
- CONSoc in IDB representations in LAC
- Interested Private Sector organizations
- Governments of IDB member countries

- LAC Integration Institutions

VIII.

END NOTES

¹ See for example Estevadeordal, A., Frank, B., Nguyen, T. (2004).

² See Sapir, A. et al. 2004 on the European experience.

³ Consider that, as of 2008, a region-wide LAC integration scheme would lead to a US\$ 4.2 trillion market, comparable to that of China.

⁴ See for example Devlin, R. and Estevadeordal, A. (2004) and Devlin, R. and Giordano, P. (2004).

⁵ Under the *New Regionalism* the growth benefits were somehow slow to come, but have become unmistakable in the last decade. Since 2003, the region's GDP has grown at 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 export (29 percent) and GDP (2.5 percent). But unlike past experiences, recovery has been relatively swift and most countries in the region are expected to resume growth in 2010.

⁶ See Estevadeordal, A., Freund, C, Ornelas, E. (2008) regarding the complementarity between multilateral and regional liberalization.

⁷ Around 1994, the LAC sub-regional agreements started to evolve into deeper forms of integration, adopting the goal of customs unions. At about the same time, more ambitious initiatives such as NAFTA and the FTAA, with more promising scale and trade gains, began to take shape, the former with greater success than the latter. This was followed in the 2000s by a strong wave of bilateral and inter-bloc agreements that relaxed some of the scale constraints of traditional initiatives, but generated growing costs related to the complexity and fragmentation of trade rules (Estevadeordal, A. et al. 2009).

⁸ See for example Moreira M., Volpe, C. and Blyde, J. (2008)

⁹ In particular, initiatives such as the *Initiative for the Integration of Regional Infrastructure in South America* (IIRSA) and the *Mesoamerican Integration and Development Project* (*Proyecto Mesoamerica* or former *Plan Puebla-Panamá*) whose foundational objectives were to develop regional energy, communication and transport infrastructure outside the realm of sub-regional and bilateral agreements.

¹⁰ See for example this strategic approach for Europe EC (2006) or for Asia in ADB-ADB (2009).

¹¹ Support for economic integration has declined steadily in LAC since the mid-nineties (Latinobarometro, 2009). See also Blyde, J., Fernández-Arias, E. and Giordano, P., 2008.

¹² The allocation of resources to cohesion funds may indirectly compensate for disparities provided that there is adequate capitalization and capacity at the national level to complete high-return integration projects. 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). In LAC, MERCOSUR and CARICOM have already taken steps in this direction. However, it is imperative to bear in mind that they should not be seen in any circumstance as a substitute for direct action on the root causes of the problem, that the level of income and fiscal constraints of the larger and richer countries of the region does not allow for substantial - European style - transfer of resources, and that their effectiveness

ultimately depend on the national capacity to steer scarce resources towards high-quality integration-oriented projects.

¹³ See IDB 2006 and 2007 for a review of the Bank's action and strategy to support global and regional integration through national interventions.

¹⁴ The Bank developed INTRADE, the most comprehensive resource center on trade agreements available for LAC (www.iadb.org/int/intradebid).

¹⁵ 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.

¹⁶ Trade integration projects were developed in the areas of: trade negotiation and implementation; trade facilitation and customs modernization; and trade promotion and investment attraction.

¹⁷ 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, broader effective platforms.