

INTER AMERICAN DEVELOPMENT BANK
Integration and Regional Programs Department

COFAB - DFID

RS-X1038

I. GENERAL DATA

Name of TC project: Assessment of the Impact of Trade Liberalization Options
 (Regional) on Poverty with Computable General Equilibrium Models:
 The Case of the Andean countries

Name of Fund: Cooperation Framework Arrangement (DFID - Department
 for International Development of the United Kingdom)

Beneficiary Countries: Andean Member Countries

Executing agency: Integration, Trade and Hemispheric Issues Division
 (INT/ITD), Integration and Regional Programs Department

Estimated Total Amount
 To be financed by Donor: £77,134(Pounds Sterling); equivalent: US\$136,500

Execution and Disbursement
 Deadlines: Execution: 12 months; disbursement: 15 months

Project Team: Paolo Giordano (INT/ITD), Project Team Leader; Fidel
 Jaramillo (RE3/RE3); and César Bouillon Buendía
 (SDS/POV).

II. OBJECTIVE

- 2.1 The general objective of the technical cooperation is to help facilitate increased access to markets and international trade for IDB borrowing member countries, and particularly poor groups. The specific objectives are to implement state-of-the-art methodologies for policy analysis and to contribute to generate innovative policy approaches and identify areas for operations to support the transition of the poor to freer trade.
- 2.2 The project will contribute to generate innovative policy-oriented approaches in the area of trade and poverty reduction with the support of leading experts in this new field. It will support the extension of the INT Computable General Equilibrium (CGE) model, which is currently used as a basis for the trade-related capacity building activities currently implemented by INT in Andean trade Ministries. It will also contribute to the preparation of the IDB Regional and

Country Papers currently under way. In this framework it will identify the implication for the poor of the transition to freer trade, particularly in the Andean countries that are negotiating a bilateral free trade agreement with the United States.

III. BACKGROUND AND JUSTIFICATION

- 3.1 The countries of the Andean Community are currently negotiating a reciprocal free trade agreement with the United States and may soon enter into bi-regional negotiations with the European Union. The region is still characterized by high levels of persistent and severe poverty. In the last five years the IDB has deployed in the sub-region a notable effort to strengthen the capacity of Trade Ministries to evaluate the impact of trade liberalization through a variety of instruments: trade facility loans, capacity building for trade negotiators, bilateral framework agreements for the development of CGE models, etc. However, the countries of the sub-region do not have specific instruments to evaluate the impact of trade liberalization on the poor.
- 3.2 A significant opportunity for poverty reduction in the region is offered by the possibility of greater trade integration. However, trade may affect the poor in many different ways, directly or indirectly. CGE models are increasingly used by policymakers to evaluate the distributive impact of trade liberalization. The attraction of a CGE model is that it arrives at a numerically precise evaluation of the impact of trade liberalization while ensuring that the results are theoretically consistent. However, the results of CGE simulations are only as good as the specification of the model and the data that are fed into them. It is important that local authorities have full ownership of the models and of the underlying databases so that they can focus on the specific issues that are relevant for policymaking.
- 3.3 Trade liberalization will be one of the policy reforms that will affect the most the challenges and opportunities for the Andean countries in the near future. In fact these countries are actively participating in the Doha negotiations, are currently negotiating demanding bilateral reciprocal free trade with the United States and may negotiate in the future a bi-regional agreement with the European Union. Unless the disaggregated effects of these negotiations are well identified, it is unlikely that the potential gains from trade for poverty reduction will be fully realized or that the potential threats will be fully protected against. In order to develop such understandings, it is necessary to extend the CGE model that is used throughout the region to assess the disaggregate impact of trade liberalization on different groups of poor people. Furthermore, it is also important to develop capacity building on these techniques in order to spread their use in the region.
- 3.4 In 2005-06 the Bank will be very active in the design of assistance strategies for Andean countries: the Regional Programming Paper for the Andean region is currently being prepared by INT, while RE3 is currently launching the

preparatory work for the Country Papers of several countries of the region. The social impact of free trade agreements will be one key issue in both programming exercises.

- 3.5 The project is consistent with the objective of the IDB's Strategy for Poverty Reduction and Promotion of Social Equity to promote faster progress in the reduction of poverty by tackling its root causes and fostering inclusion and greater social equity, as an essential element of development. In addition, it reinforces the Bank's work in the area of regional integration, one of the four areas of competitive advantage identified in the IDB Institutional Strategy.
- 3.6 Given the importance of the transition to free trade in the region and given the significant challenges it faces in terms of poverty reduction, it would be a very suitable region with which to carry out the extension of the INT CGE model to incorporate the disaggregated household-level analysis of trade integration. The development of the model and the results of the simulations could be subsequently used for: expand the trade-related capacity-building activities carried out by the Bank; contribute to the Regional and Country programming exercises currently under way; promote a high-level dialogue with local authorities and with stakeholders on the impact of freer trade; and for identifying appropriate pro-poor policies and strategies.
- 3.7 Two of the objectives of DFID's Regional Assistance Plan (RAP) for Latin America are to: 1) support the IDB and World Bank to better enable poor people to shape, participate in and benefit from access to markets and international trade; and 2) improve regional analysis and lesson sharing on global policy issues to help countries adopt trade policies that better reflect the impact of trade on poverty and inequality.
- 3.8 In taking forward these objectives, DFID has designed a 4 year program that will involve working closely with the IDB and World Bank to promote greater access of poor people to markets and international trade (Latin American Markets and International Trade - LAMIT Program). A key part of this program involves the establishment of a multi-donor Trade and Poverty Trust Fund with the Integration and Regional Programs (INT) Department of the IDB. This will support work to strengthen the capacity of the IDB to assess the impact of trade liberalization on poverty and support the adoption of pro-poor trade related strategies and policies in the countries of the region. This project supports activities consistent with the objectives of the LAMIT and is intended to make the program operational during the interim phase in which final administrative arrangements between DFID and the IDB are established.

IV. DESCRIPTION

- 4.1 The project has two components: i) the **extension of the INT CGE model** through the design of a suitable micro-macro modeling framework; and ii) the **construction of CGE compatible national datasets** that include household

surveys. This project will be developed in close conjunction of local authorities under the framework of IDB bilateral CGE cooperation frameworks. It will serve as the basis for future activities to be developed under the LAMIT.

- 4.2 **Component 1 – Extension of the INT CGE model:** The objective of the component is to expand the current structure of the CGE model currently used in INT. The extension will allow to: i) consider the impact of trade liberalization on selected types of households, in contrast with a single representative household; ii) consider different assumptions on the adjustment of the labor markets; iii) as feasible, differentiate the impact of trade liberalization with respect to socio-economic variables such as gender, age, education, access to productive assets, etc. Such modeling effort will help improving the assessment of policy reforms considering heterogeneous characteristics of social groups and therefore allowing a better target of compensatory policies.
- 4.3 **Component 2 – National CGE compatible datasets:** This component will consist of the adaptation of the data collected in the household surveys to the needs of CGE modeling. There are two main technologies to achieve this goal: i) micro simulations; ii) income distribution function embedded into the CGE model. The final choice of the selected technique will necessarily depend on the quality of the data and on the trade-off between accuracy and reliability. The project will finance at least the adaptation of three national datasets, depending on the availability of the data.
- 4.4 The project will generate three main outputs: i) a CGE model that will be used in INT projects related with the distributive impact of trade liberalization in other sub-regions; ii) at least three national datasets to assess the distributive impact of trade liberalization policies in the Andean region; and iii) a technical manual with explanations of the model that will be used as a basis for INT CGE related capacity-building activities.

V. BUDGET AND EXECUTION

- 5.1 The technical cooperation will finance: (i) one expert senior consultant to develop the CGE model; (ii) two junior consultants to prepare the background data and the policy simulations; and (iii) travel tickets and per diem; and (iv) logistical support costs related to the execution of the project. The tentative terms of reference of the consultants are included in Annex I to III.

| Item | Estimated Cost |
|-------------------------|----------------|
| Consultants | 120.000 |
| Travel and perdiems | 5.000 |
| Logistical Costs | 2.000 |
| Contingencies | 3.000 |
| Administrative Fee (5%) | 6.500 |
| TOTAL | 136.500 |

- 5.2 INT/ITD will be responsible for managing the project, in coordination with SDS/POV and DFID. The period of execution is 12 months and 15 months for disbursement.

VI. RESPONSIBILITY IN THE BANK

Technical Responsibility

Paolo Giordano, Economist, Integration, Trade and Hemispheric Issues Division (INT/ITD) (ext.2611, fax. 2169, email: paolog) will have technical responsibility, in consultation with SDS/POV.

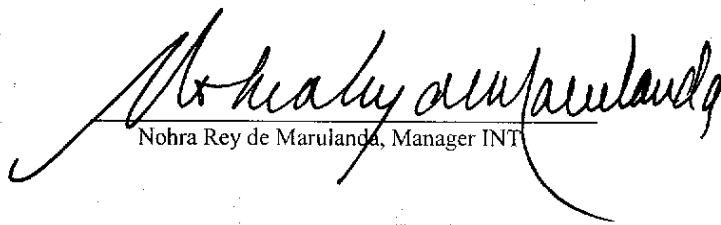
Responsibility for Disbursements

The Co-financing Division, Financial Services Sub-department (FSS/CEP) will have the responsibility of the disbursements from the Donor to the IDB. INT/RTC will have the responsibility of disbursements from the IDB.

VII. RECOMMENDATION

Paolo Giordano Project Team Leader of the Integration, Trade and Hemispheric Issues Division (INT/ITD) recommends the use of equiv.USS136.500 to be authorized to finance the project described in this Brief.

Approved:


Nohra Rey de Marulanda, Manager INT

9.22.05
Date