Brief
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EUROPE - DEVELOPING COUNTRIES

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Improving Global Governance for Development: Issues and Instruments

What are the problems facing developing countries in this era of globalisation? How do current governance instruments address these problems and how far can these instruments go in overcoming related governance problems faced by developing countries? Do new instruments strengthen the influence of developing countries on policy formulation? Are they effective in promoting economic development? What are the suggestions for improving governance instruments and what is the role for the EU?

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Introduction

These were some of the key issues addressed at the EU-LDC Network conference on "Improving Global Governance for Development: Issues and Instruments" held on 7-10 December 2002 in Chiang Mai, Thailand. Issues of global governance have assumed great significance over the last years, and questions have been raised concerning the functioning and legitimacy of many of the most important international organisations. The conference aimed to move the discussion away from the analysis of international organisations, and rather focus on some of the instruments that are being used in global governance.

The goal of this EU-LDC Brief is to summarise the current debate on a number of governance instruments that deal with three problems developing countries are facing: volatility of capital markets, lack of sustainability, and poverty. We look at a number of relatively new instruments and at some proposals for new instruments that address these issues.

What clearly comes out of this debate is that it is very difficult to design instruments that are effective in reaching their objectives. Although lessons from the past have led to some improvements, the current instruments still do not fulfil the needs of developing countries. An important reason for this seems to be that developed countries or international organisations have often been responsible for the design of the instruments. Yet, in most cases they are not sufficiently aware of the constraints facing developing countries in dealing with these instruments. At the same time, the input from developing countries into the design of new instruments remains limited. Apparently it is difficult for them to formulate alternative proposals. To improve governance instruments in the future, it will be important to actively involve developing countries in the design stage. This will require commitment from developing countries themselves, and support for capacity building from developed countries.

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Conditionality

Developing countries are forced to live by the rules of international organisations. In a number of cases this does not seem to be conducive to solve the major problems of sustainability, poverty reduction, etc. It seems moreover unfair, as the leading powers that have set these rules have not observed them in the past and do not observe them now. An example is the policy prescription of small government. Highly developed countries have big governments and very dense networks of institutions. Developing countries should be allowed to make their own choices in this respect.

What is the problem?

Developing countries have to find solutions to the problems of underdevelopment, poverty and lack of sustainability. The support they get from the international organisations is conditional. This is so *in extremis* for countries that have fallen victims to a financial crisis (created by the volatility of international markets). The conditions of the IMF are particularly severe.

Why conditionality?

The principle of conditionality is not disputed. However, there is much controversy with respect to the justification of individual conditions and on the best way they should be applied.

Some conditions find their justification in their effectiveness: they are based on results of empirical research showing the factors that contribute to growth and poverty reduction. Such conditions are not disputed, for example the basic condition of a market economy has never been questioned in Latin America (except for Cuba). Less clear is the imposition of conditions based on moral principles, e.g. democracy. There is empirical support for the hypothesis that democracy enhances growth. But there are many forms of democracy. In the past one may recall that lack of democracy has been a widespread phenomenon. One may also recall that where democracy existed in developing countries it has often been challenged with the active support or at least benign connivance of the USA. Now the condition of democracy is not a problem for many developing countries, e.g. Mercosur explicitly demands its members to be democratic.

However, there is a set of more detailed conditions that are much more controversial, as these are much more based on ideology instead of on robust results of research. We refer here notably to the conditions inspired by the so-called Washington consensus. Essential ingredients are: adequate institutions (minimum government), non-interventionist policies and openness to world markets for goods and capital. The Bretton Woods institutions stipulate that these conditions create the best stimuli for growth by restricting distortions and disciplining competition. Many question the justification of this view and hence the adequacy of the ensuing policy prescriptions. Among them is the EU, which cherishes the so-called European social model. This is strongly based on elements such as solidarity among regions and social categories, and puts a strong accent on safeguarding public goods provision through regulation.

Opposition to conditionality

There is opposition from several sides. Conditionality is found to be:

- *Ineffective* with respect to poverty reduction. There is no serious attention for the long term monitoring of the poverty aspects by the responsible international organisations;
- *Inadequate* for stimulating growth. Many of the measures imposed on developing countries have actually been based on both a wrong diagnosis and a wrong therapy (e.g. Stiglitz 2002). A case in point is budgetary deficits; these could be accepted in periods of downturn, but should be restricted in periods of upturn;
- *Unfair*, as none of the presently highly developed countries have actually followed these policy prescriptions in the past. Even now, highly developed countries continue to live by the orthodox view; they still apply protectionist policies in sensitive areas and use dense networks of institutions to foster the smooth functioning of their economies. So, it looks as if rich countries have climbed a ladder in the past that they kick away, now that poor countries want to climb it as well (Chang 2002).

How could it be solved; what proposals for change?

The solution would be to limit conditionality and to let international organisations go back to their essential tasks and founding principles. In practice, this means that they should take a longer-term view with respect to preservation of basic functions in society. They should accept a much broader variety of institutional settings that are capable of creating consensus

on policies and facilitate collective action. They should permit governments in developing countries to experiment with a variety of policy instruments aimed at finding solutions to the real problems of poverty alleviation, sustainability improvement and volatility reduction. They should attack more clearly problems inhibiting the good functioning of institutions such as fraud and corruption (e.g. Rappoport 2002).

Who should do something?

Overthrowing the so-called Washington consensus demands action by countries that do not feel comfortable with it. This applies in particular to the EU, which has opted for a governance model that is quite different from the one that stands out in the Washington consensus. But the EU should not act alone. It should make sure that it is joined by the most important developing countries. Together they should be able to mobilise sufficient voting power in the Bretton Woods institutions to impose change. The EU has interesting solutions to governance problems to offer (Molle 2001). The WB and IMF could learn for instance from the experience of the EU, in the way it provides support for the regions in difficulty. Its Structural Funds finance a number of actions in the less wealthy regions of the EU. They do so under very clear rules with respect to types of measures and governance. A case in point is for instance the Single Programming Document, which sets the framework for interventions, specifies the financial resources and defines the forms of assistance. Another is the obligation to have all partners involved subscribe to the strategy and programmes (EU, national and local).

Further reading:

Chang, H-J. (2002) *Kicking away the ladder; development strategy in historical perspective, London, Anthem Press.*

Molle, W. (2001) *The Economics of European Integration*, fourth edition, Ashgate, Aldershot.

Rappoport, L. (2002) *Global governance and poverty reduction; the lessons of the Argentina case*, paper for the EU-LDC conference 2002.

Stiglitz, J.E. (2002) *Globalization and its discontents*, Norton and Co, New York and London.

Sovereign Debt Work-Outs

Poverty struck countries need to borrow for their development. Many of them have become heavily indebted. If they get into financial turbulence they may end up in acute insolvency. On the international level there is no mechanism in place that provides a solution for such a situation, which implies that countries may be locked into a problem situation for a long time. The proposal is to set up a sovereign debt work-out mechanism. The best institutional form seems to be an independent arbitration panel; the IMF should not be entrusted with this authority.

What is the problem?

Many LDCs do not have sufficient resources to finance their investment needs and some even need external funds to pay for their current expenses. This dependency on foreign loans has led for many to an accumulation of high levels of debts. In the past, such loans were mainly to governments; now an increasing part of the loans are private. Countries that are confronted with a fall in their capacity to repay their loans may find themselves in a situation of insolvency. In this case, there should be a possibility to reach a work-out by forcing all creditors to accept to write off part of the debt. Such mechanisms (bankruptcy) exist for the private sector in all countries. They even exist for the local authorities in some federal countries. They do not exist for national states on the international level. The absence of such a procedure prevents bona fide creditors from coming to an agreement with the debtor. They will only be prepared to take on part of the burden in case all other creditors do the same. Now this is unlikely to happen. Some creditors may prefer to wait, hoping for a work-out by others so that they might get paid in full. Moreover, there are so-called vulture funds around that look for the possibility to buy up the remaining contracts in the market at very low prices and demand 100% payment from the country as soon as it has returned to solvency.

Sovereign debt work-out as a solution

The solution to the problem just presented seems obvious: there should be an international mechanism to restructure the debt of sovereign countries that have become insolvent. After that, the country can be subjected again to normal conditions in financial markets. In the past, a number of proposals have been put forward to set up such a procedure (Rogoff

and Zettelmeyer 2002). These proposals have two aspects in common (Raffer and Singer 1996); they:
- Give countries that risk insolvency some breathing space to work out solutions with their creditors;
- Force all creditors to accept the solutions arrived at by the majority of them.

What are the best means to put such a mechanism in practice?

There are mainly three approaches to find a solution to the problem:
- *Legal*. This works through a change in the legislation of the major financial centers (US and UK). They need to include one sentence saying: "Starting international insolvency procedures voids/suspends all waivers of immunity relating to this case". It would mean that some contracts that are made in other centers would not fall under this solution, but as most bona fide creditors would pass through these two important markets, most of the problem is likely to be taken away.
- *Contractual*. A standard clause for compulsory arbitration in case of insolvency should be included in all contracts for international loans to countries. This should specify rules for collective action and representation (Eichengreen 2002).
- *Statutory*. This solution works via the set-up of an international organisation, which specifies in its statutes that private and public actors from its member states agree to cooperate on debt restructuring.

What role for the IMF?

In the past, the IMF has been a staunch opponent of such ideas. The Fund was very much afraid of an increase of the risk of moral hazard. It feared that countries in difficulty would be inclined to borrow too much in the knowledge that they would benefit from a debt write off anyway. Recently the IMF has changed its view. The Fund has seen that the big debt overhang made the solution of the latest crises very difficult and tended to strain the capacities of the Fund too far. With a sovereign debt work-out mechanism, the need for massive aid packages would be much reduced. Moreover, the Fund has been under attack for its incapacity to provide sustainable solutions to poverty problems. The debt relief possibility would improve its reputation. However, while supporting the proposal, it has also claimed a central role for itself (see Krueger 2002). Its idea is to use the statutory approach and to have the articles of the IMF amended in such a way that they give the IMF the authority to declare a standstill on payments, organise restructuring negotiations and impose the results of the deal.

In his contribution to the conference Raffer (2002) argued that this would not be the right solution, because the IMF is:
- party to the dispute: it is itself creditor in most cases and in some cases a very important creditor;
- at the root of many of the problems: in the framework of its policy of conditionality it has given prescriptions for so called good policies that sometimes have worked out in a disastrous way.

Other solutions should therefore be envisaged. The most evident one is to replicate in some way the situation that exists at a national level; that is independent arbitrage panels. This is also an accepted practice in international matters so no new treaty would be necessary; it can be implemented immediately. It would be separate from the IMF packages, which would leave countries the possibility to make their own choices with respect to social and anti-poverty policies.

Who should now come into action?

The international community has to make a number of choices with respect to the approach to follow.
- *Statutory*. A coalition should be formed to prevent the IMF approach from being taken. There seems to be a majority of the voting rights in IMF against this proposition, as both the EU and the US (albeit for different reasons) are not inclined to go along that path.
- *Contractual*. The EU should commit itself to work with other major creditor and debtor countries to work out a solution in the form of a clause and the set up of international arbitrage panels.
- *Legal*. The US and UK have to change their laws.

Further reading:

Eichengreen, B. (2002) *Financial crises, and what to do about them*, Oxford, Oxford University Press.

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Raffer, K. and H.W Singer (1996) *The Foreign Aid Business; economic assistance and development cooperation*, Edward Elgar, Cheltenham.

Raffer, K. (2002) *Which sovereign debt workout arrangements? Proposing a model for meaningful debt relief*, paper for the EU-LDC Conference 2002.

Rogoff, K. and J. Zettelmeyer (2002) *Bankruptcy procedures for sovereigns; a history of ideas, 1976-2001*. Working paper 02/133, IMF, Washington.

International Financial Standards and Codes (S&Cs)

Recent financial crises in East Asia and Latin America have nurtured discussions on the functioning of global financial markets and on the need for improving the international financial architecture. In the debate the introduction of international financial standards and codes (S&Cs) has become an important issue. Developing countries in particular have a large stake in the discussions. The International Financial Institutions (IFIs) and some developed countries are in favour of making financial support from the IFIs conditional to compliance with S&Cs.

What is the problem?

Modern financial markets are characterised by a high degree of volatility. Therefore, there is a need for instruments that contribute to financial stability. Crises in Thailand, Indonesia, Brazil and Argentina have shown that the current international financial architecture is not sufficiently able to prevent and alleviate financial crises. Developing countries are in particular sensitive to the volatility of financial markets. They are large borrowers on international markets and their economies have less absorption capacity than developed countries to cushion shocks on financial markets.

S&Cs as a solution

Industrialised countries and IFIs have welcomed the idea of introducing international financial S&Cs as a potential means to deal with volatility and to increase stability. S&Cs provide valuable information which enhances transparency on the financial situation of a country. Examples of S&Cs include the Special Data Dissemination Standard (SDDS), International Standards on Auditing, and Core Principles for Effective Banking Supervision.

In 1999, the IMF started to comprehensively address S&Cs on a voluntary basis through its Reports on the Observance of Standards and Codes (ROSCs). The use of this mechanism is still in a preliminary stage. In the same year, the G7 countries established the Financial Stability Forum (FSF). The FSF has defined twelve S&Cs which are regarded essential for maintaining global financial stability. The twelve S&Cs cover three main areas:
- macroeconomic policy and data transparency;
- institutional and market infrastructure; and
- financial regulation and supervision.

What are the problems with S&Cs?

Despite the potential benefits of S&Cs, there is still uncertainty among policy makers and academics about the effectiveness of S&Cs. Research on their role is limited. It is clear, however, that the introduction of S&Cs alone will not be a sufficient means to prevent crises.

The discussion about introducing international financial S&Cs has, furthermore, been initiated by the rich countries. Some of the developed countries and IFIs believe that the introduction of S&Cs will be most effective if their implementation is made conditional for international financial assistance. Thus far, developing countries have not been able to influence the definition and implementation of S&Cs. As a result, they do not have ownership in the application of S&Cs. Internationally agreed S&Cs imply a "one-size-fits-all" approach. If developing countries cannot raise their concerns in the discussions on S&Cs, they might not "fit" into this approach. Representation will enhance the appropriateness of the standards to the circumstances in developing countries and facilitate a better implementation of S&Cs.

The need for S&Cs, and thus the incentive for their implementation, is higher in developing countries than in developed countries. Developing countries borrow from private financial markets or from bilateral and multilateral official sources in a foreign currency. Developed countries are no longer borrowing from multilateral official sources and on private markets they are usually able to borrow in their own currency, thus eliminating currency exchange risks (Schneider 2002).

Who should do what?

International financial S&Cs provide valuable information and deserve to be considered as tools for promoting global financial stability. However, the current discussions on the issue are too much driven by developed countries. Since developing countries will be mostly affected by the introduction of S&Cs, they need to involve themselves more actively in the discussions. Naturally, they need to be invited to do so. The benefits of applying S&Cs will be the best incentive for implementation. Negative incentives such as conditionalities or sanctions need to be avoided. Withholding financial support because of non-compliance with S&Cs will have a counterproductive impact

on financial stability. Implementing S&Cs on a voluntary basis will allow transition periods in which developing countries can systematically implement S&Cs according to their priorities as well as to their different structures and stages of development.

Furthermore, it is clear that developing countries will need support through technical assistance. Developed countries could assist by the provision of technical support. Projects such as the Financial Sector Reform Strengthening (FIRST) Initiative, which assists developing countries with the implementation of S&Cs, are important examples for other developed countries. The FSF has also embarked on projects providing technical assistance for banking supervision. These can be expanded to other areas of S&Cs. Finally, more research on the effectiveness of S&Cs will be beneficial in order to understand the potential contribution of S&Cs to achieve global financial stability.

Further reading:

Clark, A., Drage, J. (2000) International standards and codes, in: *Financial stability review*, Issue 9 - December 2000, Bank of England, London.
Schneider, B. (2002) *The road to financial stability: are key financial standards the answer?* Paper presented at the EU-LDC Conference 2002.

Sustainability Impact Assessment (SIA)

Over the past decades, it has become clear that trade agreements do not only have positive effects. There are many concerns about the economic, social and environmental impact of trade agreements. In response to these concerns, the European Commission developed a new instrument: the Sustainability Impact Assessment (SIA).

What is the problem?

The European Union aims to promote sustainable development[1]. This means that it wants to pursue development strategies that secure economic growth whilst preserving environmental resources and promoting social equity. It is clear, however, that trade agreements concluded by the EU in the past have not always contributed to sustainable development. There are numerous examples of increased pollution, limited or very uneven economic growth, and increased social imbalances as a result of trade agreements.

SIA as a solution

To make sure that trade agreements will contribute to sustainable development, the European Commission has launched the Sustainability Impact Assessment (SIA). SIA is a methodology for identifying and assessing the likelihood and scale of economic, social and environmental impact of new policies or changes in existing policy. Gradually, from 2003, all major EC policy initiatives will be subjected to a SIA.

The SIA process consists of three main stages. The first stage, “screening and scooping”, identifies which aspects of the policy initiative are likely to have significant impacts and determines the terms of reference for a detailed assessment of these measures, in terms of scenarios, indicators, time horizons, methods to be used, etc. In the second stage, a detailed assessment of the trade measures and their sustainability impact is made. In this stage, usually a combination of general equilibrium modelling, causal chain analysis, case studies and expert opinion is used. The third stage identifies the types of measures that can be used to mitigate negative impacts and/or enhance the positive impacts, and assesses these measures in terms of cost-efficiency, feasibility and effectiveness. Consultations are an integral part of SIAs throughout the entire process.

What are the problems with SIA?

The shortcomings of the SIA relate to the methodology, the consultation process, and the role of SIA in policy-making.

The methodology of a SIA involves both quantitative and qualitative analysis. In the quantitative analysis, economic models are used, which are always a simplification of reality, and even more so if there is lack of data. In addition, it is very difficult to estimate dynamic effects of policy changes. In the qualitative analysis, a problem is that the input of parties who are directly affected by a policy measure is generally limited. Finally, it should be kept in mind that an impact assessment is never purely rational and objective, as the analysis involves decision-making on, for example, the methods to be used, the experts to involve, the scenarios to explore, the criteria to be used, etc. Due to financial and time constraints, only a limited number of countries and sectors can be analysed in detail.

Consultations play an important role in the SIA process. However, participation of the various stakeholders seems to be uneven. Within the EU, civil society meetings are organised and stakeholders also have the opportunity to directly contact the consultants. Not all stakeholders are aware of the SIA process however. In the non-EU countries under study, it is up to the research team who will be consulted and no general meetings are organised. In these countries, there is also a general lack of awareness, and in addition, the lack of documentation in local and more accessible language is limiting stakeholder participation.

Finally, the question is to what extent a SIA is able to influence policy. For the SIA to be effective, it is important that it is carried out a time that it can still influence policy, i.e. the SIA should start before the negotiations so that it can keep pace with the negotiations. This has not always happened in the past. Some civil society organisation expressed fears that SIAs are used for "green washing" or supporting already-made decisions.

Who should do what to improve SIA as an instrument?

There are three main messages for the EU. First, the consultation process needs to be improved by increasing awareness both in the EU and third countries and by communicating in an accessible language. Secondly, to keep the SIA process credible, it is important to carry out the SIA at a time when it can still influence policy formulation and increase transparency in the decision-making process. Finally, given the shortcomings of SIAs, monitoring and ex-post evaluation is very important for assessing the actual implementation and impact of policy, so that if necessary, flanking measures can be adopted.

Developing country governments or other stakeholders may consider carrying out their own SIAs in parallel with those of the EU. This may prevent the possible bias in the selection of stakeholders in the consultation process, and also the possible bias in the sectors and subjects studied when the Commission finances the SIA. Donor support is needed to build capacity and finance these efforts.

Note:

1. Sustainable development is defined as a process that "meets the need of the present without compromising the ability of future generations to meet their own needs", following the Brundtland Report (1987) *Our common Future.*

Further reading:

Kirkpatrick, C. and S. Mosedale (2002) *European Governance Reform: The role of Sustainability Impact Assessment*, paper prepared for the EU-LDC Conference 2002.

Dourmashkin, N. (2002) *Sustainable Impact Assessment Mercosur/Chile*, paper prepared for the EU-LDC Conference 2002.

Proceedings of the EC seminar "SIA of trade agreements: Making Trade sustainable?" 6-7 February 2002. Available at: http://europa.eu.int/comm/trade/sia/seminar/index_en.htm

Corporate Social Responsibility (CSR)

Is corporate social responsibility a myth? Are we asking lions and tigers to be vegetarians? No rational manager will operate in a way that erodes shareholder value. If this is the case, then what, in terms of governance, can be done to promote that management decisions on strategy and operations not only reflect the short-term interest of shareholders, but are also based on business ethics and awareness of the environmental and societal interests of the communities affected by corporate operations?

What is the problem?

The end of communist economics has prompted an unparalleled reliance on private sector led growth. In developing countries, "business against poverty" has become a credo and worldwide governments are working to liberalise markets and privatise services formerly defined as public goods. As a result the private sector has a bigger role than ever in our lives. The profit-driven interests of corporations do not necessarily coincide with the sustainable development goals of societies. Private sector entities, whether small businesses or large corporations, are in business for making profit and some of the ways open to companies for increasing profits and shareholder value may harm economic, social or environmental conditions in society.

The instruments developed in OECD countries for regulating company behavior and protecting communities against bad corporate practices have their weaknesses (e.g. Enron in the US). In developing countries, the capacity for regulation is even weaker. In such a situation, companies might neglect the negative impact of their activities. This possibility becomes greater for large corporations such as

multinational enterprises (MNEs), who have the means to effectively influence authorities in host countries. The value-added of Siemens, for example, is larger than the GDP of Vietnam (UNCTAD 2002).

CSR as a solution

The principle of CSR is that business entities should themselves be primarily responsible for ensuring that their operations do not have harmful side effects on the communities and environment in which they operate. The implicit idea behind CSR is that a win-win situation is possible, i.e. that it is in the long term financial interest of shareholders to endorse corporate policies, which aim at building up a good reputation with customers, employees, capital providers and local communities. The corporation thus obtains "a social license to operate" (Solignac-Lecomte, 2002).

Along these lines UN Secretary General Kofi Annan launched the Global Compact initiative in 1999, which calls on the world business community to adopt codes of conducts based on human rights, labour rights and environmental protection. One year later the OECD reviewed its Guidelines for MNEs, which were first drafted in 1976. These voluntary guidelines are endorsed at the international level by OECD member countries and cover MNE best practices, e.g. on employment and industrial relations, environment, combating bribery, and consumer interests. Also the EU has endorsed the CSR concept and the Commission is developing a voluntary code of conduct for businesses operating in and from Europe.

Problems with CSR

Socially responsible behaviour does not come naturally to enterprises. Abiding by CSR principles may increase the short-term costs of business operations and thus impede implementation. CSR is mainly found in small family businesses firmly based in a local community and in large MNEs that have a long-term interest in maintaining a good reputation with their capital providers and in the various societies in which they operate. In the majority of the world business community, however, CSR is not internalised in business culture and corporate governance. For them, the win-win concept is not valid as short-term profit considerations prevail over longer-term considerations. Thus for companies with a short-term planning horizon CSR does not seem to work on a voluntary basis.

How can CSR be improved?

The main question to be addressed is how CSR can be further promoted. The longer-term benefits of complying with CSR principles for companies do not provide sufficient incentives for many of them to adopt such principles. Moreover, the impact of the voluntary initiatives at the international level seems to be limited. Most scope for enforcing and promoting CSR therefore seems to lie at the national and local level, where enforcement capacity is highest. In addition, this will make CSR more responsive to national needs, norms and values.

National and local governments can develop both binding rules and other incentives to promote CSR principles. An example of binding rules is standards for maximum emission of certain pollutants. In addition, they can promote CSR by internalising ("mainstreaming") the CSR concept in domestic legislation and regulations. It can, for example, give preferences to companies that have adopted CSR principles in public procurement, licensing, taxation, stock exchange regulations, and banking and lending regulations. In the past, this has been an effective approach for the promotion of environmental protection in OECD countries. By tightening reporting and accounting practices, public authorities can further promote enterprises to provide relevant information in an accurate and timely manner. These measures would facilitate the monitoring of company behaviour by public sector authorities as well as by civil society interest groups.

Such a package of CSR-oriented regulation would, in combination with the reputational advantages, create powerful incentives to internalise CSR at the company level. With these kinds of institutional incentives for CSR, enterprise stakeholders, civil society organisations, stock exchange regulators, and national and local public authorities would contribute to CSR compliance of enterprises. This could provide the basis for new forms of public-private partnerships in which welfare and job creation are better balanced with social and environmental gains/costs.

Developing countries need support to develop an institutional system for CSR, in which incentives, regulation, monitoring and legal enforcement are carefully balanced. Capacity building and policy support is required for this. The EU can play an important role in this respect.

Further reading:

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UNCTAD (2001), *Social Responsibility*, UNCTAD Series on issues in international investment agreements, UNCTAD/ITE/IIT/22, Geneva.
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Poverty Reduction Strategy Papers (PRSPs)

PRSPs are promoted by the IMF/World Bank as a key instrument for mainstreaming poverty reduction in the development process. The idea is that PRSPs are drawn up by governments in developing countries in consultation with civil society, the private sector and international donor community. Do PRSPs really represent a new instrument and opportunity for poverty reduction, or are they nothing more than a new donor conditionality? How about country ownership and legitimacy of a PRSP in the domestic policy formulation process of developing countries?

What is the problem?

Depending on the definition of poverty, between 600m and 1200m people world wide are either very poor or move in and out of severe poverty conditions. Poverty does not only refer to lack of income, but also, for example, to limited access to food, education and health facilities. Empirical evidence shows that the last two decades of economic growth and multilateral and bilateral development co-operation efforts have done little to reduce this number (UNCTAD 2002). The key assumption that economic growth would automatically trickle down in the reduction of poverty proved to be wrong.

PRSP as the solution

In recognition of this, the World Bank, IMF and most other donors have made poverty reduction the overall objective of their policies. In 1999, the World Bank and IMF developed a new instrument for poverty reduction: the Poverty Reduction Strategy Papers (PRSPs). A PRSP sets out the macroeconomic, structural and social policies and programmes that a country wishes to pursue in order to promote growth and reduce poverty. It includes a budgetary framework and identifies external financing needs.

Ownership and participation are key to the PRSP preparation process. This means that national governments are responsible for the preparation of the PRSP, in consultation with domestic and external stakeholders. These stakeholders include government at different levels, civil society organisations, the private sector, as well as international donors, including the World Bank and IMF. PRSPs are mandatory for countries who want access to concessional lending from IMF/WB and for countries receiving debt relief under the enhanced HIPC (Highly Indebted Poor Countries) initiative. Since its launch in 1999 about 70 low-income countries are developing or implementing PRSPs.

The PRSPs are increasingly seen as a framework for donor co-ordination. Main multilateral and bilateral donors have recognised the merits of PRSPs as framework for donor co-ordination and have to some extent aligned their planning with this initiative.

Problems with PRSPs

There are a number of problems regarding PRSPs, related to the following issues:

- *Ownership*. Effective ownership is hindered for several reasons. Firstly, there is a donor-bias in the PRSPs. Since the papers are partly written as guiding documents for donors, there is an incentive to write them in such a way so as to attract funds. This is not necessarily a beneficial approach for poverty reduction. Secondly, in the PRSPs, developing countries have to conform to the ideas of the International Financial Institutions (IFIs), which support those countries that liberalise their trade and financial markets.
- *Participation*. Most countries do not have established consultation mechanisms. Often the formulators of a PRSP decide which stakeholders to consult. A choice needs to be made among different NGOs, which do not always represent the interests of the poor. Even within the government it often turns out that only a few officials of one ministry are actively involved in the PRSP process. In many countries, PRSPs are not discussed in democratic institutions such as parliaments, despite the fact that PRSPs also include budgetary aspects of policies.
- *Content*. Not all issues that may have an impact on poverty are always included in the PRSP. In particular, there is a lack of attention for the political dimension of poverty. Presidential power, patronage, bribery systems and human rights issues tend to be obscured. Links with private sector development, trade liberalisation and trade capacity building are also often weak.
- *Poverty impact*. Notwithstanding the emphasis on liberalisation, poverty impact assessments of policy recommendations are currently lacking in PRSPs. Many developing countries also have problems in poverty data collection and analysis, and in setting realistic targets for poverty reduction. Constraints on the administrative capacity of countries and lack of resources are important reasons for this.

- *Monitoring*. Most developing countries lack an institutional structure for monitoring the implementation of the PRSP. In particular, public expenditure management systems (PEMs) in developing countries are often too weak to support a meaningful presentation of the overall expenditure programme in the PRSP and to monitor implementation.

What can be done to improve the PRSPs and by whom?

To minimise the donor bias and to improve the legitimacy of the PRSP and its implementation, it seems essential to focus on strengthening country ownership and civil society and private sector participation. Moreover, successful implementation requires broad consensus in society and the prioritisation of the PSRP action plans in government programmes and budgets. This implies the need for increased political commitment and putting the PRSP on the agenda of democratic institutions like parliamentary committees.

To tackle implementation problems, more resources and more capacity is needed in developing countries. An important step seems to be the PRSP Trust Fund established by the WB. This is intended to fund country initiatives that aim: "to institutionalise the participatory process; improve poverty diagnostics; improve public expenditure management systems; improve the prioritisation of public actions; cost policies and programs; undertake poverty and social impact analysis (PSIA); analyse sources of growth; establish monitoring and evaluation systems for the PRSP; and translate and disseminate PRSP documents (WB 2002)". NGOs are also involved in capacity building, in order to improve the consultation process. Major western-based civil society organisations engaged in development co-operation like Oxfam have set up programmes to strengthen the participation of civil society in the PRSP preparation and implementation monitoring.

Further reading:

Oxfam (2002) *Oxfam International Global Initiative on PRSPs (OIGIP)*.
UNCTAD (2002) *From adjustment to poverty reduction: what is new?* Geneva.
World Bank (2002) *Poverty Reduction Strategy Papers, Good practices*.
IMF/World Bank (2002) *Review of the Poverty Reduction Strategy Paper (PRSP) approach: main findings*, 15 March, IDA and IMF, Washington.
World Bank (2001) *World Development Report 2000/2001, Attacking poverty*.
Wolfersohn, J.D. and S. Fischer (2000) *The Comprehensive Development Framework (CDF) and Poverty Reduction Strategy Papers*, a joint note, April 5, 2000.

Integrated Framework

Many developing countries are faced with a multiple set of trade negotiations at bilateral, regional and multilateral levels. It is increasingly being recognised that developing countries have insufficient capacity to formulate and implement trade policy reforms and also within the negotiation process itself. Trade-related capacity building projects have therefore acquired an important place on the aid agenda. One trade-capacity building programme is the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries (IF).

What is the problem?

Many of the least developed countries (LLDCs) have benefited very little, if at all, from trade liberalisation in the past. According to UNCTAD (2002), the share of LLDCs in world trade has decreased over the last two decades, and trade liberalisation has so far not been closely associated with poverty reduction. One explanation for the limited benefits is that trade liberalisation and reforms can only contribute to economic growth and poverty reduction, if they are complemented with support from other policy areas (e.g. macro-economic and regulatory policies). A problem in many LLDCs is that trade policy is not considered a priority, resulting in limited resources for trade and little coordination between trade and other policies. In other words: trade is not "mainstreamed" in national development plans and poverty reduction strategies.

The IF as a solution

To promote the integration of LLDCs into the global economy, the Integrated Framework programme was inaugurated in 1997 by six international agencies: the WTO, IMF, World Bank, UNDP, UNCTAD and ITC. The objective of the IF is "to assist LLDCs to develop a trade integration strategy that will foster sustainable pro-poor growth by embedding trade policies and priorities into national development strategies."

Progress was initially slow and the IF failed to produce the expected results. The IF was therefore revised in 2000. Since then, fourteen countries have been selected to participate in the IF programme.

The IF consists of three phases. The first stage is the preparation of a Diagnostic Trade Integration Study (DTIS). The DTIS assesses the competitiveness of the economy and of sectors that are or may get engaged in international trade. It also identifies the key constraints for the integration of a country into the multilateral trading system and the global economy. Secondly, based on the findings of the DTIS, an action plan is formulated in consultation with all stakeholders. This provides a set of policy recommendations and identifies priority areas for technical assistance to overcome the constraints identified. In the final phase, trade policy priorities are incorporated into the national development plan and PRSP. Priority areas for financing of technical assistance are considered in donor forums, like the World Bank Consultative Group or the UNDP Round Table.

What are the problems with the IF?

The main problem with the current IF is that funds for the IF can only be used for mainstreaming trade policy. Only in limited and exceptional cases, IF Trust Fund resources can be deployed for selected projects. This means that hardly any actual technical assistance is provided under the IF. Moreover, supply-side constraints in LLDCs, which often prove to be among the most important factors that limit the integration of countries into the world economy, cannot be addressed in the IF. In principle, individual agencies or donors must fund the follow-up of the IF, but in practice attracting funds has proven to be difficult.

A second problem is the lack of co-ordination in the IF management process within a country. There is a lack of co-ordination between government and donors, between the public sector and private sector, between different ministries, etc. This makes mainstreaming of trade policy difficult, and also leads to a situation in which very few of the follow-up projects identified are implemented.

Who should do what to improve the IF?

To ensure that trade policy reforms lead to higher economic growth and poverty reduction, it is important that donors follow up priority areas for technical assistance and address supply-side constraints identified under the IF. The EU and its member states, which account for more than 50 percent of official development assistance, should be at the forefront of addressing these issues. The EU can also help improve coordination within the IF by promoting the establishment of an independent secretariat for each IF country. This would facilitate sound communication and co-ordination between the various stakeholders. It could also manage the funding and implementation of an agreed set of projects as a follow-up to the IF.

LLDCs participating in the IF can maximise the benefits of the IF by improving communication between each other, so they can exchange experiences and exert more influence over the activities to be carried out.

Further reading:

Cuthbertson, S. (2002) *Diagnostic Trade Integration Study for Cambodia*, presentation prepared for the EU-LDC Conference 2002

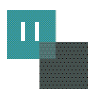
IF website http://if.wto.org

Imani Development (2002) *Malawi Integrated Framework- Case Study and Comments*, paper prepared for the EU-LDC Conference 2002.

Powell, J. (2002) *Concerning the market: The World Bank and Trade Capacity Building*, Bretton Woods Project.

UNCTAD (2002) *Least Developed Countries Report 2002, Escaping the poverty trap*, Geneva.

The proceedings of the conference and the papers presented are available on the EU-LDC Network website:
www.eu-ldc.org



Colophon

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The EU-LDC Network provides a platform for the exchange of information, research, analysis and views on issues pertaining to the evolution of economic relations between Europe and developing countries, most notably in the fields of trade, investment and aid. Through its activities the Network seeks to support informed discussion and debate, to encourage research, and to assist in agenda building on these issues. The ultimate goal of the Network is to help contribute to the design of effective policies for dealing with problems of economic development and, in particular, to address those aspects with a specific 'Europe-developing country' dimension.

The EU-LDC Network is a non-profit foundation, registered in the Netherlands. Between 1993 and 2000, the Network operated on a less formal basis as the EU-LDC Trade and Capital Relations Network. The Ministry of Foreign Affairs of the Netherlands has provided funding to assist in establishing the activities of the Network.

The EU-LDC Network recognises that to build awareness of the needs and sensitivities of the many parties interested in the economic relations between Europe and developing countries requires broad-based dialogue and sharing of experience. To this end, the Network encourages participation from researchers, policy-makers, civil society organisations and other interested individuals and organisations. Network registration, for which there is no charge, is available on-line via the Network's website.

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