CHAPTER 9

Winners without Borders

Integrating poor countries with world markets

Many leaders in Africa called for a political union of the continent at the time of independence. Félix Houphouët-Boigny, Côte d'Ivoire's first president, was more pragmatic, promoting a gradual increase in economic cooperation with neighboring countries. He proposed one of the first regional economic agreements in Africa, the "Conseil de l'Entente," backed by a solidarity fund provided mainly by Côte d'Ivoire. The key elements of the *Entente* were free trade and free movement of people.[1]

The preferred destination of migrants was, naturally, Côte d'Ivoire. Its share of foreigners increased from 5 percent in 1950 to 26 percent of its 16 million people in 1998—making the country one of the top dozen destinations for international migrants in the world. Côte d'Ivoire benefited as foreign workers contributed to export-led growth in industry and agriculture. Sending countries—especially Benin, Burkina Faso, Niger, and Togo—benefited from remittances and increased trade. The political crisis triggered by a coup in 1999 affected the entire region. But Houphouët-Boigny had vested his country's neighbors in its future, earning the nickname of "The Sage of Africa."

Côte d'Ivoire reflects the main lines of argument in this chapter. In today's developed regions—Europe, North America, and Northeast Asia—most economic activities are highly concentrated, their exports are specialized, and living standards are converging. These regions have overcome national borders and have integrated their economies within their neighborhoods and with the rest of the world. Regional and global integration have been complements, not substitutes, in the development of these regions (see box 9.1).

But in most of the developing world, concentration and convergence have been slow, often because of persisting economic, political, and cultural divisions between countries (see chapter 3). These divisions make it hard for countries to take advantage of scale economies (see chapter 4), mobile labor and capital (see chapter 5), and falling transport costs (see chapter 6). Some developing countries have tried to globalize through unilateral liberalization; others have tried to integrate regionally. There have been successes and failures with both strategies. This chapter deals with ways to combine these strategies by increased cooperation among neighbors and strong connections to world markets, while recognizing and avoiding the tradeoffs that can arise between these two approaches.

The chapter proposes regional integration as a mechanism to increase local supply capacity and global integration to improve access to markets and suppliers. Integration means cooperation between countries in trade, domestic regulations and policies, regional infrastructure, and other cross-border initiatives, including public goods. Regional integration implies cooperation within a neighborhood of countries. Global integration implies cooperation at an even wider international level.

This chapter's framework for policy action uses a taxonomy of neighborhoods

to organize thinking about how best to confront the development challenges of each of the developing world's regions.

The main strategies are as follows:

- ***Countries close to large world markets should strive to benefit from proximity to high economic density and become an extension of the large markets.*** Mexico, the Caribbean, the European Union (EU) accession countries, and the Republic of Korea are linked, respectively, with the U.S., EU, and Japanese markets. But integration must go beyond a simple free trade agreement to gain significant development benefits. The biggest challenge is to make domestic markets attractive enough to investors to be seen as an extension of the large market nearby.
- ***Countries with big neighbors but far from world markets should develop their regional market.*** This requires two instruments: institutional reforms that facilitate intraregional trade and factor mobility—and infrastructure investments that link lagging to leading countries and the region to major world markets. Regional integration can naturally support regional production networks. These networks maximize production-cost advantages that come with increasing returns to scale, and they allow small countries to specialize in niche products in regional supplier networks. Greater cost efficiency on the supply side makes it easier for such regions to then integrate with global markets.
- ***Countries far from world markets in Central Asia, the small Pacific Islands, and Sub-Saharan Africa—the world's "bottom billion"—face the stiffest challenges to economic growth and need a strong commitment for cooperative solutions.*** Regional integration can occur in "natural" neighborhoods with three sets of instruments. They need close institutional cooperation and comprehensive regional infrastructure investments, as with the others. But they also may need cross-country compensation mechanisms to sustain the integration effort because deep integration is likely to lead to uneven short-term gains and losses across countries. The international community can support these integration efforts through coordinated incentives.

East, Central, and West Africa fall into the third category. Resource-poor coastal countries in these neighborhoods have been the poorest growth performers in the world relative to other world regions.[2] For them, the Report suggests a pact involving regional governments and the international community to improve social services and human capital in lagging countries and to

BOX 9.1 ***Are the policy messages of this Report anti–global integration? No.***

World Development Report 2009 focuses on regional integration because that is where considerable scope for policy action now lies. But this does not imply that the message is against global integration. Quite the contrary. This chapter argues that regional cooperation boosts the supply capabilities of a neighborhood by providing regional public goods and taking advantage of regional specialization. In this way, it can broaden the gains for each country from global integration. In this sense, regional and global integration are complements, not substitutes. Without global integration, the benefits from regional cooperation would be small or negative, as was true of many past regional agreements. But without regional integration, the benefits from globalization might simply be unattainable for some countries, because they cannot compete on a global scale by themselves.

For many countries, especially in Africa where global export market shares have fallen, the benefits of global integration have been ephemeral. Global integration is sometimes seen as risky, and progress in the Doha Round on several issues central to developing countries, such as agricultural trade, has been slow. In the same vein, past regional cooperation also did not yield significant benefits, and many regional agreements fell apart. Those experiences also highlighted the uneven gains across large and small countries in a neighborhood, which affected the long-term stability of the agreement and the willingness to respond to unexpected events. With many previous efforts at regional integration having failed, the pursuit of further regional agreements has drawn considerable skepticism in development circles.

This chapter argues that, given current conditions, this skepticism is misplaced. Instability stemming from macroeconomic policy and poor governance is far less common today than even a decade ago, so it is less likely that a country will import problems from its neighbor even if their economies are integrated. And with the decline in transport costs and expansion in global trade, the benefits from successful export-led growth are higher than ever. To compete, countries are now more willing to harmonize their policies and institutions with others, so the prospects for regional cooperation have grown substantially. That may be one reason why, in June 2006, 56 regional, 49 regional extension (cooperation between a regional agreement and an individual country), 5 superregional (cooperation between two or more regional agreements), and fully 118 bilateral agreements were signed or initiated under the World Trade Organization (WTO). By acting under the global rules of the game, these agreements strive to recognize and avoid tradeoffs between regional and global integration.

Source: WDR 2009 team.

improve infrastructure in leading countries where takeoff is most likely. This should be augmented by preferential access to developed country markets for regional exports. In return, both leading and lagging countries in these "natural neighborhoods" would allow freer intraregional movements of labor, capital, goods, and services.

Today's developing countries, as latecomers, face a stark choice: stay divided and lose ground, or become winners without borders.

Regional integration to scale up supply, global integration to scale up demand

Some countries, such as Chile, Mauritius, and the well-known East Asian tigers, have integrated globally without much cooperation within their world region. They enjoyed significant first-mover advantages. But many other developing countries have found this hard to achieve, and some wonder if the emergence of highly competitive exporters like India and China makes the likelihood of a successful export-led strategy even lower today.

The counterargument is that the range of goods in which a country can develop a comparative advantage has expanded along with the growth in global trade. Intermediate goods and services, more tradable and traded, provide developing countries with a broader range of diversification opportunities than before.[3] Empirical evidence suggests this is true even for Sub-Saharan Africa.[4] Across individual countries within each of nine Sub-Saharan African neighborhoods, imports in the previous year of intermediate goods from neighbors are positively correlated with total exports in the current year. As the level of intermediate imports grows larger and crosses a threshold, this effect becomes noticeably stronger.

These findings show that higher exports occur when countries cooperate regionally (in terms of scale economies, greater factor mobility, and lower transport costs) as well as integrating globally. Regional cooperation means that firms in neighboring countries can produce final goods more cheaply (by building international supply chains) than they can by relying on suppliers in one country alone (see box 9.2). Global integration provides the demand and incentive to develop such efficient regional supply networks. This combination of regional and global integration has produced successful developers in today's rich neighborhoods.

Plant data add further detail to aggregate econometric findings.[5] Firms exporting to regional markets are hurt more by power outages and inefficient border procedures than are firms exporting to global markets, although firms exporting time-sensitive products such as textiles to global markets are hurt by inefficient borders as well. The efficiency of firms dictates where they sell their products: the least efficient sell only in domestic markets, others serve both regional and domestic markets, and the most efficient are involved in domestic, regional, and international markets.[6]

A successful integration policy will concentrate economic activities in places with better access to markets and inputs, whether subnational, national, or regional. Integration could lead to income divergence in a regional neighborhood for a while, before successive waves of lagging countries catch up with the leading countries as growth spills over to the neighborhood. When the integration process is market driven, as in East Asia, production factors will relocate and promote convergence in country per capita incomes within the neighborhood (see chapter 3). But when it is institution driven, as in most developing neighborhoods today, political economy challenges can become major concerns.[7]

Regional and global integration imply tradeoffs

Regional integration agreements, complex to negotiate, implement, and maintain, are intensive in the use of administrative resources. Efforts to align regional institutions through such agreements can come at the expense of domestic administration and unilateral liberalization that can determine a country's integration with the rest of the world. Regional agreements also prevent countries from pursuing more rapid global integration, when some members within a region want to move more slowly.

BOX 9.2 *Diversifying production through regional cooperation*

Diversifying an economy is no easy task. Hidalgo, Barabasi, and Haussman (2007) show that the current export structure of a country determines how easy it will be to diversify its production base over higher-value products. They use the metaphor of a forest representing the product space (the same for all countries in the world). Each tree is a product, and firms are monkeys that can climb higher on a tree to improve their value added (intensive diversification) or jump to another tree with higher value (extensive diversification).

Developing country firms find it easiest to grow through intensive diversification, which builds on capabilities they already possess. The alternative, required at higher incomes or in response to even lower-cost competitors, is to jump to higher value trees. Even if a country is lucky enough to have such higher value trees close to its production base, the jump remains costly and risky. It may require physical infrastructure, specific know-how, knowledge of the tastes and standards in the targeted markets, and easy and cheap access to specific inputs. Haussman and Rodrik (2003) called these initial investment needs "cost discovery," a search by the first firms to explore these new opportunities. Cost discovery can be facilitated in several ways. Foreign direct investment can provide much of the required information and know-how. So can learning from one's neighbors. Cooperation between neighboring countries can therefore help, providing the scale attractive for foreign investors and the access to critical intermediate goods that makes the leap to a new product less costly and risky. Cooperation can provide an outlet for intermediate goods producers who sell to innovating firms elsewhere in the neighborhood.

When African exports during 1980–2004 are mapped against a global product space of some 800 products (four-digit industries), the Central African Economic and Monetary Community appears to have only a few options for diversification (wood and its manufactures). Members of the East African Community have more options because their exports are more diversified (fruits and vegetables, prepared food, fish, wood and its manufactures, cotton, textiles, low-tech manufactures, metallic products, chemicals, and minerals). Other countries with similar production structures have gone on to diversify into such clusters as cotton, textiles, and garments, which currently enjoy preferences under the African Growth and Opportunity Act in the U.S. market.

Nearly all members of the West African Economic and Monetary Union can benefit from cooperation in at least seven product clusters (fruits and vegetables and their products, wood and its manufactures, cotton, low-tech manufactures, chemicals, and minerals) to reduce their overdependence on traditional agricultural exports, such as coffee and cocoa.

Southern Africa Customs Union members, except for South Africa, can gain significantly more than other unions from cooperation in natural-resource-based and manufacturing clusters, because they have much easier diversification options driven by the logistics, finance, skills, and infrastructure that reflect their middle-income status.

By looking at which areas of economic activity offer the most promise for further development, countries can focus cooperation on sector-specific infrastructure, such as common standards, compliance and metrology systems, and specific curricula to build a skilled labor force and adapt new technologies. That can serve as a complement to the general areas of cooperation in regional infrastructure, better business regulations, and a strong judicial systems.

Based on contributions from Vandana Chandra, Jessica Boccardo, and Israel Osorio.

The regional versus global debate is not new. It revolves around the welfare implications of potential trade diversion and trade creation compared with the first-best welfare- improving effects of unilateral liberalization or multilateralism.[8] Yet a "new regionalism" debate has been launched with the recent proliferation of free trade agreements. One side of this debate sees in regional integration a competitive liberalization process that will ultimately support global integration.[9] The other side sees the emergence of "spaghetti bowls" impeding global integration.[10]

This debate will not be readily concluded. But the lens of the new economic geography gives it a different perspective. Some have argued that when physical geography is properly included in trade models, regional trade agreements can be more welfare improving than multilateral trade agreements if intercontinental transport costs are much higher than intracontinental trade costs.[11] There are also noneconomic gains to regional integration initiatives, such as greater peace and security as well as increased bargaining power in international forums.[12] These noneconomic motives are sometimes more important than the economic in the decision to sign regional integration agreements.

Regional integration can take many forms, from formal treaties regulating many aspects of economic exchange and cooperation to informal, de facto integration that follows from the private sector–led deepening of economic ties. This variety allows for a different dynamic. While global agreements are comprehensive and rare, regional agreements can start small and

move at a pace and scope with which each party is comfortable. Each region needs to find the path that allows it to benefit from both regional and global integration.

Developed neighborhoods provide useful insights—think big, start small

Successful neighborhoods in Europe, North America, and Northeast Asia provide three lessons for the design and implementation of regional and global integration initiatives: think global, start small, and compensate the least fortunate.

Think global. For all developing neighborhoods, the most important export markets are outside the region. The Republic of Korea, Mexico, and Romania are fortunate to be close to one of these large world markets, but most nations are not. The main goal of any regional integration process should thus be to promote sound export-led growth. Indeed, the success factor of regional integration agreements is "open regionalism," setting low external tariffs and suppressing all the internal ones.[13] This is a key difference from the first wave of regionalism in the 1970s, which simply extended inward-looking import-substitution policies from countries to regions.

Start small. Regional integration initiatives do not need to address all issues immediately. Nor do they need to involve a whole continent at once. The Latin American and Sub-Saharan experiences in the 1970s show that comprehensive agreements involving a large number of countries often remain "paper agreements."[14] The European Union started with a narrowly focused agreement—the European Coal and Steel Community (see "Geography in Motion, Overcoming Division in Western Europe"). The North American Free Trade Agreement (NAFTA) started with a free trade agreement for automobiles, between the United States and Canada.[15] East Asia's regionalization accelerated in the 1980s, with Japanese multinationals setting up manufacturing export platforms across the region. Often regional integration can start without a formal agreement of any kind but with a statement of intent for strategic cooperation that gives firms comfort that any disputes will be resolved quickly and fairly.

Regional integration implies complementary policy actions by participating countries. The larger the number of participants, the more complex the coordination, with a higher risk of failure. Specific agreements based on country interest can build variable-geometry regional integration in which countries (or areas within countries as with the "growth triangle" in East Asia) deepen their cooperation at their own speed. Such cooperation on trade and nontrade issues can gradually build a stronger neighborhood. This does not preclude specific continentwide initiatives to carry out projects with high fixed costs, such as launching and maintaining a satellite.

Compensate the least fortunate. Regional integration can produce winners and losers across countries—at least in the short term.[16] If two countries with different domestic infrastructure integrate, the country with the better infrastructure will attract more industrial activities, which may deepen differences in income and employment.[17] Building a sustainable neighborhood of countries with different endowments is thus helped by a compensation mechanism to ensure equitable sharing of the gains from integration. In the EU, rich members subsidize infrastructure development in poorer member nations. In the Association of Southeast Asian Nations (ASEAN), richer member countries have programs specifically designed to assist poorer member countries—the Integrated ASEAN Initiative. Some regions also have bilateral aid programs for their poorer neighbors.

One approach to compensation is pooling customs revenues collected in customs unions and redistributing them according to each member's development needs. The West African Economic and Monetary Union (WAEMU) adopted a common external tariff in 2000, and introduced a 1-percent levy on all third-party imports to build a compensation fund. By September 2006, $500 million had been collected and shared. Côte d'Ivoire and Senegal, the richest members of WAEMU, contributed 60 percent of the funds but received only 12 percent. Such transfers are politically feasible if the wealthier countries realize that they will benefit in

the long run if their neighborhood prospers. Revenue-sharing initiatives are strengthened by the involvement of a developed country as an external partner willing to subsidize the process. The Economic Partnership Agreements (EPAs) currently being negotiated between the EU and African, Caribbean, and Pacific countries are examples (see box 9.3).

Building integrated neighborhoods: a framework

The “thickness” of country borders is a self-imposed obstacle to development, with isolation increasing the economic distance to markets (see chapter 3). On top of division, some neighborhoods have small countries whose local markets are simply not large enough to trigger or sustain industrialization, or that lack the capabilities to diversify and advance up the value chain. Different countries thus face different problems that require different policy responses to integrate them into the global economy. Integration happens largely through private activity in trade and factor mobility. But most of the institutions or infrastructure needed to connect a region to the global economy are public goods, requiring collective action to overcome coordination problems and externalities.

Three types of policy instruments can be used to pursue regional integration. They also help with global integration.

- *Institutional cooperation* can address coordination problems within neighborhoods and foster greater scale economies.

BOX 9.3 *Economic partnership agreements between the EU and African, Caribbean, and Pacific countries can be made better*

Until 2007 the EU granted nonreciprocal trade preferences to African, Caribbean, and Pacific (ACP) countries. This policy did not comply with the WTO principle of most-favored-nation treatment, but got a temporary waiver that expired in December 2007. The economic partnership agreements (EPAs) between the EU and the ACP countries are a new approach to promoting trade and achieving more general development goals at the same time.

In 2003 the EU started negotiating EPAs with six self-defined ACP regions: the Caribbean (CARIFORUM), Central Africa (CEMAC), Southeast Africa (ESA), West Africa (ECOWAS), Southern Africa (SADC), and the Pacific.

At the core of the EPAs are regional trade agreements between the EU and each of the six regions. The export structure from these regions to the EU is heterogeneous, often reflecting dependency on just a few products. But the EPAs are broader in scope. They will extend 100 percent duty-free and quota-free market access into the EU from each region (with simplified EU rules of origin) while permitting ACP countries to open their markets to a lesser extent (on average 80 percent within 15 years).

The goal is ambitious. The EPAs give incentives to ACP countries to increase regional trade and cooperation, unlike the previous arrangements that favored a hub-and-spoke structure, discouraging interaction with neighbors. And while the previous trade preferences were determined unilaterally by the EU, the EPAs are jointly negotiated. Understandably, some countries are unwilling to cooperate on issues in which they might lose. But the EU can provide incentives—like aid—to help overcome such differences.

Experience shows, however, that (North-South) trade liberalization alone does not promote economic development. So the EPAs try to improve the coherence between trade and development. Besides trade in goods, the EPAs include trade in services as well as investment, public procurement, and competition law. Although the agreements on trade of goods and services are about mutual—though asymmetric—trade liberalization, the trade-related issues follow another route. They aim to support regional integration by common regional regulation, harmonization, and implementation, thus improving political and economic stability and creating a better business and investment climate.

One of the most difficult issues is the expected loss in tariff revenues, which are, on average, about 2 percent of gross domestic product (GDP) for Sub-Saharan countries. But for some, the loss can be 4 to 6 percent of GDP, a sizable fraction of the public purse. A phased reduction in tariffs is designed to mitigate big declines in government revenues. Over the long term, the lost tariff revenues need to be replaced through reforms of domestic tax and tax administration. A more radical approach would be for the EU to provide budget support to the most affected countries over a predetermined transition period.

Another issue involves complicated rules of origin that need to be simplified and liberalized. Technical assistance is also needed to enable developing countries to fulfill EU standards and stimulate a supply response to enhanced market access. “Aid-for-trade” programs provide resources for such efforts.

Contributed by Sebastian Vollmer.

- *Regional infrastructure,* strategically linking the neighborhood to the leading world markets, can reduce transport costs.
- *Coordinated incentives* involving all the neighborhood's stakeholders and donors from the leading world markets can promote factor mobility and converging living standards between leading and lagging countries in the neighborhood.

Institutional cooperation

Behind-the-border reforms. Institutional cooperation—such as mutual recognition agreements on technical and business procedures, adoption of international standards, and macroeconomic convergence frameworks—expands the size of regional markets, supporting scale economies. Indeed, domestic and foreign firms assess investment opportunities and related government policies and the business environment—such as property rights, regulation, taxes, finance, infrastructure, corruption, and macroeconomic stability—as part of a package that determines a country's attractiveness for investment.[18] Another part is the quality of the legal system, which increases equity investments and firm sizes.[19] These effects spill over even to countries with better institutional endowments in leading world markets. The less attractive the neighborhood of a country, the less attractive the individual country, particularly when its local market is tiny.

Now that tariff preferences have fallen, behind-the-border barriers are more important determinants of the pattern of trade. And by aligning domestic and international standards and institutions, a neighborhood can improve its attractiveness for foreign direct investment (FDI) and increase its opportunities for trade, particularly important given the need to connect to regional and global production networks and markets. For instance, the crisis facing the fish-processing sector in Kenya in the 1990s would have been less severe if raw and semi-processed fish providers in Kenya, Tanzania, and Uganda had all cooperated to adjust to EU hygiene standards.[20] Many countries in Sub-Saharan Africa are now aiming for such cooperation.[21]

At-the-border policies. Facilitating the flow of capital, labor, and intermediate inputs is a precondition for cross-border production networks. The WTO provides a framework for such liberalization that permits the scope of agreements to vary. Almost all new regional trade agreements include provisions on service liberalization, but some of these services are embodied in people and require corresponding agreement on labor mobility, on which there is little uniformity (see table 9.1).[22] Movement of labor raises economic and political concerns that appear to be far higher than for traded goods or investments, so few agreements provide the kind of mobility required for countries and people to benefit fully.

Financial and monetary cooperation improves capital mobility and increases a region's attractiveness to FDI, especially for small countries.[23] Indeed, small financial markets tend to be less competitive and less efficient because they cannot exploit the substantial economies of scale in financial markets. Some market segments may be missing, and small markets are less able to diversify investments and operational risks. The regulatory structure tends to be more costly and of lower quality in small markets, and ancillary services such as credit information are more difficult to maintain. Regional and global trade in financial services is the best

Table 9.1 Few regional agreements provide for full mobility of labor

Degree of mobility stipulated	Agreement
Full labor mobility	European Union, Agreement on the European Economic Area, European Free Trade Association, Australia–New Zealand Closer Economic Relations, Economic Community of West African States
Market access for certain groups	Caribbean Community, North American Free Trade Agreement, Europe agreements, Group of Three, and Canada-Chile, U.S.-Singapore, U.S.-Chile, Japan-Singapore Free Trade Agreements
Based on GATS mode 4, with additional provisions or limitations	ASEAN Free Trade Area, Euro-Med Association Agreements, New Zealand–Singapore Closer Economic Partnership, Southern Common Market agreement, and EU-Mexico, EU-Chile, MERCOSUR, U.S.-Jordan Free Trade agreements
No effective provisions for labor mobility	Asia Pacific Economic Cooperation Forum, South Asian Association for Regional Cooperation, Central European Free Trade Agreement, and Common Market for Eastern and Southern Africa

Source: World Bank 2004a, updated by the WDR 2009 team.
Note: ASEAN = Association of Southeast Asian Nations; GATS = General Agreement on Trade in Services; MERCOSUR = Southern Common Market.

way to cope with being small—by opening national markets to foreign financial intermediaries, by fully or partially integrating with a regional financial system, and by gradually opening national markets to international capital flows. The benefits of regional financial integration increase as a group of countries moves toward a single currency, a single central bank, and a single licensing and regulatory system for financial services firms.[24] But such integration also reduces the policy flexibility in responding to shocks.

Efforts beyond borders. Developing countries, particularly the landlocked, are hurt by high transport costs due to expensive and unreliable freight services. They have overregulated transport sectors, inefficient logistics services, oligopolistic freight forwarders, as well as roadblocks and demands for bribes along international corridors.[25] Each day a product is delayed before being shipped is estimated to translate into an increase in the distance to its trading partners by 70 kilometers, reducing its trade volume by 1 percent.[26] Landlocked countries, in particular, would enjoy greater exports if their neighbors improved the quality of their transport logistics and customs procedures: it is estimated that a one standard deviation improvement in a landlocked country's logistics together with one standard deviation improvement in its neighbors' logistics would raise the landlocked country's exports by 74 percent.[27]

Beyond-the-border institutional reforms facilitating trade and transport in a neighborhood can greatly increase the efficiency and reliability of logistics chains. Central Asia and Sub-Saharan Africa, whose international competitiveness is seriously affected by high transport costs, are now exploring corridor approaches that have worked well elsewhere, as in Southeastern Europe.[28]

In 1998 six countries asked for World Bank support in designing a regional program of trade and transport facilitation in Southeast Europe. By 2004 eight countries were involved: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Moldova, Romania, and Serbia and Montenegro. The initiative reduces transport costs, fights corruption, and helps customs administrations gradually align their procedures with EU standards. The goals are to reduce the processing time for traders and transporters, reduce facilitation payments, reduce corruption related to international transport and trade, and improve the effectiveness of controls and antismuggling efforts. The results provide an encouraging precedent for replicating and scaling up regional trade elsewhere.

Regional infrastructure

Regional transport infrastructure reduces the economic distance between trading partners, both within the neighborhood and between the neighborhood and leading world markets. Electricity, water, telephone lines, and Internet access all raise productivity but are severely inadequate in many developing regions (see table 9.2). Many countries could benefit by coordinating and cooperating in infrastructure provision. Hydropower development launched in 1997 by Mali, Mauritania, and Senegal lowered costs and improved access, reliability, and quality of electricity supply.[29] The East Caribbean telecommunications project, implemented in 1998, increased access to telecom services, reduced prices, and increased employment opportunities.

Table 9.2 Sub-Saharan Africa, South Asia, and the Middle East and North Africa are most affected by unreliable infrastructure, East Asia the least

	World regions						
	EAP	ECA	LAC	MNA	SAR	SSA	OECD
Delay in obtaining an electrical connection (days)	19.4	9.3	32.9	53.7	**56.3**	43.8	9.7
Number of electrical outages (days)	9.3	14.0	17.8	46.1	**121.5**	56.4	1.5
Value lost due to electrical outages (% of sales)	2.5	3.1	3.6	4.2	5.6	**5.7**	2.3
Number of water supply failures (days)	3.5	7.5	14.5	41.7	12.0	**37.2**	0.3
Delay in obtaining a mainline telephone connection (days)	15.8	13.4	45.1	49.9	**66.3**	58.4	9.0
Firms using the Web in interaction with clients/suppliers (%)	23.7	56.7	40.9	34.2	29.2	**20.4**	80.2

Source: World Bank ICA database.
Note: EAP = East Asia and the Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MNA = Middle East and North Africa; SAR = South Asia Region; SSA = Sub-Saharan Africa; OECD = Organisation for Economic Co-operation and Development.

Regional infrastructure is an important part of regional integration, but it often requires considerable outside financial support because the upfront costs can be high. Cross-border project preparation is complex, and individual countries may not have local capacity to conceptualize the technical design and to build a consensus.[30] And the legal and regulatory framework to facilitate the provision of cross-border infrastructure is often lacking. All these constraints can prevent promising regional infrastructure projects from getting to the bankable stage.

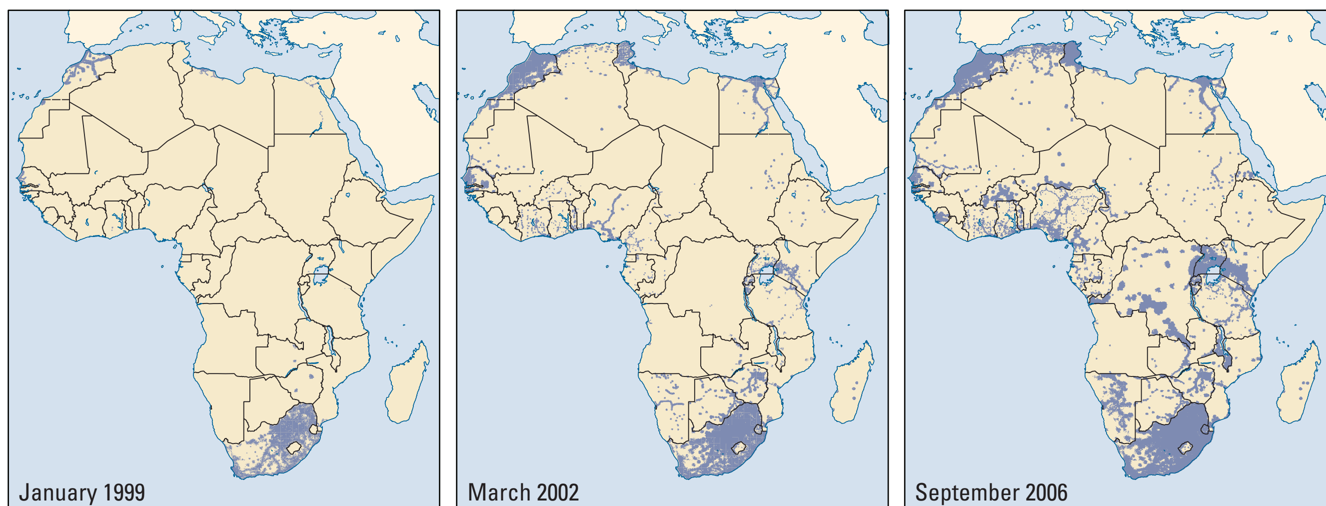
Three types of regional infrastructure and related services enhance scale economies, factor mobility, and trade between countries.

Productivity-enhancing regional infrastructure. Power, mobile phones, Internet connectivity, and major trunk roads can all generate revenue through fees. The productivity increases from these infrastructure services translate into a high willingness to pay. Private firms will provide regional infrastructure when it is profitable—as with the South Atlantic 3 (SAT3) marine cable connecting West Africa to the global fiber optic network, or the Regional African Satellite Communications Organization (RASCOM) public-private partnership to provide satellite telecommunications coverage in Africa. Regional cooperation can provide a sound regulatory framework that, for example, permits free access of neighboring countries to the backbone infrastructure and free entry by firms into national markets. But the rapid spread of mobile phone coverage in Africa still leaves out many areas (see map 9.1).

Mobility-enhancing regional infrastructure. Cooperation in higher education and training can not only increase the endowment of skilled workers but also enhance labor mobility as students from different countries establish cross-country networks.[31] French cooperation and the EU Commission sponsor a network of three statistical schools in Abidjan (*Ecole Nationale Supérieure de Statistique et d'Economie Appliquée,* ENSEA), Dakar (*Ecole Nationale d'Economie Appliqué,* ENEA), and Yaoundé (*Institut Sous-regional de Statistique et d'Economie Appliqué,* ISSEA), training highly qualified statisticians for French-speaking African private and public enterprises.[32] Recognizing the importance of mobility-enhancing regional infrastructures, a high-level panel of the African Development Bank has proposed centers of excellence in research, tertiary education, and vocational training in collaboration with the private sector.[33]

Trade-enhancing regional infrastructure. Good transport infrastructure reduces transport costs, which in turn increases trade flows.[34] Some observers have argued that there is little potential for intraregional trade within developing neighborhoods

Map 9.1 Mobile phone coverage has spread rapidly in Africa
Global System for Mobile communications network coverage



Source: Buys and others 2008.

because the small size of economies will not create significant trade flows.[35] If so, improving the quality of regional roads would have no impact on intraregional trade. But recent studies suggest otherwise.

Trade models show that regional investments to pave all the unpaved interstate roads would increase the intraregional trade of West African countries threefold—and boost the region's trade with the rest of the world.[36] Upgrading the main highway network in Sub-Saharan Africa could expand overland trade by about $250 billion over 15 years, with major benefits for the rural poor, while requiring about $20 billion for initial upgrades and $1 billion annually for maintenance.[37] In Central Asia road upgrades could increase trade by half, exceeding the expected gains from tariff reductions or trade facilitation programs of comparable scope. Total intraregional trade in Eastern Europe and Central Asia could be increased 30 percent by upgrading roads in just Albania, Hungary, and Romania.[38]

Coordinated incentives

Coordinated incentives can address market failures and disputes between countries in a regional association. The Central American Common Market, created in 1960 by El Salvador, Guatemala, Honduras, and Nicaragua, faced periodic complaints about redistributing benefits to Honduras and Nicaragua. The agreement collapsed in 1969 following conflict between El Salvador and Honduras. Some studies suggest that the underlying reason for the collapse was that El Salvador gained much more from regional cooperation because of its better infrastructure.[39] In 1977 the East African Community of Kenya, Tanzania, and Uganda also collapsed after disagreements over the benefits that would be received from common regional services such as airline, harbors, and telecommunications—as well as over ideological differences.[40] Sound compensation mechanisms and better communication about longer-term gains for all participants can reduce the risk of failure of such initiatives.[41]

Consider a taxonomy that incorporates the three essential properties of public goods: nonrivalry, nonexcludability, and aggregated contributions (see table 9.3).[42]

- *Nonrivalry* implies that several groups or individuals can consume the good without diminishing its value. Clean air and water are common examples.
- *Nonexcludability* means that no one can be prevented from consuming the good. There is an incentive to leave the cost of provision to a third party.
- *Aggregated contributions* relate to resource pooling to finance public goods. Commonly, the willingness to contribute decays over time.

Each of these properties requires a coordinated response or some mechanism for equitably matching benefits and costs, or else the good will be underprovided. The quantity and quality of the public good both depend on member contributions. In some instances,

Table 9.3 Regional "club goods" can easily be provided because costless exclusion is possible
Regional public goods, types, and examples

Impact of aggregated contributions	Pure public goods (nonrival, nonexcludable)	Impure public goods	
		Goods for which exclusion is easy	Shared public services
Each contribution has the same impact on the quality and quantity	A clean lake	Transnational park	Preserving the rain forest
Countries more interested in the good can contribute more	Curbing the spread of HIV/AIDS	Power grid	Eliminating transnational terrorist threats
Contribution of weakest member determines the quantity and quality	Implementing international financial standards	Airport hub-spoke network	Preventing and mitigating natural disasters
Contributions of weaker members determines the quantity and quality	Forestalling the spread of pests	Transport infrastructure	Providing Internet connectivity
Contribution of leading countries determines the quantity and quality	Eradication of a disease	Satellite launch facility	Regional peacekeeping
Contribution of strongest member determines the quantity and quality	Discovering an effective treatment	Biohazard facility	Agricultural research and bioprospecting

Sources: Sandler 2002, adapted by the WDR 2009 team.

each member is equally important. In others, the public good depends on the weakest or strongest member, or some combination. This taxonomy suggests that the nature of regional cooperation varies depending on the goal.

When the regional public good is sensitive to the performance of the weaker members, as in a hub-and-spoke airport network, the challenge for the other members is to raise the performance of the weaker links to an acceptable standard. This can be done through cross-country subsidies, as in the EU structural funds. In poor neighborhoods, foreign aid may be the only feasible way to ensure the provision of such public goods. If the good depends on the best-performing member of the neighborhood, such as targeted agricultural research, the weaker members may be asked to contribute to stronger members, or foreign assistance can facilitate its provision.[43]

Trust is especially important in regional cooperation. For the waters of the Nile, the Arab Republic of Egypt and Sudan, two countries that were culturally and politically closer, built the Aswan High Dam near their common border instead of cooperating with Ethiopia, where a dam might have been more efficient for the electricity and water needs of all three countries.[44] International organizations can help build trust, as in the Aral Sea Basin rehabilitation. Another example is the "development diplomacy" used to resolve the Indus River Basin dispute between India and Pakistan, with the World Bank facilitating cooperation. This diplomacy was recognized by the then–World Bank President Eugene Black as "the most important thing the Bank has ever done, by far."[45]

Specific regional agreements can get things started, but they can also lead to multiple and at times overlapping agreements, weakening coordination. Many developing regions need to rationalize their regional economic communities and clarify relations with river basin or power pool organizations.[46] Broader regional agreements can foster trust, provide an institutional framework for compensation that facilitates bargaining, and allow for more effective sanctions.[47] The Southern African Development Community (SADC), for instance, promoted the Southern Africa Power Pool to take advantage of the distribution of power sources in the region. The Central American Electricity Connection System was initiated in 2005 under the umbrella of the Central American Common Market (CACM). So an umbrella agreement can spawn smaller agreements, or small agreements can be consolidated into umbrella agreements. The path is a tactical choice.

In the same vein, there is a choice between starting with aggregate political agreements, as in the EU enlargement, or starting with economic ties, as in East Asia, with ASEAN+3. Both approaches have seen success and failure. The United Arab Republic joining Egypt and Syria in 1958 foundered in part because of its limited economic advantages. The First East African Community started in 1967 as an economic grouping, but collapsed 10 years later because of political divisions between the major countries. It has since been revived, but the forces for economic and political union remain divided.

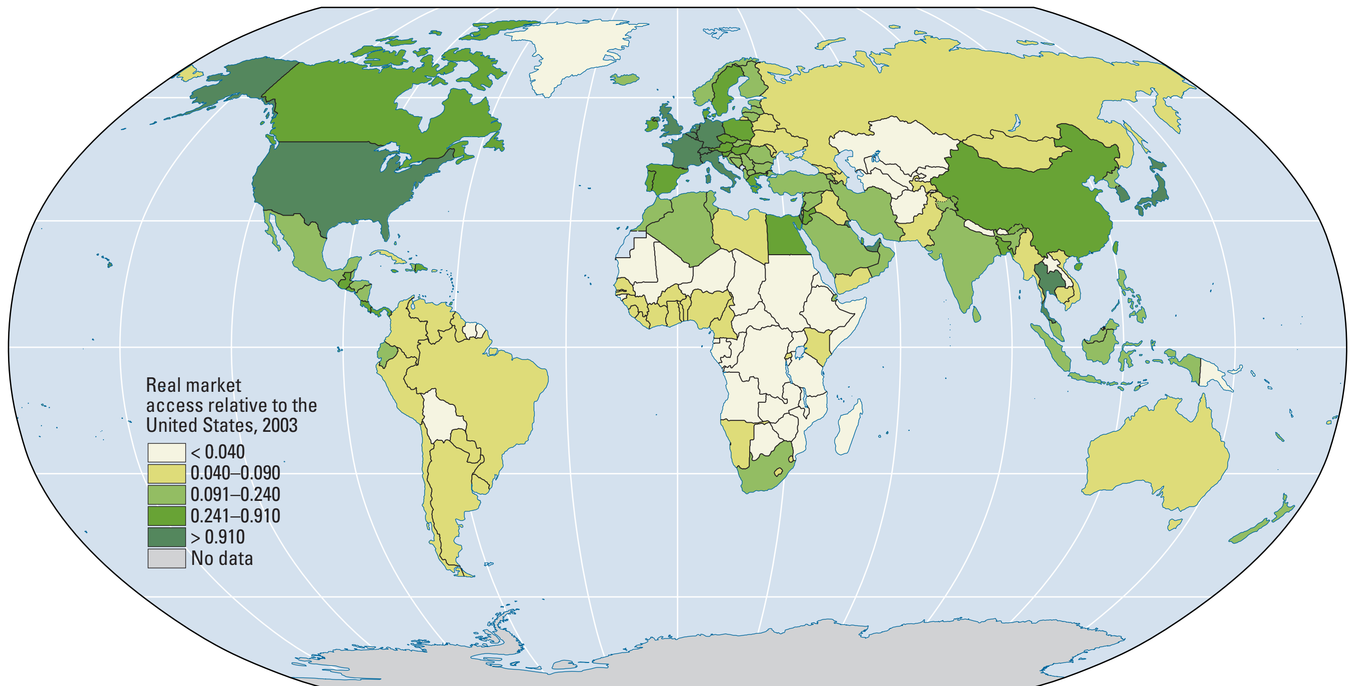
The geography of regional integration

Looking at the world's neighborhoods through the lens of market access highlights the role of the three major world markets: Europe, North America, and Northeast Asia, rich neighborhoods where most of the world GDP is clustered (see chapter 3). Proximity to these markets, the thickness of borders, and the fragmentation of world regions reveal the potential market access of all countries (see map 9.2).[48]

Adding up the country scores for potential market access produces three broad types of developing regions:

- *Type 1 countries are in regions close to large world markets,* where the market access score is dominated by proximity to the densest areas in the world. They include those on the periphery of the two largest markets: North America and Western Europe. The neighborhoods are Central America and the Caribbean, Eastern Europe, and the Middle East and North Africa.

Map 9.2 Density, distance, and division combine to determine access to markets
Real market access, relative to the United States in 2003



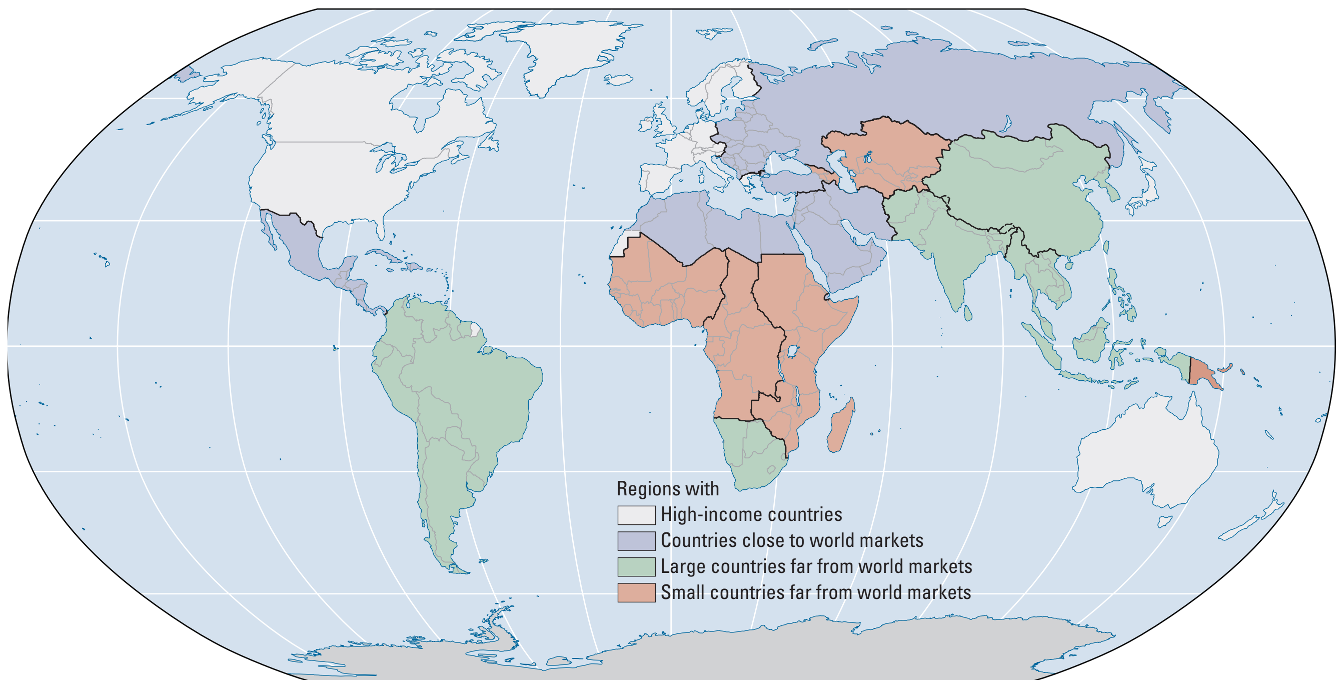
Source: Mayer 2008 for this Report.
Note: To compute potential market access: Each country is assigned a score for the size of its own market (real GDP) and the size of international markets with which it can trade. This is computed by weighting the GDP of other countries by the inverse of a measure that combines physical distance, transport costs, and barriers to trade to show how difficult it is to access these markets. The measure, which is expressed relative to the market access of the United States, essentially combines all three spatial dimensions of density, distance, and division into a composite of potential market access. This map is a complement to the map showing foreign market access in box 6.6.

For these countries, the major problem is division between themselves and major markets. The main instruments for integration will be *institutional:* formal regional trade agreements, more limited sector-specific agreements (on labor mobility or natural resource-sharing), and harmonization of standards and regulations—all implemented with or without formal regional bodies.

- *Type 2 countries are in regions with big neighbors far from world markets.* They include the neighborhoods of the developing world's giants—Brazil, China, India, and South Africa. Although these are potentially large markets, growth has not yet been sustained long enough and many domestic distortions remain.[49] Integration with them runs a risk—to different degrees in different parts of the world—of exposing a neighbor to volatility and of importing inefficiency from the large neighbors' domestic structures. But because their market potential is attractive to enterprises in Europe and North America, they can serve as a conduit to accessing markets everywhere. In some regions, like those in South Asia, political considerations also preclude economic integration of all the countries in the neighborhood.

These countries have moderate market access potential (see map 9.3). Their distance from major markets holds down their overall score, but the presence of large developing country neighbors can offset this score to some degree. Brazil, China, Nigeria, the Russian Federation, and South Africa are examples of large emerging economies that add considerably to the market access scores of their immediate neighbors. For countries in these neighborhoods, division is compounded by distance. Appropriate instruments include *institutional* and *infrastructure* development, including regionally shared utilities, transport corridors and hubs, and a range of other regional public goods.

Map 9.3 Potential access to major world markets distinguishes the developing world's regions



Source: WDR 2009 team.

- *Type 3 countries are in regions far from world markets, without a big neighbor.* They make up the "bottom billion" described in Collier (2007) and consist of Central Africa, Central Asia and Caucasus, East Africa, the small Pacific Islands, and West Africa. Many of these countries are falling behind because they are trapped in conflict, suffer from a natural resource curse, are landlocked with bad neighbors, or are small with bad governance.

  A range of countries, mostly small, have low market access potential. Having to contend with being far from major markets, these countries face division, distance, and low economic density. In addition to *institutional* and *infrastructure* instruments, they need coordinated *incentives* for regional integration. The incentives include transfers from customs unions and other revenue sources, direct aid, and preferential market access, such as relaxed rules of origin.

All three types of countries have much lower market access potential than rich countries, implying considerable potential for more effective economic integration. But their persistent divisions from major world markets pose barriers to the beneficial flows of people, goods, capital, and ideas.

For each of these country types, the economic integration strategies and priorities will differ (see table 9.4). As the potential for market access becomes lower, the complexity of the integration problem becomes greater, and a broader range of instruments is required to manage integration effectively. For each dimension of the integration challenge, this chapter proposes an instrument for integration—"an I for a D."

Some countries do not fit neatly into any of these three types, such as Chile and Russia. Chile is a relatively small country far from major markets. But it has grown by exporting to world markets without significant regional integration. Russia is another special case because of its peculiar economic geography that spans eleven time zones, connected to Europe at its most populated and most developed western part, and connected with Northeast Asia through the inhospitable and sparsely populated Siberia.[50] One part of Russia, and some of the former Soviet republics with political and economic ties, could be considered a neighborhood with a big country far from world markets. But given that its economic center is in the western part, Russia is more

Table 9.4 An instrument per dimension—a simple framework for regional integration

	Region or neighborhood		
	Close to world markets	**With big countries far from world markets**	**Small countries far from world markets**
World neighborhoods	Central America and Caribbean, North Africa, Middle East	South America, Southern Africa, East Asia, South Asia	Central Africa, East Africa, West Africa, Central Asia and Caucasus, small Pacific Islands
Dimensions of the regional integration challenge	International division (1-D)	Regional division, economic distance (2-D)	International division, economic distance, low density (3-D)
What policy instruments should facilitate	Integration with large nearby markets	Regional integration Regional and global connectivity	Regional integration Regional and global connectivity Regional compensation mechanisms
Priority instruments			
Institutions	Agreements on trade and factor mobility within region and with large markets nearby	Agreements on trade and factor mobility within region and with large markets nearby Regional provision of public goods	Agreements on trade and factor mobility within region Shared facilities (research, central banks, regulatory bodies)
Infrastructure		Transport corridors connecting to large regional economy Regional power grids, telecoms, water management	Hub-and-spoke infrastructure Regional power grids, telecoms, water management
Incentives			Subsidized human development investments in lagging countries and areas Productive investments in leading countries and areas Preferential market access

Source: WDR 2009 team.

appropriately considered close to world markets.

Russia also highlights the point that the concept of market potential is not countrywide but more spatially specific. It is convenient to measure it as a single number for all localities within a country, but many developing economies have areas where markets in other countries are potentially more accessible than their own domestic markets because of poor local infrastructure. Northern areas of Pakistan are closer to Afghanistan and western China than to the major markets in Karachi and Lahore. Medan in Indonesia is closer to Penang in Malaysia than it is to its own capital city. The principles of economic integration in the real world and the use of the instruments can be applied as readily at the subnational level as at the country level (see table 9.4).

The framework in action

What concrete steps can countries take toward regional integration to build better neighborhoods and increase global competitiveness?

Integration options for countries close to world markets

Market access is essential for growth, and proximity is an asset for just-in-time production. Many examples in car manufacturing and in segments of the garment industry demand short-term repeat orders. Perishable goods (fresh fruits and vegetables) are easier to export to nearby markets. Tradable services—such as marketing, research, and complex information technology tasks—benefit from frequent face-to-face interaction, easier if the client is nearby. Countries close to world markets thus have an intrinsic advantage in connecting to markets, suppliers, and ideas. Conversely, for the wealthy world regions—Europe, North America, and Northeast Asia—neighboring developing regions expand their growth potential as domestic markets mature, while also delivering lower-cost platforms for their firms. There are mutual gains to regional cooperation and ongoing processes to further deepen integration.

The Euro-Mediterranean Forum is a long-standing coordination mechanism

between Europe, the Middle East, and North Africa. The Caribbean Basin has benefited from privileged access to the U.S. market through various preferential trade schemes, including NAFTA, the Caribbean Basin Initiative, and the Dominican Republic–Central America Free Trade Agreement (DR-CAFTA). China, Japan, and the Republic of Korea are intensifying their relations with Southeast Asian countries through the ASEAN+3 initiative. The long-term benefits are clear to all sides, but the short-term risks and adjustment costs have to be managed.

Institutional reform. The key for countries close to world markets is to undertake institutional reforms and improve domestic governance to fully integrate with the large markets nearby. Free trade alone does not bring the full benefits of integration. Although Turkey has had a free trade agreement with the EU for many years, it did not receive significant FDI until it embarked on major institutional reforms associated with membership talks. The policies and governance standards in countries close to large world markets have to converge with those in the nearby high-income region. Indeed, multinational firms are more likely to locate in a country if it has both institutional and physical connections to a larger market. The large market nearby also has a strong incentive to foster sound policy and governance frameworks in nearby small markets to ensure the stability of its neighborhood. These two factors make the coordination of national policies in neighborhoods close to large world markets both desirable and feasible. The prospect of joining the EU has accelerated the pace of reform in Central Europe. And the prospect of better access to the U.S. market triggered policy reforms in Mexico long before NAFTA took effect.[51]

Institutional reforms include moving to a sound macroeconomic environment that contains inflation and an efficient fiscal system that does not rely on distorted trade policies for budget revenues. They also include establishing a sound institutional framework that limits corruption and improves governance. The Stabilization and Association Agreements between the EU and the Balkans specify the legal and regulatory reforms to be undertaken before joining the EU. The Balkans also have signed an intraregional free trade agreement, the Central European Free Trade Agreement (CEFTA), to replace the patchwork of 32 bilateral agreements formerly governing their intraregional trade. The new agreement simplifies and harmonizes rules of origin and extends the trade and transport facilitation initiative launched in 2000. The region has also established a common power market and signed an open sky agreement with the EU that could boost tourism.

The Balkan region is close enough to the EU to permit tight integration of its companies into pan-European production networks. Governments can facilitate regional production chains linking their supply capacity to that of the EU by signing mutual recognition agreements, conformity assessments, and other trade-related coordination initiatives. Besides trade promotion, government policies can attract direct investment by multinationals to help countries move from agriculture and basic manufacturing to higher technology production. In the 1990s El Salvador and Costa Rica diversified their exports from traditional products (coffee for El Salvador and bananas for Costa Rica) by developing export processing zones, tax incentives, and FDI promotion in high-tech activities. They more than doubled their exports in a decade. In Costa Rica and Mexico, human capital and FDI have jointly stimulated knowledge-intensive manufacturing activities.[52]

Small countries usually lack the economic and political weight to bargain with wealthier regions. But the Caribbean Regional Negotiating Machinery, created in 1997, has the goal of formulating and implementing a joint Caribbean negotiating strategy in international trade forums.[53] The countries now have technical specialists to deal with each area of negotiations in the WTO. The machinery also facilitates the transition of Caribbean Community (CARICOM) countries toward a single market, with a common external tariff as

the basis for a common trade policy. And it has been involved in the negotiations of the EPA between the EU and CARICOM.

To enter the world market for tradable accounting and back-office functions, countries need an efficient telecommunication system and a highly educated workforce. The small countries of the Caribbean region have pooled resources to establish the Eastern Caribbean Telecommunications Authority (ECTEL) and the Caribbean Knowledge and Learning Network (CKLN).

Contrast that with the lack of coordination in the Middle East and North Africa. The regional economy is based mainly on oil revenue and cannot create enough jobs for the 4.2 million people added to the labor force every year.[54] Governments in the region have started the transition to manufacturing and services, but the region's investment climate is still weak. The Pan-Arab Free Trade Area (PAFTA) and the Arab Maghreb Union (AMU) have had little impact on export performance. The declining imports from the rest of the world accompanying the increase in intra-PAFTA and intra-AMU exports suggest that the agreements have been more trade diverting than trade creating.[55] The region could take greater advantage of its proximity to European markets by increasing exports of high-value agricultural products, especially in the winter. But agricultural expansion will put pressure on scarce water resources, so regional agreements for water management and use are essential.[56]

Integration options for countries with big neighbors but distant from world markets

A large home market gives countries an advantage in attracting industrial activities. If this market is also well connected to world markets, this advantage is reinforced. But the second group of countries is far from world markets. South America is farther than Central America and the Caribbean from the U.S. market and even farther from the EU and Northeast Asian markets. South Asia is far from Northeast Asia. Southern Africa is far from all three large world markets. Countries in these distant regions should try to bridge the gap with world markets by reducing border barriers, but they suffer from late-mover disadvantages in major markets. They can complement their global integration with efforts to build a stronger regional market centered on a large neighbor.

The competitive advantage of neighborhoods with big countries is size: large local markets, abundant human capital, and substantial remittances. Economic activities generating scale economies—such as petroleum and coal products, refineries, pharmaceuticals, electric and electronic machinery, iron and steel, instruments, and nonelectrical machinery—benefit from being concentrated in leading countries that have strong agglomeration economies and better market access.[57] Because most investment in these sectors will go to those countries, usually the largest in the region, this creates tensions. The challenges are to balance political and economic concerns between leading and lagging countries, to ensure spillovers of direct and indirect benefits to lagging countries, and to compete with neighborhoods close to world markets and such emerging economic powers as China and Russia.

Meeting these challenges of division and distance requires institutions to ensure policies and governance that promote trade, factor mobility, and regional growth—and *infrastructure* to connect lagging and leading countries, link regional economic centers, and favor regional production networks integrated with the global economy.

Institutional reform to improve regional integration. The provision of public goods within a region depends on each member to a differing degree according to the good (see table 9.3). Although regional cooperation is sometimes seen as a process to be led by the strongest member economy, this is valid only for certain types of regional public goods, perhaps peacekeeping, research, and specialized shared infrastructure, such as biohazard facilities or satellite launch sites. For other types of goods, mainly network related, institutional reforms depend on the contributions of the weaker members of the region. In these cases, some assistance to build the capabilities of weaker

member states can promote overall regional integration.

Countries grow faster when other countries in their neighborhood are also growing, as several studies confirm.[58] For small countries far from world markets but close to a large developing country, their best prospects often lie in growth in the dominant economy.[59] Regional growth centers are one reason for regional economic groupings and for regional peer surveillance. What happens in one's neighborhood, good or bad, is too important to one's own development prospects to ignore.

Economic advantage may not be the sole determinant of regional integration prospects. Conflict in South Asia after the end of the British colonial rule in 1947 prevented the neighborhood from taking advantage of its market size, more than a fifth of the world's people. It took four decades before trade volumes between India and Pakistan passed those of the early 1950s.[60] A recent study estimates that trade between India and Pakistan would increase by 405 percent if the territorial and political disputes were resolved.[61] In 2004 the two countries engaged in the "Composite Dialogue" on peace and security issues, including terrorism and drug trafficking, confidence-building, economic and commercial cooperation, and friendly exchanges in various fields. On a broader regional basis, the South Asian Association for Regional Cooperation is a forum to discuss development challenges, such as cooperation in energy production and water basin management. The burden is on India, the largest country by far in the neighborhood, to take the lead in promoting the common agenda.[62]

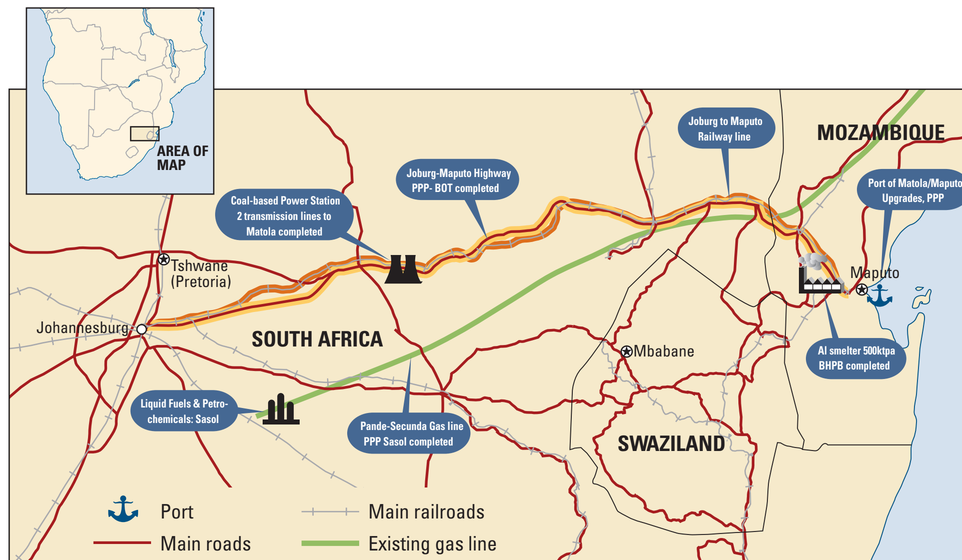
Zimbabwe's political instability since 1998 has dimmed growth prospects in the Southern African neighborhood. Attempts to mediate by the African Union and the SADC have brought limited results. South Africa, the largest country in the Southern Africa Customs Union, has a large interest in a stable neighborhood. But the large rents from natural resources along regional transport corridors are realized even during conflict, though most of the benefits are not shared widely. So economic reasons may be unlikely to provide enough incentives, and the growing political crisis poses risks to the effectiveness of deeper regional integration.

Investments in cross-country infrastructure to connect regional markets. In neighborhoods with big countries distant from world markets, the costs and benefits of cross-country infrastructure can differ between large and small countries in the neighborhood. Where the distribution of benefits differs from the proposed sharing of the costs, there may be underinvestment in such infrastructure. One example is a landlocked country such as Bolivia or Paraguay that needs access to the coast to export its products. International transit agreements guarantee this right to landlocked countries, but since they are not always enforced, support from the international community, or from regional institutions, may be necessary. Another example is the potential for better infrastructure to link India's northeastern lagging regions and Bangladesh, Bhutan, and Nepal. The South Asia Subregional Economic Cooperation (SASEC) initiative of the Asian Development Bank suggests that such cross-border cooperation can be beneficial for all these countries.

Several major cross-border infrastructure projects are being developed. The Maputo Development Corridor between South Africa and Mozambique was initiated in 1995 to rehabilitate the primary infrastructure network along the corridor (road, rail, port, and border posts), attract investment in the corridor's catchment area, and provide employment opportunities for disadvantaged populations (see map 9.4). Its structure, led by South Africa, promotes fast-track design and implementation of bankable private investment projects and public-private partnerships. But it risks failing to address the social service needs of local communities.[63] Some ongoing evaluations of the corridor show that border-crossing costs and delays are common impediments, possibly diverting freight to domestic corridors. This suggests that more formal institutional cooperation between the countries could generate additional benefits.

South America has been much more ambitious in its plans with the Initiative

Map 9.4 Building regional infrastructure in Southern Africa
The Maputo Development Corridor



Source: MINTEK 2007.

for Integration of Regional Infrastructure, launched in 2000 to promote the integration and modernization of the 12 countries' physical infrastructure in the energy, telecommunications, and transport sectors, with the goal of improving global competitiveness. The initiative focuses on 10 hubs of economic integration across the continent and on harmonizing regulatory frameworks. It has identified 40 megaprojects and hundreds of smaller infrastructure improvement projects for potential financing, with an aggregate cost in the tens of billions of dollars. Implementation has been slow, however.

Integration options for countries distant from world markets and with small neighbors

Central Asia has the highest proportion of landlocked countries (see box 9.4) with many common problems that could be more effectively tackled through better regional cooperation. The small Pacific Islands are the most geographically fragmented, making them "sealocked," with limited accessibility to world markets (see box 9.5). And Africa between the tropics has the largest number of landlocked countries, many small in population and GDP, most among the world's poorest, and far too many prone to conflict. These neighborhoods face divisions and barriers to trade and factor mobility, are distant from major markets, and lack the density of economic production to benefit from agglomeration economies. Collier (2007) identifies their populations as the "bottom billion."

The challenge for countries in isolated neighborhoods is to find ways to integrate regionally and globally. Their geographic situation implies that the degree of integration rarely will be as high as in other countries, so the prospects for manufactured trade are more limited. Conversely, their isolation provides them with natural protection of their home markets.

Many of these economies have minerals and other natural resources, such as water, that can best be exploited on a regional basis. While there is evidence of growth spillover from resource-rich countries to their neighbors in Sub-Saharan Africa,[64] regional integration is the key to getting resource-led growth going and to spreading benefits more broadly. These countries face the triple challenges of division, distance, and density. Addressing them will require institutional reform, scaling

BOX 9.4 *Integration in Central Asia*

Central Asia has five landlocked countries: Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. The countries vary in population, type of government, and willingness to cooperate with each other and the rest of the world. But the region has established national identities and institutions, avoided violent conflicts, established the foundations for market-based economies, and sustained an economic recovery since the end of the 1990s.

Consider many regional institutions and initiatives. The Central Asia Cooperation Organization (CACO) comprises Kazakhstan, the Kyrgyz Republic, Russia, Tajikistan, Turkmenistan, and Uzbekistan, which merged with EURASEC (Eurasian Economic Community) in 2005. The Central Asia Regional Economic Cooperation Initiative (CAREC) comprises Azerbaijan, China, Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, and Uzbekistan. The Shanghai Cooperation Organisation (SCO) comprises China, Kazakhstan, the Kyrgyz Republic, Russia, Tajikistan, and Uzbekistan. Then there are the Commonwealth of Independent States (CIS), the Collective Security Treaty Organization (CSTO), the Economic Cooperation Organization (ECO), and the Special Programme for the Economies of Central Asia (SPECA).

The sheer number of regional agreements illustrate the problems that can arise from a disjointed regional approach. Regional initiatives in Central Asia can foster integration but add duplication and complexity to reform. The ongoing WTO accession for many of these countries could help, because the WTO has clear rules on regional trade agreements. Also needed are trade and transport facilitation initiatives and behind-the-border reforms to improve the countries' attractiveness to FDI and bolster their global integration. (Countries with the highest cost of business entry have lower imports, exports, and FDI inflows.) Regional forums for business communities could offer suggestions and feedback on the design and implementation of trade and related policies.

The region loses an estimated 3 percent of GDP annually because of poor water management. Agreements are also needed for oil and gas resources to reach international markets. Many environmental problems remain as a legacy from the Soviet era, such as radioactivity from abandoned uranium mines and dangerous remnants of biological and nuclear tests. Regional organizations could be rationalized around these key themes of trade and transport facilitation, water, energy, and environment management. They could develop long-term plans for these issues, bringing civil society and academic institutions into the fray. The international community could facilitate the strengthening of institutions with clear mandates and targets.

Sources: Linn and Tiomkin 2006; Broadman 2005; United Nations 2005a.

BOX 9.5 *Integrating the small and distant Pacific Islands with world markets*

Small island developing states face a great risk of marginalization in the global economy because of their small size, remoteness from large markets, and vulnerability to economic and natural shocks. And with their fragile ecosystems, they are highly vulnerable to domestic pollution and rising seas. Their share in global merchandise trade fell from 0.4 percent of world exports of goods in 1980 to 0.2 percent in 2003, while their share of global services trade remained at 0.7 percent.

One effort to deal with the special problems of small islands is the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), a nonreciprocal trade agreement for which Australia and New Zealand offer duty-free, unrestricted, or concessional access for almost all products originating from the countries of the Pacific Islands Forum. To qualify for preferential access, goods exported to Australia and New Zealand must meet the rules of origin set out in SPARTECA.

The textiles, clothing, and footwear industry has been a major beneficiary. But Australia and New Zealand are planning to adopt free trade by 2010, ending this preferential access to their markets. Without significant trade preferences, the Pacific Islands need other ways to integrate with their large neighbors. More radical approaches, including consideration of greater labor mobility, could be required. Children in island families receiving remittances from overseas family members show strong improvements in education and health outcomes, suggesting labor mobility could be a powerful driver for longer-term development in these countries.

Sources: UNCTAD 2002; SPARTECA 1996.

up infrastructure investments, and targeted incentives to encourage regional integration.

Identifying natural neighborhoods for institutional reform. Neighborhoods with small countries distant from world markets need to focus on specific institutional needs that drive their cooperation. There is no shortage of international agreements. But these agreements are often poorly implemented, their effectiveness tends to be low, and they overlap in responsibilities. The administrative costs of participating in such agreements are high in relation to the small benefits, given the small size of the participating economies. The African Union has spotlighted the inefficiencies of 13 or 14 overlapping regional economic

communities and has called for their rationalization.[65]

Regional integration can be rooted in the traditional economic and sociocultural interactions within natural neighborhoods, as building blocks for broader integration. Trust can be built on a shared language. East African countries share Swahili, which has facilitated trade in the neighborhood for centuries. Free trade was established between Kenya and Uganda during colonial times.[66] West African countries share the Dioula, Haoussa, and Peuhl cultures, which, nurtured by Islam, developed an impressive trade network.[67]

Interactions between neighboring areas or cities across countries can also provide the base for broader integration—a form of transfrontier regionalism that could follow European models.[68] Sub-Saharan Africa has many pairs of large cities that are near each other but separated by a national border (see map 9.5). This carries hidden economic costs that can be overcome through cross-border agreements. Cameroon shares twin cities with West African neighbors, but none in its Central African neighborhood. Similarly, local integration initiatives, such as growth triangles starting in the early 1980s in East Asia, can take advantage of the economic complementarities in bordering regions.

A succession of large coastal cities along the Gulf of Guinea spans from Abidjan in Côte d'Ivoire to Douala in Cameroon, and includes Accra, Cotonou, Lagos, and Lomé. When discussing "growth champions," it may be worth keeping in mind the potential of such multicountry agglomerations, rather than thinking of some nations as regional growth leaders. When seen through the lens of economic geography, the regional integration priorities change to prioritizing regional infrastructure investments in leading areas that span several countries.

Regional trade in agricultural products can be another entry point for broader regional integration. This requires a revival

Map 9.5 Twin cities for local integration

City pairs in bordering regions within 150 kilometers and with more than 100,000 inhabitants

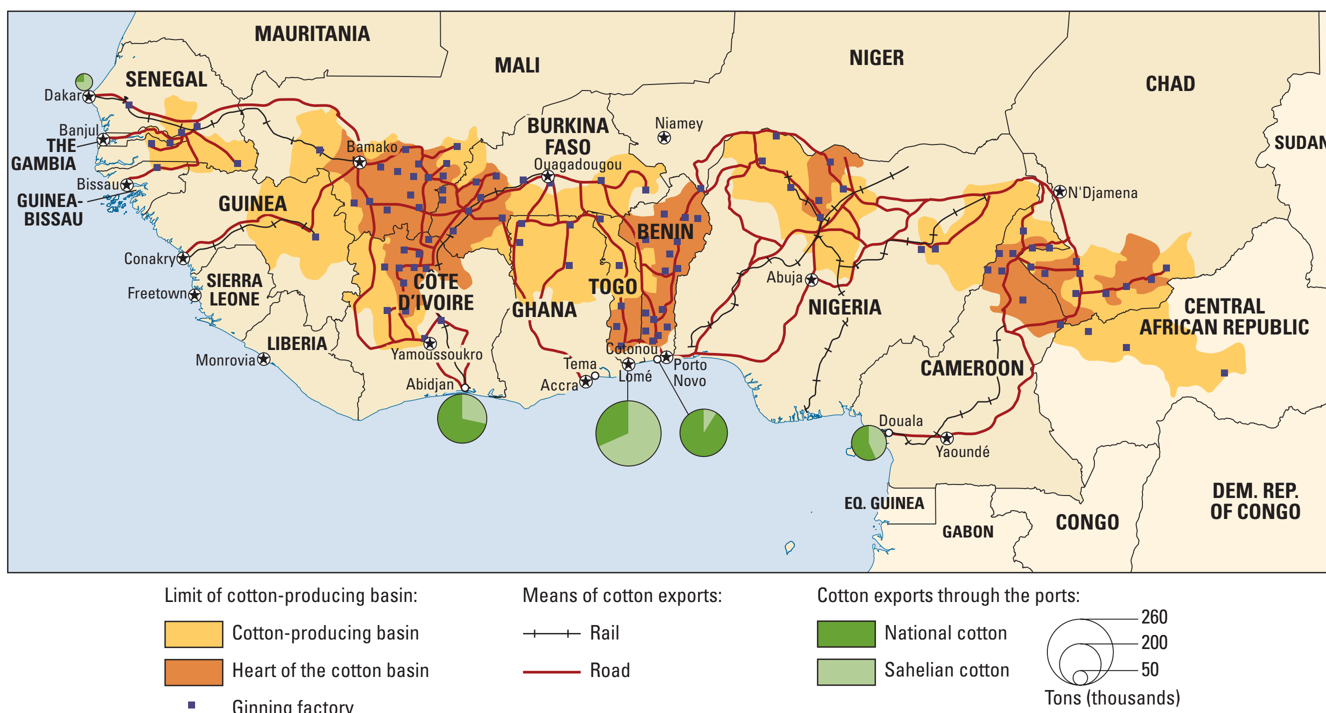
Source: WDR 2009 team.

of regional trade agreements, adequate cross-country infrastructure, institutional reforms, and nonmarket institutions such as farmer cooperatives.[69] The Horn of Africa could build on its livestock trade, though security poses a problem.[70] West Africa could build on cotton, if leading agricultural areas across several countries can be integrated into a single, efficient production and processing zone: the Sahelian cotton basin in the border region of Burkina Faso, Côte d'Ivoire, and Mali (see map 9.6). This region, dominated by Dioula ethnic groups, is anchored by three cities—Bobodioulasso in Burkina Faso, Korhogo in Côte d'Ivoire, and Sikasso in Mali.[71] In 2000 the population of this area was 4 million (11 percent of the total in the three countries), with an estimated gross regional product of 1,000 billion CFA francs (10 percent of aggregate national GDPs).

The areas in this region have complementary economic endowments. Bobodioulasso has an international airport with storage facilities. Korhogo has a regional airport, a specialized university, and training centers in agricultural science. Sikasso is the center of the cotton basin, with the most production. Rails connect Ouagadougou and the port of Abidjan, and roads link all three cities. And many ginneries and textile industries are located in the region. By upgrading and pooling infrastructure within a regional industrial development program, input costs could fall and cotton-based industries such as textile and garments could become competitive in the global market. Such an initiative would require a strong commitment from the participating countries and support from regional associations and the international community.

Institutional development to increase scale, support labor and capital mobility, and improve market access. Some regions have taken concrete steps toward integration. ECOWAS has signed protocols for the free movement of people, abolishing visa and entry permit requirements. In fact, labor mobility has always been a hallmark of Sub-Saharan Africa, where tradition or colonial laws have favored circular labor mobility. Nomads moved across countries in response to seasonal climatic change,

Map 9.6 West Africa has potential for cotton-led industrial development



Sources: Atlas on Regional Integration in West Africa. ECOWAS; Sahel and West Africa Club/OECD 2006.

while sedentary farmers also moved seasonally in search of supplementary income during the dry season.[72] But the skills of the workforce need to improve. For higher education, technical training, and research, cooperation within the neighborhood can support institutions beyond the means of individual countries. And a better local business climate and new opportunities in regional growth centers may induce African migrants with technical and business know-how to return from abroad.

Invest in regional infrastructure. The New Partnership for Africa's Development (NEPAD) spatial development initiative identified the Bas-Congo development corridor involving Angola, the Democratic Republic of Congo, and the Republic of Congo as a region where deep integration would have large benefits, based on enormous hydroelectric power potential.[73] Two other development corridors also have promise in West and East Africa:

- The Gulf of Guinea development corridor—linking Benin, Côte d'Ivoire, Ghana, Liberia, Nigeria, and Togo—could integrate West African economies through transport and energy. It could also connect five large coastal cities with a critical mass of economic activities and administrative service provision: Abidjan, Accra, Cotonou, Lagos, and Lomé.
- The Mombasa development corridor—linking the Democratic Republic of Congo, Kenya, Sudan, and Uganda—could use established infrastructure links such as the Northern Corridor to unlock natural resources in the Democratic Republic of Congo and southern Sudan.

Even with more regional infrastructure, better human capital, and greater factor mobility, these neighborhoods still face being latecomers in the global market, where other developing countries with low-cost advantage dominate the market for basic manufactures. African countries need to diversify their export base to reduce dependence on natural resources. Many of these neighborhoods need to design explicit export diversification strategies to capture a larger share of the world market (see box 9.2). Success requires institutional cooperation as well as specific infrastructure among countries in the neighborhood.

Providing a regional public good is less complex politically if it is based on a mutually beneficial and profitable project, as in much of energy, communications, and irrigation infrastructure. But for small isolated countries, regional infrastructure projects require considerable outside support. Traffic volumes are too small in most parts of Africa for toll roads to be feasible. And regional infrastructure may be more beneficial for one country, even though most of the investment costs are incurred in another. In addition to reinvigorating public-private partnerships in infrastructure, there is a need for scaling up International Development Association (IDA) contributions to regional integration, systematizing Aid-for-Trade initiatives[74] and rationalizing the interaction between regional development banks and global financial institutions. Less than 3 percent of all international development support now goes for regional programs.[75]

Use coordinated incentives to facilitate regional integration. African countries need to make a strong commitment to regional integration, sharing the costs and benefits from opening borders in natural neighborhoods. Multilateral agencies and donors need to commit to long-term support of these initiatives by providing financial and technical assistance and better access to markets. Concrete steps can be sequenced, gradually ensuring the irreversibility of policy reforms in leading and lagging countries. Preferential trade agreements and aid flows could be tied to cooperation among recipient countries, with the proposed EPAs with the EU as one model (see box 9.3). In cases in which incentives for regional cooperation are insufficient for some partners—such as facilitating access for a landlocked economy to a port in its neighboring country—conditional aid flows with clear performance targets may be required.

A key incentive for policy reform in Africa is temporary preferential access to OECD markets.[76] Africa cannot wait for a big wage difference with Asia before starting to attract greater productive investment

BOX 9.6 *A contract with Africa? The give and take of the world's biggest development challenge*

Better understanding of the geography of development can lead to more effective development aid. This Report advocates different strategies for Africa's landlocked countries and its resource-poor coastal economies. The former have natural disadvantages associated with geography and a large distance to market that reduces their potential growth by as much as half a percentage point per year. But what is unusual in Africa is that resource-poor coastal countries have underperformed. These are the types of countries that act as engines of growth in other world regions. Africa's growth poles are still weak.

This Report argues, to exaggerate somewhat, that development strategies for leading areas should invest in places, and strategies for lagging areas should invest in people. Seen through the lens of economic geography, the thrust of development assistance to Africa that focused on education, health, and other social infrastructure in the late 1990s seems correct for the lagging, landlocked countries. But this assistance appears to focus on the wrong priorities for coastal countries, which need physical infrastructure and better integration with global markets.

A better contract between donors and countries would be to differentiate approaches across countries depending on their potential market access. This Report proposes a tailored approach, which would lay out the rights and responsibilities of countries according to their potential regional role. For each of Sub-Saharan Africa's regions, the contract would include specific obligations and actions that encourage regional development. The governments of East, West, and Central Africa would commit to the following:

- Establishing "Regional Economic Areas" that would tie the economic interests of leading and lagging countries in Africa's regional neighborhoods tightly together and provide a framework for the provision of regional public goods.
- Pursuing freer movements of labor, capital, goods, and services within these areas.
- Maintaining and protecting access routes between landlocked countries and outlets for trade.

The strategy would combine institutional cooperation, investment in regional infrastructure, and coordinated interventions that may require giving up some hard-won and jealously guarded attributes of national sovereignty.

In exchange for these actions, bilateral and multilateral development partners would commit to the following:

- A large increase in international financial assistance for improved social services and other life-sustaining infrastructure aimed at raising living standards and creating portable human capital in lagging countries.
- Increased financial support for growth-sustaining infrastructure—including ports, transport links, and information and communication technology—in the coastal countries, as well as corridor infrastructure to link coastal and interior markets.
- Preferential access for Sub-Saharan Africa's exports, with liberalized rules of origin that encourage regional supply chains.

Things are already headed in this direction. In 2007 the Government of the United Kingdom, through its Department for International Development, allocated $1.4 billion over the coming decade to efforts by the governments of Burundi, Kenya, Rwanda, Tanzania, and Uganda and to revitalize the East African Economic Community. The European Commission is also adopting a regional approach with its economic partnership agreements. But all donors could be bolder in their approaches.

The experience of Europe after World War II illustrates how national determination to prioritize reconstruction coupled with international assistance can pay off. Regional integration in Europe did not go smoothly initially. But encouraged by the tough terms of cooperation in the Marshall Plan, a process of integration that would have been impossible a generation earlier, created the largest common market for capital, labor, and ideas today.

Source: WDR 2009 team.

and larger export shares, especially with multilateral trade negotiations at the WTO driving down tariffs at a fast pace. Initiatives such as the U.S. Africa Growth and Opportunity Act and the EU Everything But Arms could be extended to all Sub-Saharan countries, with more liberal rules of origin and a longer time span. This may allow at least some of these countries to break into world markets and could jump-start export diversification in African neighborhoods. A "contract with Africa" could be a framework for supporting such coordinated incentives (see box 9.6).

Over the past centuries, East, Central, and West Africa have suffered a series of "formative disasters" (see "Geography in Motion, Density, Distance, and Division in Sub-Saharan Africa"). Today, they pose an especially difficult development challenge spanning the three development dimensions—density, distance, and division. To reshape their economic geography, the policy response has to be commensurately calibrated. A three-dimensional challenge demands employing all three instruments of integration—institutions, infrastructure, and incentives.