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INDUSTRY AND ENERGY DEPARTMENT WORKING PAPER
INDUSTRY SERIES PAPER No. 14

Regional Integration And Economic Development

November 1989

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Regional Integration And Economic Development

November 1989

The World Bank Industry and Energy Department, PPR

Regional Integration And Economic Development

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November 1989

**Industry Development Division
Industry and Energy Department
Policy, Planning, and Research**

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REGIONAL INTEGRATION AND ECONOMIC DEVELOPMENT

i. Does it make sense for developing countries to pursue regional integration as a means of accelerating development? Economic analysis based on static comparative advantage clearly indicates that such a course does not make sense if multilateral or even unilateral trade liberalization is a politically feasible alternative. Under second-best scenarios, the creation of regional free trade areas or customs unions may--or may not--represent an improvement over the status quo -- depending on the characteristics of the countries and the integration framework being pursued.

ii. The worldwide proliferation of economic unions since the late 1950s indicates a strong consensus, at least among policymakers, in favor of promoting regional integration. Currently, most developing countries belong to one or more regional economic associations; in Latin America and the Caribbean four major preferential trading arrangements exist, in Africa eight, and in Asia two (see Table 1). Furthermore, only one union has been officially disbanded, the East African Community (EAC), in 1978, and new ones are in the process of formation, e.g., a preferential trade agreement among the Maghreb States and a trade agreement between Argentina and Brazil. Formation of these economic unions was not motivated by the static cost-benefit calculations of classical economic analysis. Other objectives, such as achieving rapid industrial growth and greater economic independence, were dominant motivating factors.

iii. Although some economic unions have been more effective than others, none has lived up to the initial expectation of accelerating growth and development. This disappointing performance can be explained partly by exogenous factors such as deteriorating terms of trade, rising international interest rates, civil strife, and infrastructural constraints. However, much of the blame rests with the inward-oriented policies adopted in conjunction with the regional integration efforts.

iv. It is clear that if existing unions are to become effective instruments of development, they will need significant reform. In addressing reform, a fundamental question is whether regional integration has an economic rationale independent of inward-looking, import-substitution industrialization (ISI) strategies. If unions cannot be justified without ISI, the prospects for effective integration among developing economies remain severely limited. The need for competitive, outward-oriented approaches has been recognized increasingly in both academic and policymaking circles. The changing international economic environment and the successful adjustment exemplified by the export-oriented East Asian NICs argue strongly in favor of outward-oriented growth strategies. From this perspective, the main issue becomes whether economic integration can play a positive role in an outward-oriented strategy and help in facilitating structural adjustment.

v. Section I reviews (i) the criteria for judging whether common markets and customs unions are likely to be welfare-enhancing, and (ii) the main motivations for regional integration under import-substitution strategies. Section II presents cross-country evidence that argues against

the adoption of inward-oriented policies as a basis for development, while not negating the proposition that significant benefits may be reaped through the creation of larger internal markets. Section III examines the impact of past integration efforts on growth and trade performance. In view of the disappointing performance of most economic unions among developing countries, Section IV examines the main barriers to effective integration, which have prevented the potential benefits of an enlarged internal market from being captured. Section V suggests a revised strategy of regional integration, based on more outward-oriented policies, which would reduce some of the barriers to integration while providing a better basis for achieving sustained growth.

Table 1: MAJOR ECONOMIC UNIONS AMONG DEVELOPING COUNTRIES

Economic Grouping	Aggregate 1986 GDP millions US \$)
<u>Latin America and the Caribbean</u>	
Latin American Integration Association (LAIA)	550,140
of which: The Andean Group	120,700
Central American Common Market (CACM)	21,570
Caribbean Community (CARICOM)	9,858+
<u>Africa</u>	
Economic Community of West African States (ECOWAS)	77,920
of which: West African Econ. Commun. (CEAO)	17,790
Mano River Union (MRU)	4,150
Economic Community of Central African States (CEEAC)	27,124
of which: Customs & Econ. Union of	
Central Africa (UDEAC)	18,127
Econ. Comm. of Great Lakes Countries (CEPGL)	8,960
Preferential Trade Area for East Africa (PTA)	33,209+
Southern African Development Coordination Conf. (SADCC)	17,878+
Southern Africa Customs Union (SACU)	58,228
<u>Asia</u>	
Association of South-East Asian Nations (ASEAN)	196,053
Regional Cooperation for Development (RCD)	82,700+
<hr/>	
Memo: Selected OECD countries	
United States	4,185,490
Japan	1,955,650
Germany	891,990
Spain	229,100
Netherlands	175,330
Ireland	21,910

Source: See Annex Table A.2.

I. BASIC APPROACHES TO REGIONAL ECONOMIC INTEGRATION

A. The Liberal Approach

1.01 The most widely used method for assessing the welfare impact of integration^{1/} originated with Viner's pathbreaking study in 1950 and focuses on trade creation versus trade diversion as proxy measures of the effect of a customs union on incomes.

- Trade creation refers to a union-induced shift of domestic consumption away from higher-cost domestic products toward lower-cost products from one of the partner countries.
- Trade diversion refers to a union-induced shift in imports away from lower-cost third-country sources toward higher-cost partner-country sources.

The basic presumption is that if trade creation dominates the trade diverting effect, economic integration is a step toward freer trade and, thus, constitutes a net welfare improvement for the combined members of the union. An important refinement of this approach is the inclusion of economies-of-scale effects. This introduces an additional (welfare-enhancing) cost-reduction effect versus a (welfare-reducing) trade-suppression effect in quantifying the trade creation and diversion effects. However, it does not qualitatively alter the nature of the welfare analysis.

1.02 The only significant departure from the general rule that a net trade-diverting union reduces overall welfare arises when the economic union is large enough to affect the external terms of trade. In that case the diversion of trade away from the rest of the world would result in a terms of trade improvement that benefits the members of the union. (A certain amount of trade diversion would be optimal in this context for the same reason that a single large economy could gain by imposing an optimal import tariff or export tax.) This possibility, however, is not of much relevance to most existing unions among developing countries, since they are too small in a global context to wield significant market power. The total GDP of Sub-Saharan Africa, for example, is approximately that of The Netherlands or Spain, both of which are considered small economies in an international context (Table 1).

^{1/} Throughout this study the terms "integration" and "economic union" are used in a broad sense, encompassing a variety of regional economic arrangements. On a technical level, the main forms of integration are: free trade areas, in which barriers to the movement of goods between partner countries are eliminated; customs unions, which are free trade areas with a common external tariff; common markets, which are customs unions where barriers to factor movements are also eliminated; and economic unions, which are common markets where all major economic policies are harmonized among partner countries.

1.03 Several policy and structural features of a prospective union favor trade creation over trade diversion. For example, net trade creation is more likely to result:

- a) the higher the prevailing trade barriers are among prospective partners prior to integration;
- b) the lower the trade barriers are toward third countries after integration;
- c) the higher the trade barriers are in third countries;
- d) the lower the transportation costs and non-policy barriers are among prospective partners relative to such barriers to trade with third countries; and
- e) the higher the existing degree of rivalry and potential degree of complementarity are between industries in the partner countries.

1.04 The first two features refer to policy choices that lie within the discretion of the policymakers creating the economic union. The last three features are either exogenous or refer to structural characteristics of the partner countries. In view of these last three features, most developing countries would not appear to be suitable candidates for creating welfare-improving unions based on the trade creation/diversion criterion. With respect to item (c), it is generally the case that trade barriers in industrialized countries, the main trading partners for developing countries, are fairly low compared to the barriers in developing countries. Furthermore, most developing countries are also granted trade preferences by the industrialized countries through the Generalized System of Preferences, the Lomé Convention, and arrangements such as the U.S.-Caribbean Basin Initiative. Regarding item (d), the infrastructural links (posts, transport, and telecommunications) among developing countries often are much less advanced than between developing and industrialized countries (see Robson, 1985), particularly in Africa. For item (e) it can be argued (in a static context) that the similarity of factor endowments among LDCs severely limits the potential for efficient intra-union specialization compared to the specialization opportunities opened up through trade with industrialized countries.

1.05 On the basis of these structural features alone, economic unions among developing countries tend to be trade diverting. This could be avoided, however, through an appropriate choice of the policy-determined variable referred to in item (b). An important insight by Vanek (1965) is that through the correct choice of external tariffs and intra-regional transfers it is possible to render any customs union welfare-enhancing for the world as a whole without leaving any country worse off. That is, if post-union external tariffs were reduced sufficiently, net trade creation would result. But this line of argument also suggests that the best strategy would be for developing countries to choose industrialized countries as integration partners--as Turkey is currently attempting by seeking membership in the European Community and as Israel has done in its 1985 free-trade agreement with the United States.

B. The GATT Approach

1.06 The General Agreement on Tariffs and Trade, which has served as the primary instrument in defining the postwar international commercial order, is based on a liberal non-discriminatory trading system. As such, the formation of preferential trading areas necessarily violates GATT's Most Favored Nation principle. Nevertheless the GATT makes explicit provisions (Article XXIV) that enable its signatories to form customs unions or free trade areas provided they meet several conditions (summarized in Pomfret, 1988). These few conditions, in essence, represent a pragmatic approach to integration:^{2/}

- i) trade barriers against non-members must not "on the whole" be higher than those previously in effect -- a condition clearly intended to limit trade diversion and that roughly conforms with item (b) above;
- ii) trade barriers must be eliminated on "substantially all" trade among members -- a condition that can also be seen as limiting trade diversion (as argued by Wonnacott and Lutz, 1989); and
- iii) interim arrangements to permit scheduling the customs union or free trade area must be completed over a reasonable period of time -- a condition meant to prevent the violation of the two prior conditions through prolonged delays in the process of implementation.

C. The Inward-Oriented Approach

1.07 As Robson (1987) points out, the liberal approach and, by extension, the GATT approach fail to provide a clear rationale for integration because, "apart from the terms of trade argument, the grounds on which it can be shown that a customs union may be superior to a non-discriminatory tariff are precisely those on which customs unions and free trade areas can themselves be shown to be necessarily inferior to (unconstrained) free trade." The benefits of free trade, as explained in the traditional literature, are that it (a) expands an economy's set of feasible consumption opportunities and (b) enables the most efficient allocation of productive resources through specialization. A fundamental difference of opinion on this latter aspect (specialization under free trade) is what primarily distinguishes the inward-oriented from the liberal approach.

1.08 According to proponents of an inward-oriented strategy, free trade inhibits economic development by perpetuating past patterns of specialization;

^{2/} These conditions have been frequently criticized as insufficiently precise, since no exact guidelines are stated in reference to time, tariff levels and product coverage. From the viewpoint of liberal economic principles, however, the pursuit of regional integration represents a second-best choice from the outset, which (by definition) does not permit the enunciation of a short and precise set of rules that would always assure a welfare-improving outcome.

developing countries would continue to rely on exports of a few primary products that are relatively intensive in unskilled labor and natural resources in exchange for high-skill labor and technology-intensive manufactured imports. Thus, developing economies would remain highly vulnerable to fluctuating terms of trade and would be deprived of the positive externalities (e.g., skill-enhancement through learning-by-doing, technological progress) that are generally associated with a growing manufacturing sector. From this standpoint trade diversion resulting from economic integration need not constitute a welfare loss, but instead could be desirable for achieving rapid industrialization.

D. Principal Motives for Integration

1.09 In practical terms, the implementation of an inward-oriented approach is synonymous with the adoption of a selective import-substitution industrialization (ISI) strategy. Two basic features of the ISI strategy applied on a regional level are: the elimination of intra-regional trade barriers and the imposition of highly protective external import duties. Past integration efforts in Latin America were all based explicitly on the ISI strategy. Before the 1960s, this strategy had been applied at national levels, but it was increasingly recognized that autarkic industrialization is extremely costly due to the small size of individual markets. The main purpose of regional integration, thus, was to create larger internal markets for better capture of potential economies of scale. Still, the economic size of most unions was too small to achieve self-sufficiency, which meant that industries had to be granted protection in a selective fashion, resulting in a high dispersion of external tariff rates.

1.10 It was hoped that ISI-based integration, by accelerating the pace of industrialization, would lead to greater economic stability. In particular, the expansion of the industrial base would facilitate the diversification of exports, thereby reducing the traditional vulnerability to the terms-of-trade fluctuations that afflict many developing countries. The perceived vulnerability to exploitation by foreign multinational firms also provided a motivation for integration; which is to achieve greater economic independence from industrialized countries.^{3/} A further argument in favor of integration is that it would provide a training ground for infant exporters. Most policymakers did not see regional-based industrialization as the final development objective but as a step that would lead to a stronger industrial base more capable of competing in world markets. The promotion of intra-regional trade would provide export experience and a more competitive regional environment in preparation for the eventual penetration into third markets.

3/ The perceived threat to economic independence did not always emanate from the industrialized countries; e.g., SADC was set up mainly to reduce the dependence of member economies on South Africa. Also, the Andean Group was created within LAFTA in part to provide an economic counterweight to the region's largest economies, Argentina and Brazil.

1.11 In the Caribbean and in Africa, integration efforts initially were motivated by the desire to retain the economic ties that had evolved through a common colonial heritage. Over time, however, these efforts also focused increasingly on restricting economic links to industrialized countries, in the hope of promoting greater stability and growth. This was reflected, for example, in the Lagos Plan of Action adopted by the African Heads of State in 1980, which advocates "a far-reaching regional approach based primarily on collective self-reliance" (Preamble, Article I). In Asia, integration efforts were more limited in scope than in the other regions and focused mainly on promoting cooperation in specific industrial sectors to exploit economies of scale and on establishing common negotiating positions to extract advantages in trade talks with third countries.

1.12 In contrast to initial integration efforts that sought to relax economic ties to the industrialized economies, perceptions in the late 1980s are that such relaxation may actually undermine economic advances and thus be a threat: the proposed integration of the Maghreb states is largely motivated by the fear of increased European protectionism in 1992, when trade barriers within the EC are to be largely eliminated. In this context, the expansion of regional trade ties is seen as a precautionary step to compensate for possible severance of external ties. The same fear also has led Turkey to step up its efforts to obtain membership in the EC.

II. DOMESTIC MARKET SIZE, EXPORT ORIENTATION AND OUTPUT GROWTH: SOME CROSS-COUNTRY EVIDENCE

2.01 At the most elementary level, the main purpose of regional integration is to create larger internal markets. The basic presumption, therefore, is that larger economic units perform more successfully than smaller ones. The liberal approach does not dispute this presumption but points out that internal market size becomes a less important factor the more outward-oriented a country's policies. That is, the benefits of a larger internal market (particularly the capture of economies of scale) would be multiplied if a country were prepared to integrate with the much larger world market. The inward-oriented approach, in contrast, attributes special significance to the internal markets in promoting economic development.

2.02 A simple way to assess the relative validity of both approaches is by examining the past performance of individual countries, treated as integrated economic units. In this context, two questions can be asked: (i) have larger economies grown faster in the past than smaller economies, and (ii) have more outward-oriented economies grown faster than inward-oriented economies? The second question has already been the focus of a large body of research (reviewed, e.g., in Lal and Rajapatirana, 1987) and generally has yielded an affirmative response. The following cross-country analysis reexamines the relationship between growth and greater outward orientation together with the significance of domestic market size.

Table 2: OUTPUT GROWTH REGRESSIONS
 Sample: All Developing Economies (No. of observations = 67)

Explanatory Variables	Dependent Variables							
	Average Annual Growth Rates (1965-1987) of:							
	GDP				GNP/capita			
	1	2	3	4	5	6	7	8
Constant	-2.10 (-1.69)	1.38 (1.15)	2.45 (4.98)	-2.21 (-1.77)	-4.81 (-3.81)	-1.40 (-1.15)	-0.03 (-0.06)	-4.83 (-3.80)
LogGDP87	0.644 (4.64)*			0.620 (4.43)*	0.654 (4.67)*			0.649 (4.54)*
LogGDP65		0.316 (1.88)**				0.341 (2.01)*		
Log POPUL87			0.490 (2.64)*				0.434 (2.29)*	
DEXSH	0.041 (2.41)*	0.054 (2.85)*	0.053 (2.84)*	0.048 (2.67)*	0.046 (2.64)*	0.059 (3.05)*	0.058 (3.06)*	0.047 (2.60)*
DTOT				-0.017 (-1.20)				-0.004 (-0.29)
T-Statistics in Parentheses; * (**) = significant at 5% (10%)								
R-Sq.	0.35	0.17	0.21	0.36	0.36	0.19	0.21	0.36
F-Stat.	17.03	6.73	8.71	11.91	18.09	7.74	8.43	11.91
Summary Statistics								
	DLGDP	DLGNPC	EXSH65 (percentages)	EXSH87	POPUL87 (millions)	TOT 1987 (1980=100)		
Mean	3.75	1.15	21.6	24.0	22.58	81.88		
Std.Dev.	2.00	2.04	12.1	13.7	32.58	15.09		

Definition of Terms:

- DLGDP = Average Annual Growth Rates of Real GDP (1965-1987)
- DLGNPC = " " " " " " " " percapita GNP " "
- GDP87(65) = Level of GDP in 1987 (1965) converted into U.S. Dollars
- POPUL87 = Size of Population in 1987 (in millions)
- EXSH(.) = Exports of Goods and Services as Share of GDP (year)
- DEXSH = Change in Export Orientation, computed as EXSH87 - EXSH65
- TOT = Level of Terms of Trade Index in 1987 (1980 = 100)
- DTOT = Change in Terms of Trade from 1980 to 1987

Source: Own Calculations based on data from World Development Report, 1989; see Table A.1 in Annex.

A. Market Size and Aggregate Output Growth

2.03 Table 2 shows the statistical relation between the average annual GDP or per-capita GNP growth rates between 1965 and 1987 and both the size of the domestic market and the change in export orientation, using data for 67 developing countries. Domestic economic size is measured by the log-levels of GDP (in U.S. dollars) or of population. The overall change in the ratio of exports to GDP from 1965 to 1987 is used as a proxy for changes in outward orientation. The results show that for the entire sample of countries both

domestic market size and increased outward orientation are positively and significantly correlated with economic growth.^{4/}

2.04 A more differentiated picture emerges when the sample is split into two groups (Table 3); the first group comprises the least developed countries (with 1987 per-capita GNP < US\$ 800), and the second contains the higher-income countries. For the least developed countries, the relation between domestic market size and output growth is highly significant, while the export-orientation variable turns out positive but insignificant. For the more developed countries, the opposite pattern applies: domestic market size is statistically insignificant, while increased export orientation is positive and significant. Similar results concerning the significance of export orientation had been observed earlier by Helleiner (1986) and Michaely (1977), who conjectured that growth may be significantly affected by export performance only in countries that already have achieved a certain minimum level of development.

^{4/} Several potential problems in interpreting these results need to be considered: One is that the change in export-to-GDP shares may be due to changes in export prices. In that case, it would not be surprising to find a positive correlation between increased export shares and growth. Of course, such a finding neither supports nor rejects the proposition that more outward-orientated policies are associated with higher economic growth, independent of outward policy orientation. To assess the influence of changing export prices on the behavior of export shares, the change in exports-to-GDP was regressed against the change in the terms of trade from 1980 to 1987 (In 1980 the terms of trade were very favorable by historical standards for most developing countries, but by 1987 they had deteriorated significantly, reflecting a prolonged decline in primary exports prices.) Terms of trade changes turn out to be associated significantly with the change in export shares, but with low explanatory power (R-Sq. = 0.07; F-Stat. = 4.83). Moreover, when the terms-of-trade changes are included as an explanatory variable in the growth regressions (alone or in conjunction with other explanatory variables) the relation is statistically insignificant, whereas the export share variable remains significant. A second problem is that we do not know offhand what constitutes the optimal level of trade for a country. Too much export orientation through excessive export incentives and currency undervaluation can be just as inefficient as too much inward orientation. The working hypothesis in this paper, however, is that policymakers generally have erred on the latter side; i.e., keeping their economies too closed rather than too open. Finally, suppose all countries in the sample had equal GDP levels in 1965. Then the countries that grew faster would have a corresponding larger level of GDP in 1987. The correlation between output growth and 1987 GDP would be perfect, but this obviously could not be explained by the hypothesis that larger economies encourage faster growth. To account for this simultaneity problem, GDP in 1965 also was used as an explanatory variable. The results are qualitatively similar to those when 1987 GDP is used (as exemplified in Table 2), but the statistical significance level is usually substantially lower, suggesting that a certain simultaneity bias exists.

2.05 Lal and Rajapatirana (1987) have suggested that the preceding results may be biased, since the least developed countries are also those generally most reluctant to adopt trade liberalizing policies. In this case, changes in export shares are more likely due to other phenomena that need not be growth-inducing. Table 4 shows the results obtained when countries are divided into two groups according to whether export shares increased or declined over 1965-87. These results are similar to those in Table 3 and suggest the following explanation: obviously, countries that have not opened up their economies have had to rely more on the domestic market as a source of growth. In those circumstances it would be expected that the economies with larger domestic markets would have performed better than the smaller economies. This does not mean, however, that the closed economies were better off by not opening up toward the rest of the world. The summary statistics indicate that the set of countries that did not record increasing export shares experienced a lower average rate of growth than the countries with increased export shares; 0.53% versus 1.71% in terms of per capita GNP, and 3.41% versus 4.05% in terms of GDP. Furthermore, as the second set of regressions in Table 4 shows, the countries that have experienced increases in export shares show a significant correlation between growth and both domestic market size and export orientation need not be mutually exclusive sources of growth.

Table 3: OUTPUT GROWTH REGRESSIONS: SUBSAMPLES DETERMINED BY LEVEL OF DEVELOPMENT

Sample: <u>Low-Income</u> Economies (1987 GNP percapita < 800 U.S. Dollars)						
No. of Observations = 36						
DLGDP =	-4.27	+	0.890 LogGDP87	+	0.005 DEXSH	R-Sq. = 0.39
(T-Stat.)	(-2.49)		(4.31)*		(0.20)	F-Stat. = 11.38
DLGNPC =	-5.93	+	0.762 LogGDP87	+	0.017 DEXSH	R-Sq. = 0.30
	(-3.16)		(3.37)*		(0.644)	F-Stat. = 7.08
<u>Summary Statistics:</u>		DLGDP	DLGNPC	EXSH65	EXSH87	
Mean (%)		3.08	0.36	21.08	21.44	
Sample: <u>Higher-Income</u> Economies (1987 GNP percapita > U.S.\$ 800)						
No. of Observations = 31						
DLGDP =	0.53	+	0.383 LogGDP87	+	0.056 DEXSH	R-Sq. = 0.23
(T-Stat.)	(0.23)		(1.61)		(2.29)*	F-Stat. = 4.21
DLGNPC =	-2.14	+	0.405 LogGDP87	+	0.056 DEXSH	R-Sq. = 0.25
	(-0.96)		(1.78)		(2.39)*	F-Stat. = 4.76
<u>Summary Statistics:</u>		DLGDP	DLGNPC	EXSH65	EXSH87	
Mean (%)		4.53	2.06	22.23	27.03	

(* = significant at 5%)

Source: Same as Table 2.

Table 4: OUTPUT GROWTH REGRESSION: SUBSAMPLES DETERMINED BY CHANGE IN EXPORT ORIENTATION

Sample: Developing Economies with $DEXSH < 0$ (No. of Observations = 32)									
DLGDP	=	-1.53	+	0.625	LogGDP87	+	0.063	DEXSH	R-Sq. = 0.32
(T-Stat.)		(-0.80)		(2.96)*			(1.58)		F-Stat. = 6.70
DLGNPC	=	-5.12	+	0.664	LogGDP87	+	0.009	DEXSH	R-Sq. = 0.22
		(-2.39)		(2.80)*			(0.21)		F-Stat. = 4.18
<u>Summary Statistics:</u>				DLGDP	DLGNPC	EXSH65	EXSH87	TOT(1987)	
Mean				3.41	0.53	25.75	18.84	76.75	
Sample: Developing Economies with $DEXSH > 0$ (No. of Observations = 35)									
DLGDP	=	-3.22	+	0.688	LogGDP87	+	0.085	DEXSH	R-Sq. = 0.40
(T-Stat.)		(-1.83)		(3.71)*			(2.55)*		F-Stat. = 10.74
DLGNPC	=	-5.21	+	0.667	LogGDP87	+	0.071	DEXSH	R-Sq. = 0.38
		(-3.09)		(3.74)*			(2.21)*		F-Stat. = 9.97
<u>Summary Statistics:</u>				DLGDP	DLGNPC	EXSH65	EXSH87	TOT(1987)	
Mean				4.05	1.71	17.83	28.77	86.52	

(* = significant at 5%)

Source: Same as Table 2.

Table 5: MANUFACTURING GROWTH REGRESSIONS

Sample: <u>All Developing Economies</u> (T = 46)									
DMANSH	=	4.61	-	0.168	LogGDP87	+	0.151	DEXSH	R-Sq. = 0.15
(T-Stat.)		(1.16)		(-0.384)			(2.74)*		F-Stat. = 3.89
Sample: <u>Low-Income Economies</u> (T = 26)									
DMANSH	=	7.51	-	0.540	LogGDP87	+	0.157	DEXSH	R-Sq. = 0.08
(T-Stat.)		(0.93)		(-0.57)			(1.41)		F-Stat. = 1.03
Sample: <u>Higher-Income Economies</u> (T = 20)									
DMANSH	=	4.41	-	0.116	LogGDP87	+	0.150	DEXSH	R-Sq. = 0.23
(T-Stat.)		(0.71)		(-0.196)			(2.26)*		F-Stat. = 2.61
Sample: <u>Economies with $DEXSH < 0$</u> (T = 23)									
DMANSH	=	10.20	-	0.460	LogGDP87	+	0.422	DEXSH	R-Sq. = 0.19
(T-Stat.)		(1.39)		(-0.576)			(2.18)*		F-Stat. = 2.37
Sample: <u>Economies with $DEXSH > 0$</u> (T = 23)									
DMANSH	=	-4.08	+	0.501	LogGDP87	+	0.318	DEXSH	R-Sq. = 0.56
(T-Stat.)		(-1.23)		(1.28)			(4.94)*		F-Stat. = 12.58

(* = significant at 5%)

<u>Summary Statistics</u>	Sample Characteristics				
	All Econ.	Low-Inc.	Higher-Inc.	DEXSH<0	DEXSH>0
	(Sample Means in %)				
EXSH65	20.22	21.73	18.25	25.17	15.26
EXSH87	22.26	20.50	24.55	17.69	26.82
MANSH65	12.60	9.08	17.20	10.39	14.83
MANSH87	16.00	11.85	21.40	13.52	18.48
MEXSH65	10.98	10.04	12.20	9.74	12.22
MEXSH87	27.60	19.92	37.65	14.91	40.35

Variable Definitions: MANSH(.) = Share of Manufacturing Sector in GDP (year)
 DMANSH = MANSH(1987) - MANSH(1965)
 MEXSH(.) = Manufactured Exports as % of Total Exports
 Other variables are defined in Table 2.

Source: Same as Table 2.

2.06 The low correlation between greater export orientation and output growth observed for the least developed countries does not provide an argument in favor of creating a larger internal market at the expense of external trade, given that there is also no evidence that reduced export orientation promotes higher growth for this set of countries. The safest conclusion at this point is simply that larger internal markets and greater export orientation may yield potential benefits that need not be traded off. In this context, the most disturbing observation is that the least developed countries have not been able or willing to increase their export shares, thus failing to exploit a potentially important source of growth.

B. Market Size and Industrialization

2.07 A prime objective of inward-oriented policies is to achieve rapid industrialization. From this standpoint, it could be argued that even if a closing-off toward external markets were to result in lower growth for a limited period, this could enable an expansion of the manufacturing sector, which would then provide a more solid basis for future growth. This proposition is clearly rejected by the empirical findings in Table 5, which shows the results from regressing the change in the GDP-share of manufacturing between 1965 and 1987 against domestic market size and changes in export shares. A surprising observation is that domestic market size exhibits no significant correlation with manufacturing growth (and sometimes yields negative signs) in contrast to the export-orientation variable. Furthermore, this result applies equally for the separate sub-samples of countries, whether distinguished by level of development or degree of export orientation.

2.08 The sample of countries with decreased export shares is likely to contain a higher than average proportion of countries that have pursued an ISI strategy. The basic conjecture, therefore, is that on average these countries may have experienced faster--but less efficient--industrialization. The summary statistics in Table 5 show that between 1965 and 1987 the average share of manufacturing to GDP rose from 10.4% to 13.5% (an increase of 30%) for the least opened countries, and from 14.8% to 18.5% for the more export-oriented countries (an increase of 25%). This difference is negligible -- but not so the difference in efficiency when measured by implicit international competitiveness. The average share of manufactured exports to total exports was approximately the same in 1965 for both sets of countries (9.7% versus 12.2%). By 1987 that was no longer the case: for the more closed economies, this share increased to 14.9% (an increase of 53%), and for the more export-oriented economies, the share jumped to 40.4% (an increase of 230%).

2.09 In summary, compared to countries that have turned inward, the countries that have become more export oriented have grown faster, have experienced a comparable rate of industrialization, and have achieved far greater success in reducing their dependence on primary (non-manufactured) exports. As others have repeatedly pointed out, the results from single-equation regressions do not reveal anything about causality. Nevertheless, the circumstantial evidence strongly contradicts a key proposition of the inward-oriented approach -- that greater reliance on the domestic market at

the expense of export markets is conducive to faster industrialization and growth.

2.10 A rejection of the ISI strategy, however, does not imply that market enlargement through regional integration is not a potentially useful vehicle for promoting development. As the results in Table 4 indicate, the relationship between overall growth and domestic market size remains significant even for the more outward-oriented economies.

III. REGIONAL INTEGRATION AND ECONOMIC PERFORMANCE:
FURTHER EMPIRICAL RESULTS

A. Regional Integration and Output Growth

3.01 Most regional integration efforts among developing countries have not had an appreciable impact on economic performance. To illustrate this point, the regressions shown in Table 2 were repeated with the inclusion of a DUMMY variable to see whether integration had a significant effect on growth performance. Several regional associations have only been in existence for a short time (e.g., the East African PTA and SADCC were established after 1980) and, thus, are not likely to have had a strong impact on growth performance as measured since 1965. The DUMMY variable, therefore, was constructed to equal 1 if the country belonged to a union since at least 1976 and 0 otherwise; the economic unions represented in the DUMMY variable are LAIA/LAFTA, CACM, CARICOM, RCD, CEAO and ECOWAS, which includes CEPGL and MRU. These unions comprise about 65% of the countries included in Table A.1 of the Annex. In all cases, the DUMMY variable was not significantly related to output growth and often exhibited a negative coefficient sign; Table 6 provides a representative example.

Table 6: THE CORRELATION BETWEEN OUTPUT GROWTH AND INTEGRATION

$$\begin{array}{rcccccc} \text{DLGDP} & = & -1.76 & + & 0.641 & \text{LogGDP87} & + & 0.041 & \text{DEXSH} & - & 0.493 & \text{DUMMY} \\ \text{(T-Val.)} & & (-1.49) & & (4.63) & & & (2.39) & & & (-1.18) & \end{array}$$

$$\text{R-Sq.} = 0.36 \quad \text{F-Stat.} = 11.90$$

$$\begin{array}{rcccccc} \text{DLGNPC} & = & -4.49 & + & 0.652 & \text{LogGDP87} & + & 0.046 & \text{DEXSH} & - & 0.459 & \text{DUMMY} \\ \text{(T-Val.)} & & (-3.48) & & (4.66) & & & (2.63) & & & (-1.09) & \end{array}$$

$$\text{R-Sq.} = 0.37 \quad \text{F-Stat.} = 12.49$$

No. of observations = 67

See Table 2 for data source and definition of variables.

B. Regional Integration and Trade Expansion

3.02 Another indication of the general lack of success of integration efforts among developing countries is the small amount of intra-regional trade generated by most economic groupings. As shown in Table 7, only in ASEAN and CACM has the share of intra-regional trade to total exports risen as high as 20%. In the case of ASEAN, however, intra-regional trade was already well developed before formal integration so that the union itself appears to have contributed little. The initial significant increase in intra-CACM trade can

be attributed directly to the customs union. By this criterion, CACM represented the most successful integration effort among developing countries. This changed, however, with the onset of an economic crisis that resulted in the progressive disintegration of CACM after 1980; by 1987 the share of intra-regional trade declined to about 12%.

Table 7: SHARE OF INTRA-UNION TRADE AS PERCENTAGE OF TOTAL EXPORTS

Economic Grouping	1960	1970	1976	1980	1983	1987
EC <u>a/</u>	34.6	48.9	-	52.8	52.4	58.8
ASEAN	21.7	14.7	13.9	17.8	23.1	17.7
UDEAC	1.6	3.4	3.9	4.1	2.0	0.9
CACM	7.5	26.8	21.6	22.0	21.8	11.9
CARICOM	4.5	7.3	6.7	6.4	9.3	6.3
LAIA/LAFTA	7.7	10.2	12.8	13.5	10.2	11.3
Andean Group	0.7	2.3	4.2	3.5	4.3	3.2
CEAO	2.0	9.1	6.7	6.9	11.6	7.7
ECOWAS	1.2	2.1	3.1	3.9	4.1	5.5
CEPGL	0.0	0.2	0.2	0.2	0.2	-
MRU	0.0	0.1	0.2	0.1	0.1	-
RCD	-	1.0	0.8	5.3	8.5	5.2

a/ Includes the original six members up to 1970 and nine after 1980.
Sources: Robson, Peter. The Economics of International Integration. (London: Allen & Unwin, 1987) and IBRD(CECTP), "Trade Policy Experience of the 1980s", forthcoming.

3.03 The expansion of intra-regional trade resulting from a preferential trading arrangement is not a sufficient criterion for assessing the success of integration, since it may reflect trade diversion as well as trade creation. It is, however, a necessary condition for the realization of any potential economic benefits. The fact that so little intra-regional trade has resulted in most cases, therefore, reinforces the observation made in Table 6 that past integration efforts have not had much of an impact on the economic performance of the countries involved.

3.04 A related question is whether integration has had an effect on overall export orientation. This question is addressed in Table 8, which shows the results from regressing the change in GDP-shares of exports between 1965 and 1987 (DEXSH) on the DUMMY variable. For the entire sample this relationship is negative but statistically insignificant. When the set of countries is split into two sub-samples distinguished by the level of per

capita income, however, a more interesting result shows up. For the least developed economies, membership in an economic grouping is positively correlated with increased export orientation, and for the higher-income countries the relationship is negative. This result may reflect the fact that almost half of the high-income sub-sample consists of Latin American countries that belong to regional associations and that had pursued ISI strategies most vigorously on both a national and regional basis. The low-income sub-sample comprises most of the African nations, where integration efforts generally began later than in Latin America and were initially less intent on ISI.

Table 8: THE RELATION BETWEEN EXPORT ORIENTATION AND INTEGRATION

Sample: All Economies; T = 67

DEXSH = 2.79 - 0.58 DUMMY R-Sq. = 0.001 F-Stat. = 0.04
 (T-Val.) (1.13) (-0.19)

 Sample: Low-Income Economies; T = 33

DEXSH = -3.64 + 5.80 DUMMY R-Sq. = 0.10 F-Stat. = 3.35
 (T-Val.) (-1.51) (1.83)**

 Sample: Higher-Income Economies; T = 34

DEXSH = 11.80 - 9.55 DUMMY R-Sq. = 0.10 F-Stat. = 3.66
 (T-Val) (2.81) (-1.91)**

(** = statistically significant at 10% in a two-tailed test.)
 See Table 2 for data source and definition of variables.

C. Regional Markets as Training Grounds for Exporters

3.05 Advocates of regional integration often emphasize that a protected regional market would allow infant industries to grow and gain experience in exporting to partner countries. This later enables them to compete more successfully in world markets. The danger is that these infant industries may never mature under the shelter of a permanently protected market. Willmore (1988) provides empirical support for this "training ground" argument, based on the experience of CACM. With respect to the manufacturing sector (disaggregated into about 80 industries), he observes an increasing similarity in the structure of intra-regional and extra-regional exports for each of the CACM partner countries; the rank correlation coefficients between intra- and extra-regional exports fell in the 0.40 to 0.50 range in 1970, and in the 0.51 to 0.67 range in 1985. Furthermore, he also finds that the concentration of extra-regional exports across industries has declined markedly: in 1970 the leading three (four-digit ISIC) industries accounted for over 71% of all

extra-regional exports of manufactured goods in each of the five member countries; by 1985 the shares of the leading three industries declined to between 48% and 72%.^{5/}

3.06 Although the preceding evidence lends some support to the hypothesis that the expansion of intra-regional trade facilitates the subsequent expansion of extra-regional trade, the magnitudes involved are extremely small. Table A.3 in the Annex shows the ratios of intra- and extra-regional exports to industry production for the combined CACM manufacturing sector (disaggregated into 18 industries). When the processed foods industry is excluded, less than 5% of the region's manufacturing output was exported to third countries, while intra-regional exports represented around 20%. Moreover, for the most extra-regionally oriented export industries (processed foods and wood), intra-regional exports never accounted for more than a small share of total production, and vice-versa for most other industries.

3.07 One way to assess the training ground argument directly is to examine whether the industries that have become more export oriented in an intra-regional context have increased subsequently the share of production destined to third country markets. Table 9 presents some results obtained by regressing the change in the share of extra-regional exports to production over a five-year period on the change in the share of intra-regional exports over preceding five-year periods. The cross-industry regressions are carried out for CACM as a whole, and also separately for Costa Rica and Guatemala, taking into account that production patterns in El Salvador and Nicaragua are likely to have been disrupted by civil strife during the 1980s.

3.08 For CACM and for Guatemala separately, the results in Table 9 do not support the hypothesis that past intra-regional trade expansion has been a significant factor in promoting greater export orientation toward third-country markets. For Costa Rica, in contrast, a significant positive correlation exists between the increase in the share of extra-regional exports from 1980 to 1985 and past increases in intra-regional export shares. This result partly reflects the strong decline of intra-regional trade between 1980 and 1985, which forced regionally-oriented industries to reorient their production toward third-country markets (last equation in Table 9). This ability of the Costa Rican producers to reorient exports remains a noteworthy achievement in stark contrast to the overall export stagnation in Guatemala and the rest of CACM.

3.09 One factor in the Costa Rican export experience during the 1980s is that it was much less affected by civil war and social tensions than its CACM neighbors. Another important factor, however, is the change in the trade policy environment. Efforts to promote extra-regional exports began earlier and were pursued more vigorously in Costa Rica than in any of the other CACM countries. Also, by adopting the most flexible exchange rate management, the

^{5/} Among these countries, Costa Rica exhibited the greatest improvement in export diversification, with the share from the leading three industries falling from 91% to 48%, while Guatemala exhibited the least improvement, its share only falling from 71% to 67%.

Costa Rican authorities were able to maintain stable real exchange rates, thus avoiding the disruptive influence on exports of appreciating real rates experienced in the other partner countries. The overall evidence therefore suggests that the expansion of intra-regional trade does not automatically lead to a subsequent expansion of extra-regional exports. The training ground argument may be valid to some extent in facilitating the creation of industries, but more outward oriented policies are ultimately needed if these are to mature and compete in world markets.

Table 9: THE RELATION BETWEEN INTRA- AND EXTRA-REGIONAL TRADE SHARES IN CENTRAL AMERICAN MANUFACTURING

Sample: CACH Manufacturing Sector (No. of observations = 18)

DEX(75-80)	=	-1.50 - 0.235 DINT(70-75)	R-Sq. = 0.07
(T-Val.)		(-1.20) (1.09)	F-Stat. = 1.20
DEX(80-85)	=	0.99 + 0.089 DINT(70-75) + 0.069 DINT(75-80)	R-Sq. = 0.03
(T-Val.)		(1.03) (0.54) (0.45)	F-Stat. = 0.21
DEX(80-85)	=	0.75 - 0.014 DINT(80-85)	R-Sq. = 0.01
(T-Val)		(0.72) (-0.13)	F-Stat. = 0.01

Sample: Guatemala Manufacturing Sector (No. of observations = 18)

DEX(75-80)	=	-0.32 + 0.060 DINT(70-75)	R-Sq. = 0.01
(T-Val.)		(-0.21) (0.03)	F-Stat. = 0.07
DEX(80-85)	=	-1.56 + 0.029 DINT(70-75) - 0.223 DINT(75-80)	R-Sq. = 0.11
(T-Val.)		(-0.78) (0.09) (-1.23)	F-Stat. = 0.93
DEX(80-85)	=	1.33 + 0.146 DINT(80-85)	R-Sq. = 0.04
(T-Val.)		(0.65) (0.81)	F-Stat. = 0.30

Sample: Costa Rica Manufacturing Sector (No. of observations = 18)

DEX(75-80)	=	0.019 + 0.013 DINT(70-75)	R-Sq. = 0.01
(T-Val)		(0.92) (0.05)	F-Stat. = 0.20
DEX(80-85)	=	0.887 + 0.126 DINT(70-75) + 0.457 DINT(75-80)	R-Sq. = 0.57
(T-Val.)		(0.79) (0.60) (4.38)*	F-Stat. = 9.92
DEX(80-85)	=	1.26 - 0.243 DINT(80-85)	R-Sq. = 0.35
(T-Val)		(1.07) (-2.95)*	F-Stat. = 8.69

(* = significant at 5%)

Variable definitions: DINT(..) = change in the ratio of intra-regional exports to total production over the five year period indicated in parentheses.
 DEX(..) = Change in the ratio of extra-regional exports to total production over five years.

Source: See Table A.3 in Annex.

IV. MAIN OBSTACLES TO REGIONAL INTEGRATION

4.01 If larger economies perform better on average than smaller ones, as the evidence in Section II suggests, why have regional integration efforts among developing countries been so unsuccessful? The most visible sign of this lack of success is that intra-regional trade generally failed to expand significantly following the creation of preferential trading areas. This observation suggests either that policymakers have been unwilling or unable to dismantle existing policy barriers or that the countries in question have little to trade in the first place. Three widespread reasons for the reluctance to reduce trade barriers are (i) the persistence of macroeconomic imbalances, (ii) political resistance to liberalization, and (iii) a lack of consensus on an equitable distribution of the costs and benefits of protection. Structural impediments have also represented a major obstacle in some cases, so that even if all policy barriers were removed the potential for efficient trade expansion remains small.

A. Macroeconomic Instability

4.02 An important factor contributing to the initial success of CACM in expanding intra-regional trade was the relatively stable macroeconomic environment of the region. The member countries followed fairly conservative fiscal and monetary policies, and international prices of primary agricultural products exported by the region were steadily rising. Both factors enabled the countries to peg their currencies to the U.S. dollar without serious real exchange rate disequilibria. Tariffs represented the main trade policy instrument, and they were eliminated across-the-board on regional trade except for about 10% of all tariff categories (mostly staple agricultural products, imported fuels and some luxury items). This situation changed drastically in the late 1970s when all member countries experienced increasing fiscal and balance-of-payments deficits. In an attempt to reduce inflation, policymakers were reluctant to carry out needed exchange rate adjustments; to prevent the consequent loss of foreign reserves, exchange controls were introduced.

4.03 This response led to the progressive disintegration of CACM: with the adoption of exchange controls, intra-regional imports confronted the same barrier as extra-regional imports. The impact on intra-CACM trade, however, was more damaging than on extra-CACM trade because of the manner in which exchange licenses were granted: these were allocated on a preferential basis, with highest priority given to essential items (basic foods, medicines, etc.) followed by intermediate inputs needed to sustain domestic production in each country, and lowest priority given to final consumer products and luxury goods. The pattern of trade that had developed with the CACM's adoption of a selective ISI strategy was such that the items highest on the priority list were generally imported from third countries, while intra-regional trade consisted largely of manufactured consumer goods that were lowest in priority and, thus, discriminated against. The contraction of intra-regional trade was further accelerated by the collapse of the regional payments clearinghouse when several countries experienced severe balance of payments difficulties and failed to repay intra-regional debt. As a result, between 1980 and 1986 the

dollar level of intra-regional imports declined by twice as much as that of extra-regional imports (-56% vs. -25%).

4.04 The experience of the CACM countries with exchange controls is typical of other unions as well. Many countries that participate in economic unions in Africa and Latin America rely on exchange controls to preserve a precarious macroeconomic balance. Furthermore, the structure of trade in these countries is often similar to that which prevailed in CACM; the major source of hard-currency foreign exchange is primary agricultural or raw material exports to third countries which, in turn, are the major suppliers of capital and intermediate goods used by the infant domestic manufacturing sectors. Thus, although integration is meant to promote trade in regionally-produced manufactured goods, these are often the goods first discriminated against as soon as balance of payments problems emerge and foreign exchange is rationed.

4.05 The structure of protection rates under a selective ISI strategy is typically characterized by high rates granted to final manufactures and low rates to intermediate and capital goods, and mirrors the type of trade pattern observed in CACM. The ISI strategy may initially succeed in promoting manufactured exports within the protected market, but the anti-export bias generated by the protection structure renders these industries uncompetitive in third markets. Conversely, the low protection rates on intermediate and capital goods prevent such industries from developing within the region and encourage excessive capital intensity in production.^{6/} Thus, contrary to the export diversifying objective of integration, the region's dependence on primary exports as the main source of foreign exchange is not significantly diminished, and countries remain as vulnerable to destabilization by commodity price fluctuations as before. But with intermediate products generally characterized by lower price and demand elasticities than final consumer goods, the demand for imports from third countries fostered by the ISI incentive structure becomes more rigid and makes the adjustment process required by balance of payments disequilibria more difficult.

^{6/} For example, in Costa Rica the average legal tariff rate was 26% in the mid-1980s, but the average for final manufactured consumer goods imports competing with regional production was 50%, and the average for intermediate goods imports not competing with regional production was only 10%. Moreover, a significant share of duties on intermediates was exempted as part of an industrial promotion scheme, so that the average rate of duties collected on all imports was only about 11%, less than half the legal average rate. The anti-export bias generated by such a protection structure is reflected in the CACM trade pattern: in 1980, 14% of CACM's manufacturing output (19% when processed foods is excluded) was exported within the region, and only 9% (3.5% without foods) was exported to third countries.

B. Political Resistance to Liberalization

4.06 Organized pressure groups opposed to unilateral trade liberalization are likely to remain just as opposed to regional liberalization efforts if they see their interests threatened by new competition. This has meant that most integration movements have evolved into either free-trade areas limited to certain products or to customs unions with high external barriers. Both are likely to foster trade diversion over trade creation or to have little impact at all on trade: a typical procedure in creating free-trade areas (exemplified by ASEAN, LAFTA, and the East African PTA) is to negotiate tariff reductions on a product-by-product basis. The product categories on which agreement is reached most easily are those in which one partner country produces the item in question but not the others, or in which a product is neither produced nor consumed in the region.^{7/} With this procedure, established industries that are granted preferential access to a partner country's market do not encounter local competition and only displace extra-regional imports.

4.07 Wonnacott and Lutz (1989) have examined eight regional associations, three of which comprise industrial countries, and ranked them according to the amount of intra-regional trade expansion that took place after establishment of the union. The economic groupings exhibiting the strongest expansion of intra-regional trade (CACM, EEC and EFTA) are those that have adopted an across-the-board approach to intra-regional tariff reductions rather than a product-by-product approach. Furthermore, except for EFTA, trade creation significantly exceeded trade diversion in these cases. Two other regional associations (ASEAN and the Andean Group) exhibited a significant expansion of extra-regional trade but a negligible expansion of intra-regional trade, which suggests that integration was essentially irrelevant to the evolution of these countries' trade patterns. The remaining associations (NAFTA, LAFTA and EAC)^{8/}, characterized by the product-by-product tariff cutting approach, all exhibited declining extra-regional trade and

7/ Tan (1982) provides some amusing examples of irrelevant preferences granted in ASEAN under such a procedure.

8/ NAFTA refers to the free trade area comprising New Zealand and Australia. EFTA refers to the European Free Trade Area and currently comprises Austria, Finland, Norway, Sweden and Switzerland.

negligible changes in intra-regional trade.^{9/} Wonnacott and Lutz interpret these results as broadly confirming the wisdom of GATT's Article XXIV, which advocates the elimination of barriers on "substantially all" trade among members of a union (see Section I). The main insight from this analysis, however, is not so much that the product-by-product tariff cutting approach fosters trade diversion but that it appears to result in hardly any expansion at all of intra-regional trade.

C. The Distribution of Costs and Benefits from Integration

4.08 Even if regional integration succeeds in increasing the overall economic welfare of a region, not all member countries may gain. This is because the costs of protection are borne by consumers or users of inputs and, thus, distributed according to the pattern of consumption within the region, while the benefits are distributed according to the location of the protected industries in the region. When the distribution of consumers and producers does not coincide, some countries -- particularly the less industrialized members of a union -- pay a disproportionate share of the net costs, raising their demands for compensation. The absence of a satisfactory compensation system was a major factor in the breakup of the EAC -- Tanzania and Uganda felt they were bearing too high a share of the costs while Kenya was reaping most of the benefits. The same problem also led Honduras to withdraw partially from CACM (the "football war" with El Salvador added motive) and prompted Chad to withdraw temporarily from UDEAC; both countries were among the least developed in their respective unions.

4.09 The problem of distribution arises in economic unions in large part because of a natural tendency for industries to concentrate around certain "poles of development" to take advantage of the economies of scale in infrastructure and of externalities provided by a common location. In a national context the same problem arises, of course, but it is usually less

9/ CACM, according to the Wonnacott and Lutz calculations, experienced the greatest increase in intra-regional trade (8.2% of GDP) while extra-regional trade declined marginally (-0.2% of GDP) between 1957-60 and 1966-70. These aggregated figures, however, disguise the level of trade diversion that took place. As discussed earlier, CACM eliminated most tariffs on intra-regional trade but maintained a high common external tariff on final goods manufactured within the region, while intermediate inputs and capital goods not competing with regional production received low tariffs and were often duty-exempt. The high protection granted to final-goods led to an expansion of these industries (and intra-regional trade), largely at the expense of imports from third countries; the low protection for intermediate goods allowed an equally rapid expansion of such imports from third countries, as these inputs were needed for the regional final-goods industries. In the aggregate, therefore, the total flow of imports from third countries did not change much, but the composition of trade changed considerably. That change in composition eventually increased the region's vulnerability to external shocks, as explained in the preceding section.

acute than in an international context, for two reasons: first, in most cases an established political system settles (not always peacefully) regional conflicts over equitable distribution; and second, barriers to factor mobility are lower, so that labor and capital have the option of migrating toward the industrial pol's. Although labor migration across countries has been common in many developing countries, most countries are not willing to allow unrestricted factor mobility within an economic union as a legally established right (even the EC is just now in the process of eliminating such barriers).

4.10 The most direct mechanism for compensating the weaker members of an economic union is through fiscal transfers, as done in UDEAC, CEAO, and SACU. One problem with this mechanism is how to calculate an adequate level of compensation. Another problem is that governments in countries with weak tax collection systems are often reluctant to give up "hard-earned" fiscal revenues. A standard criterion for calculating the level of compensation is the net amount of external tariff revenues foregone by participating in the union. The reason most countries choose to participate in an economic union, however, is to accelerate industrialization, and mere fiscal compensation would not correct the regional disparity in industrial development. In response, some unions have established regional development banks (such as the Central American Bank for Economic Integration or the ECOWAS Fund) with a mandate to support regional integration projects and balanced development. Other unions have focused on Industrial Programming, as particularly ASEAN and the Andean Group have done.

4.11 A basic objective of industrial programming schemes is to ensure that each country gets a fair share of industries with potential scale economies that could supply the region. Most such attempts have failed, however. For example, neither in ASEAN nor in the Andean Group has a significant regional industry been established, despite extensive planning (Vaitsos, 1978; Arndt and Garnaut, 1979). The main reason for failure is the inability to reach agreement on the location of the regional large-scale industries and on each member country's financial contribution in setting up the industry. Such industries would inevitably constitute regional monopolies, and just as conflicts arise through the unequal distribution of the costs and benefits of protection, similar conflict arises over the sharing of prospective monopoly rents. Moreover, industrial programming efforts are hampered from the outset by the fact that regionally-balanced industrialization necessarily conflicts with the capture of economies of scale in the most efficient manner.

D. Structural Constraints

4.12 The lack of adequate postal, telephone/telefax and transportation links is often cited as a powerful impediment to trade among developing countries, particularly in Africa. Substantial investments are needed in these areas if trade is to expand significantly. The development of the Pan-American Highway and other transport links in Central America during the 1950s, for example, is generally recognized as having had a high payoff in terms of accommodating the subsequent expansion of intra-CACM trade. Such infrastructural investments are generally costly and, thus, have to be weighed

against the potential benefits of trade expansion. From this standpoint, some integration efforts have been overly ambitious by attempting to promote trade between countries (i) geographically too far apart to constitute natural trading partners and (ii) where the provision of adequate infrastructural links would be too expensive to justify the likely volume of trade.^{10/} Two cases in point are the East African PTA, spanning the entire length of East Africa, and LAIA/LAFTA, which comprises most of the South American continent. The danger of resource misallocation arises here when intra-regional trade is artificially fostered at the expense of more efficient extra-regional trade.

^{10/} Brada and Mendez (1983) examined the effect of five regional integration schemes on the volume of intra-regional trade, using a "gravity model" of trade that takes into account geographic distance and differences in per-capita income as potential obstacles to trade. They found that trade among CACM countries was augmented (through integration) by a factor not different from that estimated for EFTA and the EEC, while LAFTA and the Andean Pact had no positive effect on intra-group trade. From these results they conclude that distance has a powerful, depressing effect on the ability of preference schemes to increase intra-regional trade.

V. ECONOMIC INTEGRATION AND OVERALL TRADE LIBERALIZATION

5.01 A central problem with past integration efforts among developing countries is that regional integration has been pursued primarily as an alternative to overall trade liberalization and not as a complementary process. It is important to recognize that existing economic unions, even if perfectly integrated, still constitute small economic units in a global context -- thus, to maximize their collective welfare requires progressively liberalizing trade with the rest of the world.

5.02 In a fully integrated global economy, regional integration would no longer be a relevant issue. Therefore, the question becomes whether there is any point in pursuing regional integration if the respective member countries are prepared to embark on a strategy of overall trade liberalization. Two considerations apply when addressing this question: (a) the implementation of an overall trade liberalization program is likely to be a gradual process; and (b) even after such trade liberalization programs are completed, it is likely that some policy barriers will remain. Many developing countries rely heavily on tariff revenues as a source of fiscal income; averaged over all developing economies, taxes on international trade currently account for over 20% of total current fiscal revenues. The complete elimination of tariffs, therefore, would require comprehensive fiscal reforms. Until that occurs, regional integration may represent a worthwhile objective, depending on the particular benefits and costs.

5.03 On the benefit side, regional economic integration could facilitate overall trade liberalization by the partner countries in the following manner:

- a) Macroeconomic adjustments associated with the implementation of an overall trade liberalization program may be facilitated if other countries eliminate their trade barriers simultaneously. For example, a unilateral reduction of import barriers will likely result in a surge of imports requiring commensurate exchange rate adjustments to prevent balance of payments disequilibria. When other countries simultaneously facilitate access to their markets by also reducing their import barriers, the degree of adjustment in exchange rates could be moderated, depending on how important the countries are to each other as trading partners. Although this argument generally has been used to justify trade liberalization on a bilateral basis, it also applies when two countries proceed on an overall liberalization program.
- b) During the transition to a liberalized trade environment, some industries will remain protected. In that case, it is preferable that they be protected on a regional rather than a national basis. Compared to a small national market, a larger regional market offers better opportunities for capturing economies of scale and for creating competition. Moreover, even in a liberalized trade environment, regional integration could result in gains from trade through the exchange of goods and services that would be considered "non-tradables" from an extra-regional perspective.

- c) Regional integration may also facilitate the expansion of extra-regional exports. In many cases, export success depends as much on the ability to supply in sufficient volume as on price. Some countries' resources may be too small to create industries of sufficient size to compete effectively in world markets. By enabling a more efficient pooling of resources, either through greater factor mobility or through the freer flow of intermediate inputs, regional integration could provide a more efficient basis for export production.^{11/} In this respect, it would also be more attractive to foreign investment.
- d) Trade barriers encourage smuggling. Casual evidence indicates that a considerable amount of trade between neighboring developing countries is unrecorded. Regional integration would promote trade through legal channels, rendering it more efficient since fewer resources would be wasted in the process of law evasion.
- e) Regional integration may improve the effectiveness of negotiations through GATT, on the principle that a collective stand on issues of common interest attracts more recognition than individual demands. At the same time, a collective agreement, especially through GATT, may help politicians resist protectionist pressures at home and, thus, may facilitate the adoption of outward-oriented policies.

5.04 The potential benefits described above present a case for regional integration as part of an overall liberalization strategy but not as an alternative to that overall strategy. Benefits are likely to be small in many cases but should not be overlooked. On the cost side, the main dangers of pursuing a regional integration strategy are that (a) attention is diverted away from the more important objective of achieving overall trade liberalization, and (b) the process of arriving at a regional consensus on policy actions becomes excessively cumbersome and drawn out. In the end, sufficient actions may not be taken. This problem is particularly acute when the partners of a prospective integration scheme face different economic circumstances and are not prepared to take joint policy actions. To avoid such a situation, the integration scheme would have to be sufficiently flexible to accommodate the separate needs of the partners.

A. Basic Elements of an Outward-Oriented Integration Strategy

5.05 The previous section pointed out the potential usefulness of regional integration in facilitating outward-orientation; this section describes some specific measures for realizing that potential. An important

^{11/} Allowing productive resources to migrate, however, may create difficulties and raise issues of compensation. A different possibility for capturing scale economies and generating a more concerted export effort is to encourage regional trading companies to coordinate and market the production of firms in separate countries.

point from the outset is that regional integration is likely to remain ineffective unless (a) the prospective integration partners are able to maintain sufficient macroeconomic stability through appropriate fiscal, monetary and exchange rate management, and (b) a clear consensus is established among policymakers on integration objectives. Moreover, if an ISI-based integration scheme represents the only collective option, most countries would be better off pursuing a strategy of unilateral liberalization.

5.06 With respect to the trade policy measures that define an integrated area, the GATT conditions serve as a useful starting point for creating more effective outward-oriented unions. That is, regional integration schemes should strive (a) to liberalize intra-regional trade on a comprehensive basis (not just product by product) and (b) to avoid raising the average tariff barrier against extra-regional imports. Both conditions subsume the prior elimination of non-tariff policy barriers, including exchange controls. In addition to these broad guidelines, a strategy of progressive reduction and unification of tariffs should be included as part of an integration program to prevent the stagnation of trade liberalizing efforts. Further measures that would enhance the process of integration include harmonizing tariff nomenclature and making customs procedures uniform within the region.

5.07 From a practical standpoint, free trade areas are often preferable to customs unions and common markets because they impose fewer constraints on the policies of the member countries. None of the existing economic blocs currently appears ready to establish a full-fledged common market or economic union (as defined in footnote 1), but in some cases the establishment of a customs union by adopting common external tariffs may be necessary to consolidate the integration effort. In this context, the process of liberalization would be facilitated by having a common external tariff policy that is binding only with respect to a tariff ceiling and floor.^{12/} Moreover, individual member countries should also have the flexibility to unify their tariffs further, within the permissible tariff range, without requiring the consensus of the partners. This would encourage those members that are better prepared to implement further trade liberalization to proceed as quickly as

^{12/} For countries that rely heavily on tariff revenues to maintain fiscal balance, it is desirable to accompany tariff ceiling reductions with higher tariff floors until a more comprehensive tax reform has taken place. The higher tariff floor prevents tariff revenue erosion and has the added advantage of reducing tariff dispersion, creating a more uniform incentive structure. E.g., in most CACM countries about half of all tariff positions have tariff rates below 10%. Rough calculations show that raising those tariffs to a 10% floor would allow a tariff ceiling reduction to 20% without causing a significant loss of revenues.

possible while preventing arbitrary tariff modification in a manner that disrupts intra-regional trade.^{13/}

5.08 Since regional compensation systems have not worked well anywhere, the best course is to avoid such schemes altogether. By allowing a greater degree of flexibility in the individual management of external tariffs, each country has the option to reduce the costs of protection unilaterally so that the issue of how they are distributed becomes less relevant. Similarly, past industrial programming efforts to achieve regionally balanced development have not worked. The most pragmatic approach is to allow freer intra-regional competition while maintaining adequate macroeconomic control, with the marketplace determining the most efficient location of industries. In the case of natural monopolies or specific projects involving public goods, regional coordination may be justified. But such projects are best negotiated on a bilateral basis and need not involve a comprehensive integration framework.

5.09 Finally, it is necessary for the member countries to step up efforts to promote exports in world markets. This is an area largely neglected in past integration efforts and where the creation of a freer regional market may yield the greatest benefits.

5.10 The integration strategy proposed here is far looser and less ambitious than past integration schemes. It is also necessary to recognize that in many cases the measures called for will be unlikely to promote a significant expansion of intra-regional trade. In those instances, however, such trade would not be efficient in the first place and, thus, should not be fostered artificially. The potential benefits from the proposed integration strategy may seem modest compared to those envisaged in earlier schemes--but capturing those benefits would constitute a significant improvement over the actual gains that have resulted from the earlier integration efforts.

13/ It is recommendable in this context that prospective integration partners agree on the method of nominal tariff reduction and unification. There are two basic methods that assure that the level and dispersion of effective protection rates are reduced at each step: (i) the concertina method, whereby the highest nominal tariff is reduced first toward the level of the next highest, and then both are reduced simultaneously toward the third highest, and so on; and (ii) the proportional method, whereby all tariffs are reduced simultaneously by the same proportion relative to the end-target rate. Adherence to one of these options also reduces the risk of disrupting intra-regional trade flows when countries unify tariffs at different speeds. If partner countries adjust external tariffs independently, it is necessary to agree on "rules of origin," to prevent imports from third countries being channeled through the partner country with the lowest tariff.

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TABLE A.1: Basic Data File

COUNTRY	POP 1987 (millions)	GDP 1987 (mill. US\$)	GNP/CAP (in US\$)	AVERAGE ANNUAL GROWTH RATE (65-87)		EXPORT (Share of GDP(%))		VALUE ADDED IN MANUFACTURING (Share of GDP(%))		MANUFACTURED EXPORT (Share of total exports (%))	
				GDP	GNP/CAP	1965	1987	1965	1987	1965	1987
ETHIOPIA	44.8	4800	130	2.124	0.1	12	11	7	15	1	1
CHAD	5.3	980	150	1.700	-2.0	19	17	12	15	4	0
ZAIRE	32.6	5770	150	1.396	-2.4	36	33	16	NA	8	6
MALAWI	7.9	1110	160	4.776	1.4	19	24	NA	NA	1	16
NEPAL	17.6	2560	160	2.796	0.5	8	13	3	5	22	72
TANZANIA	23.9	3080	180	3.060	-0.4	26	13	8	5	13	18
BURKINA FASO	8.3	1650	190	1.792	1.6	9	17	NA	15	5	2
MADAGASCAR	10.9	2070	210	1.184	-1.8	16	20	11	NA	5	11
BURUNDI	5.0	1150	250	3.212	1.6	10	9	NA	9	6	15
ZAMBIA	7.2	2030	250	1.260	-2.1	49	47	6	23	0	3
NIGER	6.8	2160	260	-0.404	-2.2	9	19	2	5	5	1
UGANDA	15.7	3560	260	0.672	-2.7	26	10	8	5	1	0
SOMALIA	5.7	1890	290	2.948	0.3	17	11	3	5	14	1
TOGO	3.2	1230	290	2.900	0.0	20	31	10	7	4	8
RWANDA	6.4	2100	300	4.168	1.6	12	8	2	16	1	1
SIERRA LEONE	3.8	900	300	1.992	0.2	30	9	6	4	60	59
BENIN	4.3	1570	310	2.324	0.2	13	15	NA	4	5	21
CENTRAL AFRICAN REP	2.7	1010	330	2.408	-0.3	27	17	4	8	5	33
KENYA	22.1	6930	330	5.568	1.9	31	21	11	11	1	17
SUDAN	23.1	8210	330	2.552	-0.5	15	8	4	8	6	7
PAKISTAN	102.5	31650	350	5.580	2.5	8	13	14	17	36	67
HAITI	6.1	2250	360	1.844	0.5	13	12	NA	NA	25	82
NIGERIA	106.6	24390	370	4.148	1.1	13	31	6	8	1	1
GHANA	13.6	5080	390	1.400	-1.6	17	20	10	10	3	2
SRI LANKA	16.4	6040	400	4.192	3.0	38	25	17	16	1	40
MAURITANIA	1.9	840	440	1.808	-0.4	42	50	4	NA	1	2
INDONESIA	171.4	69670	450	6.592	4.5	5	26	8	14	4	27
LIBERIA	2.3	990	450	1.828	-1.6	50	43	3	5	4	1
SENEGAL	7.0	4720	520	2.484	-0.6	24	28	16	17	4	15
BOLIVIA	6.7	4470	580	2.388	-0.5	21	14	15	13	4	2
PHILIPPINES	58.4	34580	590	3.852	1.7	17	23	20	25	6	62
MOROCCO	23.3	16750	610	4.696	1.8	18	25	16	18	5	49
EGYPT	50.1	34470	680	6.640	3.5	9	15	NA	14	20	19
PAPUA N.G.	3.7	3030	700	4.088	0.8	8	44	NA	9	10	6
DOMINICAN REP	6.7	4910	730	5.476	2.3	6	16	16	16	2	22
COTE D'IVOIRE	11.1	7650	740	5.328	1.0	37	34	11	16	5	9
HONDURAS	4.7	3530	810	3.816	0.7	27	24	12	15	1	12
NICARAGUA	3.5	3200	830	1.672	-2.5	39	14	18	28	6	10
THAILAND	53.6	48200	850	6.688	3.9	6	30	14	24	4	53
EL SALVAD	4.9	4750	860	2.796	-0.4	27	19	18	17	17	31
CONGO P.R.	2.0	2150	870	6.112	4.2	36	43	NA	8	63	16
JAMAICA	2.7	2860	940	1.012	-1.9	33	55	17	22	31	66
GUATEMALA	8.4	7040	950	3.788	1.2	17	16	NA	NA	14	36
CAMEROON	10.9	12660	970	5.708	3.8	24	16	10	13	5	9
PARAGUAY	3.9	4570	990	5.108	3.4	15	22	16	16	8	12
ECUADOR	9.9	10610	1040	6.396	3.2	16	23	18	19	2	4
TUNISIA	7.6	8450	1180	5.640	1.6	19	35	9	15	19	61
TURKEY	52.6	60820	1210	5.948	2.6	6	21	16	26	2	67
COLOMBIA	29.3	31940	1240	4.736	2.7	11	19	18	19	2	21
CHILE	12.5	18950	1310	1.612	0.2	14	36	24	NA	5	9
PERU	20.2	45150	1470	3.036	0.2	16	9	17	23	1	19
MAURITIUS	1.0	1480	1490	5.568	3.2	36	69	14	24	0	40
COSTA RICA	2.6	4310	1610	4.792	1.5	23	34	NA	NA	16	40
SYRIA	11.2	23990	1640	6.012	3.5	17	15	NA	NA	10	27
MALAYSIA	16.5	31230	1810	6.472	4.1	42	64	9	NA	6	40
MEXICO	81.9	141940	1830	4.580	2.5	8	7	20	25	16	47
SOUTH AFRICA	33.1	76260	1890	3.108	0.6	26	29	23	23	32	78
BRAZIL	141.4	299230	2020	7.176	4.1	8	9	26	28	9	45
URUGUAY	3.0	6420	2190	1.216	1.4	19	21	NA	27	5	44
ARGENTINA	31.1	71530	2390	2.284	0.1	8	10	33	31	6	31
YUGOSLAVIA	23.4	59960	2480	4.560	3.7	22	24	NA	NA	57	78
ALGERIA	23.1	64600	2680	6.316	3.2	22	14	11	12	4	1
KOREA	42.1	121310	2690	9.212	6.4	9	45	18	30	59	92
GABON	1.1	3500	2700	6.652	1.1	43	41	NA	NA	11	10
VENEZUELA	18.3	49610	3230	2.580	-0.9	26	22	NA	22	2	8
GREECE	10.0	40900	4020	4.256	3.1	9	21	16	18	13	54
TRINIDAD & TOBAGO	1.2	4260	4210	1.516	1.3	65	33	NA	10	7	23

NA = data not available
Source: IBRD; World Development Report, 1989.

Table A.2

MEMBERSHIP OF MAJOR ECONOMIC UNIONS AMONG DEVELOPING COUNTRIES

(Dates when unions were created are in parentheses; other figures refer to the 1986 level of GDP in millions current US Dollars)

LATIN AMERICA AND THE CARIBBEAN

Latin American Integration Association, LAIA (1980),
formerly the Latin American Free Trade Area (1960).

Brazil	206,750	The Andean Group (1969)	
Mexico	127,140		
Argentina	69,820	Colombia	29,660
Paraguay	3,590	Ecuador	11,510
Uruguay	5,320	Peru	25,370
Chile	16,820	Venezuela	49,980
		Bolivia	4,180
		Subtotal (AG)	120,700
		Total (LAIA)	550,140

Central American Common Market, CACM (1960)

Costa Rica	4,260
El Salvador	3,980
Guatemala	7,470
Honduras	2,960
Nicaragua	2,900
Total (CACM)	21,570

Caribbean Community, CARICOM (1973),
formerly Caribbean Free Trade Area, CARIFTA (1968)

Trinidad & Tobago	4,830	Dominica	103
Jamaica	2,430	Grenada	122
Barbados	1,308	St. Kitts-Nevis	73
Guyana	400	St. Lucia	185
Belize	200	St. Vincent	114
Antigua	193	Montserrat	NA
		Total (CARICOM)	9,958+

Table A.2 (cont'd)

AFRICA

Economic Community of West African States, ECOWAS (1975)

Communaute Economique de l'Afrique de l'Ouest, CEAO (1974)		Mano River Union, MRU (1973)		Other ECOWAS	
Benin	1,320	Guinea	1,980	Nigeria	49,110
Burkina Faso	930	Liberia	990	Cape Verde	154
Cote d'Ivoire	7,320	Sierra Leone	1,180	Gambia	176
Mali	1,650			Ghana	5,720
Mauritania	750	Subtotal (MRU)	4,150	Guinea Bissau	170
Niger	2,080			Togo	980
Senegal	3,740			Subtotal	55,980
Subtotal (CEAO) 17,790					

Total (ECOWAS) 77,920					

Communaute Economique des Etats de l'Afrique Centrale, CEEAC (1983)

Union Douaniere et Economique de l'Afrique Centrale, UDEAC (1964)		Communaute Economique des Pays des Grands Lacs, CEPGL (1976)	
Cameroon	11,280	Burundi	1,090
Central African Rep.	900	Rwanda	1,850
Equatorial Guinea	53	Zaire	6,020
Congo, P.R.	2,000	Subtotal (CEPGL)	8,960
Chad	704		
Gabon	3,190	Other CEEAC	
Subtotal (UDEAC)	18,127	Sao Tome Principe	37

Total (CEEAC) 27,124			

Preferential Trade Area for East Africa, PTA (1981)

Burundi	1,090	Somalia	2,320
Comoros	131	Swaziland	478
Djibouti	NA	Tanzania	4,020
Ethiopia	4,960	Uganda	3,310
Kenya	5,960	Zambia	1,660
Lesotho	230	Zimbabwe	4,940
Malawi	1,100		
Mauritius	1,160		
Rwanda	1,850		

Total (PTA) 33,209+			

Table A.2 (cont'd)

Southern African Development Coordination Conference, SADCC (1980)

Botswana	1,150	Tanzania	4,020
Lesotho	230	Zambia	1,660
Malawi	1,100	Zimbabwe	4,940
Mozambique	4,300	Angola	NA
Swaziland	478		
		<hr/>	
		Total (SADCC)	17,878+

Southern Africa Customs Union, SACU (1969)

South Africa	56,370	Lesotho	230
Botswana	1,150	Swaziland	478
		<hr/>	
		Total (SACU)	58,228

Maghreb Union, (proposed in 1988)

Algeria	60,760	Mauritania	750
Morocco	14,760	Libya	NA
Tunisia	7,790		
		<hr/>	
		Total (Maghreb Union)	84,060+

ASIA

Association of South-East Asian Nations, ASEAN (1967)

Indonesia	75,230
Malaysia	27,580
Philippines	30,540
Singapore	17,350
Thailand	41,780
Brunei	3,573
<hr/>	
Total (ASEAN)	196,053

Regional Cooperation for Development, RCD (1964)

Turkey	52,620
Pakistan	30,080
Iran	NA
<hr/>	
Subtotal (RCD)	82,700+

Source: World Bank, World Development Report, 1988

**Table A.3: CENTRAL AMERICA: TRADE RATIOS IN MANUFACTURING,^{a/} 1970-1985
(percentages)**

	<u>Intra-regional imports</u>				<u>Intra-regional exports</u>				<u>Extra-regional imports</u>				<u>Extra-regional exports</u>			
	<u>Apparent Consumption</u>				<u>Production</u>				<u>Apparent Consumption</u>				<u>Production</u>			
	1970	1975	1980	1985	1970	1975	1980	1985	1970	1975	1980	1985	1970	1975	1980	1985
Total	17.5	9.5	10.3	6.4	16.0	12.6	14.3	9.0	32.8	35.4	34.6	34.4	9.1	14.1	9.0	8.0
Total Less Food	12.7	10.3	11.4	7.3	21.7	17.1	18.7	12.0	41.1	42.6	41.3	42.1	3.2	4.7	3.5	4.7
Industry																
Food	7.5	6.4	6.2	3.7	6.4	4.8	5.5	3.5	6.1	7.2	10.0	10.8	19.0	30.5	19.9	14.0
Beverage	1.0	0.6	1.0	0.5	1.0	0.6	1.0	0.5	4.2	5.2	4.1	3.4	0.0	0.0	0.0	0.1
Tobacco	4.7	1.8	0.4	0.7	4.6	1.8	0.4	0.6	0.3	0.2	0.2	0.1	1.1	4.4	3.6	4.2
Textile	28.0	22.9	34.2	15.8	38.1	28.5	42.9	20.7	27.5	23.6	25.2	32.5	1.3	5.0	6.0	11.0
Garment/Shoe	14.1	10.9	16.6	8.7	14.6	11.0	17.2	8.7	4.1	3.5	5.6	4.9	0.8	2.8	1.7	5.4
Leather	19.3	9.6	11.7	6.3	21.1	9.6	11.4	6.4	8.7	4.9	4.9	5.6	0.5	4.4	7.8	4.2
Wood	10.6	12.9	7.9	6.8	7.7	9.1	6.4	4.9	3.6	8.4	3.0	2.8	28.8	34.3	20.8	29.5
Furniture	9.8	7.4	4.1	2.1	10.1	7.4	3.9	2.0	3.1	1.6	2.1	0.9	0.4	1.5	6.2	9.0
Paper	9.5	11.4	13.9	8.0	18.6	20.4	27.1	12.8	49.1	45.5	47.5	38.1	0.1	2.5	1.9	1.2
Printing	8.1	7.1	7.2	3.5	9.5	8.4	9.1	4.4	13.7	16.2	19.9	20.0	0.2	0.8	0.3	0.8
Chemical	20.3	15.3	19.3	12.7	39.5	29.9	40.8	28.4	49.5	52.3	55.4	58.5	3.5	6.6	5.5	5.8
Petrol der.	4.1	3.1	2.7	3.8	5.0	3.9	3.9	5.8	25.2	23.0	30.2	35.0	7.2	2.8	0.9	2.7
Rubber	22.9	22.2	19.3	11.8	30.8	28.8	23.9	15.4	26.3	23.4	21.6	25.6	0.7	0.7	2.3	3.4
Non-metallic mineral	10.0	11.3	11.1	7.3	27.5	14.0	13.6	8.9	23.8	21.3	19.8	20.0	0.2	1.5	1.5	2.1
Metal and prod	13.5	11.5	13.1	8.4	32.8	27.0	31.3	19.4	60.4	58.9	60.4	59.4	3.1	2.4	4.3	5.1
Machinery	7.9	6.4	7.4	4.5	39.8	36.4	32.8	19.4	80.5	83.1	78.9	77.8	1.7	3.5	5.7	3.4
Transport equipment	1.2	1.4	1.2	2.0	7.1	8.2	5.6	13.8	83.1	83.0	78.1	85.3	0.2	0.4	1.0	2.2
Other	8.2	10.1	12.2	6.9	14.6	20.4	29.1	14.7	44.5	50.4	58.5	54.4	1.2	1.6	3.0	3.4

^{a/} Intra-regional trade includes Panama.

Source: ECLAC estimates based on official statistics, reproduced in Willmore, L. "Export Promotion and Import Substitution in Central America's Manufacturing Sector" (CEPAL/MEXICO, 22/06/88)

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