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TYPES OF ECONOMIC INTEGRATION

This paper, prepared for the 4th World Congress of the International Economic Association held on August 19-24, 1974 in Budapest, Hungary, evaluates the experience of developed market economies, socialist countries, and developing nations with regional (plurinational) integration schemes. It examines the results of these integration schemes with regard to two forms of "trade integration": "market integration" through reductions of barriers to intraregional trade and "production-and-development integration" through agreements on plurinational industrial programming and investment allocation. The paper further considers the question of the optimal degree of market and of production-and-development integration as well as the relationship between economic integration and national sovereignty.

A companion paper, "Economic Integration in Developing Countries", prepared by Bela Balassa and Ardy Stoutjesdijk, is issued as Staff Working Paper No. 186.

Prepared by

Bela Balassa
Consultant
Development Research Center
Development Policy Staff

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Béla Balassa

Professor of Political Economy
The Johns Hopkins University

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Béla Balassa

Concepts and Definitions

In the Western economic literature, discussions on the types of economic integration of national states have customarily focused on the various stages of integration. From its lowest to its highest forms, integration has been said to progress through the freeing of barriers to trade ("trade integration"), the liberalization of factor movements ("factor integration"), the harmonization of national economic policies ("policy integration") and the complete unification of these policies ("total integration").[1/]

These definitions have been criticized on the grounds that they conform to the principles of classical economic doctrines but do not apply to present-day market economies, which are characterized by a considerable degree of state intervention, and apply even less to developing and to socialist economies. The relevance to developing countries of the proposed sequencing from the "negative" measures of removing barriers to the "positive" measures of policy coordination was questioned by Kitamura, in whose opinion "the attempt to coordinate and harmonize national economic policies will be an important instrument even in the earlier stages of the integration process" (1966, p.45). Kitamura further claimed that "in certain circumstances ... integration may be accomplished to a considerable extent without lifting the existing trade barriers" (*ibid*).

Pinder expressed the view that the coordination of policies is an important element of integration in present-day developed market economies also. He proposed to "define economic integration as both the removal of discrimination as between the economic agents of the member countries, and the formation and application of coordinated and common policies on a sufficient scale to ensure that major economic and welfare objectives are fulfilled" (1968, p.90).

While emphasizing the need to consider policy coordination, the prominent Hungarian economist, Imre Vajda, criticized the definition put forward by Pinder for its excessive generality. Limiting himself in the first place to trade integration, Vajda introduced the distinction between "market integration" and "production-and-development integration". The former is defined as "the guarantee of unhindered sale of each

other's products within the framework of the social system of participating countries" while the latter is said to involve "raising to an international level and programming the production of those branches of industry which ... cannot be developed to an optimum size within national boundaries" (Vajda, 1971, p.35).[2/]

Vajda's distinction between trade integration through the removal of barriers to trade and through industrial programming on the regional (plurinational) level is meant to apply to developed market, to socialist, and to developing economies as well. It will be used in the following to evaluate the results of integration schemes in the three types of countries. Subsequently, the question of the optimal degree of market and of production and development integration will be examined. In the final section, the relationship between economic integration and national sovereignty will be discussed.

Integration in Developed Market Economies

The European Common Market or European Economic Community (EEC) is the dominant integration scheme in developed market economies. It has absorbed the United Kingdom, the major participant of its would-be competitor, the European Free Trade Association, and now accounts for over four-fifths of the gross national product of Western Europe. Following the creation of the EEC, the then-existing quantitative restrictions on intra-area trade were soon abolished; tariffs on intra-area trade were reduced and, ahead of schedule, eliminated (1968); and a common tariff on extra-area imports was established.

The freeing of barriers to trade was accompanied by the rapid expansion of trade among the partner countries. Between 1959 and 1971, trade among the original member countries of the EEC (Belgium, France, Germany, Italy, Luxembourg, and the Netherlands) increased nearly sixfold as against a fourfold increase in their total imports and exports. As a result, the share of intra-EEC trade in the total rose from one-third in 1959 to one-half in 1971.

The question arises whether, and to what extent, the expansion of intra-EEC trade represents trade creation (the replacement of domestic by partner-country sources of supply) or trade diversion (the replacement of foreign by partner country sources) and how these changes in trade flows affect the welfare of member and nonmember countries. Trade creation is considered bene-

ficial as the elimination of the protection of domestic production vis-à-vis producers in the partner countries permits replacing higher-cost domestic products with lower-cost partner-country products. In turn, trade diversion may be detrimental to both member and nonmember countries. The elimination of barriers to intra-area trade entails discrimination against imports from nonmember countries which continue to pay a duty, thus providing inducements to replace the lower-cost products of nonmember countries by higher-cost products of the partner countries.[3/]

In order to separate trade creation and trade diversion, one has to select a benchmark for evaluating changes in trade flows. Under the assumption that the historical relationship of imports to the gross national product would have remained unchanged in the absence of integration, the present author suggested that a rise in the ratio of the growth rate of total (intra-area and extra-area) imports to that of GNP be taken to represent trade creation, and a decrease in the corresponding ratio for extra-area imports to represent trade diversion (Balassa, 1963).[4/]

The application of this method to the 1959-70 period shows the preponderance of trade creation in the European Common Market (Balassa, 1974). With growth rates of GNP increasing only slightly (5.5 percent in 1959-70 as against 5.4 percent in 1953-59), the growth of imports accelerated; the volume of total imports into the EEC countries rose at an average annual rate of 11.3 percent, compared with 9.6 percent in the pre-Common Market period. By 1970, total imports exceeded imports projected on the basis of the relationships observed in the preceding period by $11.3 billion. This increase accounts for over one-fifth of the imports of manufactured goods, where trade creation was concentrated.

While trade diversion has occurred in the case of foodstuffs, chemicals, and simple manufactured goods, this has been offset by increased imports of machinery and equipment that have been associated with the expansion of investment activity and the trend towards the purchase of more sophisticated machinery in the EEC. Thus, the volume of extra-area imports rose at a rate of 8.9 percent a year between 1959 and 1970, exceeding the rate of increase of 8.3 percent in 1953-59.

It should be added, however, that the effects of the EEC on various groups of nonmember countries have been rather uneven. The main beneficiary has been the United States which is the principal supplier of sophisticated machinery and equipment demanded in the EEC countries. By contrast, developing and socialist countries have been adversely affected by trade diversion in food and in simple manufactured goods (Balassa, 1974). In particular, by increasing barriers to

food imports, the common agricultural policy has penalized foreign suppliers as well as domestic consumers. This contrasts with reductions in tariffs on the imports of industrial materials and manufactured goods in the framework of multilateral trade liberalization that has proceeded since the Second World War.

Higher growth rates associated with the Common Market's establishment have also had beneficial effects on nonmember countries by increasing demand for their exports. These favorable effects have, then, counteracted the adverse repercussions due to trade diversion that some of these countries have experienced.

The described method is open to objections on the grounds that influences other than the creation of the European Common Market may have affected imports. However, the findings of other studies, which have used different methods, confirm the results. Although there is some evidence of trade diversion in manufactured goods, this is shown to be exceeded four to ten times by trade creation. At the same time, according to the various estimates, trade creation accounts for 15 to 30 percent of the imports of manufactured goods by the EEC countries (Balassa, 1974).

Rapid increases of trade in manufactured goods indicate that firms in the member countries have made use of the possibilities offered by the abolition of tariffs and quantitative restrictions. Increased trade has in turn contributed to the acceleration of economic growth in the Common Market countries by permitting the exploitation of economies of scale and greater competition.[5/] Economies of scale have been appropriated as increased specialization has led to the construction of larger plants, the lengthening of production runs in the manufacture of particular products, and the use of specialized machinery and equipment. Gains have also been obtained through the rationalization of production that has resulted from increased competition, especially in the previously highly-protected economies of France and Italy.

Increased investment undertaken to exploit the possibilities for economies of scale has given a further boost to economic growth in the member countries, enabling them to maintain the rates of growth attained during the period of postwar reconstruction. Growth has been the most rapid in Italy, with the result that differences in income levels among the individual countries have narrowed. Furthermore, all but one of the twenty-two regions which had income levels below four-fifths of the Community average have experienced higher-than-average growth rates. The most rapid increases have occurred in Southern Italian regions where incomes per head were the lowest (European Communities, Commission, 1971, pp.312-14).

Rapid economic growth has also had beneficial effects on nonmember countries through higher extra-area imports. This should not

disguise the fact, however, that the effects of the Common Market on various groups of nonmember countries has been rather uneven. The main beneficiary has been the United States which is the principal supplier of sophisticated machinery and equipment demanded in the EEC countries. By contrast, developing and socialist countries have been adversely affected by trade diversion in food and in simple manufactured goods (Balassa, 1974). In particular, by increasing barriers to food imports, the common agricultural policy has penalized foreign suppliers as well as domestic consumers. This contrasts with reductions in tariffs on the imports of industrial materials and manufactured goods in the framework of multilateral trade liberalization that has proceeded since the Second World War.

While the beneficial effects of integration on economic growth in the Common Market stem from "market integration" in manufactured goods following the elimination of barriers to intra-area trade, little progress has been made in regard to "production-and-development integration". In technologically sophisticated industries, such as aircraft, space, computer, and electronics, where efficient operations are limited by the size of national markets, there is as yet no common policy on the EEC level. Rather, decisions on research and development and on public procurement are taken in the national framework,[6/] thereby contributing to the establishment and the expansion of national firms which serve largely the country's own market.

As a result, notwithstanding agreements among national firms in a few cases, production and research in these industries take place at less than optimum scale. This fact has retarded the development of technologically sophisticated industries in the European Common Market as compared with the United States, where firms have benefitted from the existence of a large market and governmental policies of research and development in particular industries (Balassa, 1973).

Integration in Socialist Countries

The Council for Mutual Economic Assistance (CMEA) was established in 1949, with the participation of the Soviet Union, Bulgaria, Czechoslovakia, Hungary, Poland, and Romania, to provide a framework for the economic cooperation of these countries. Albania and East Germany joined shortly thereafter; subsequently, Mongolia and Cuba have become full members while Albania has ceased to participate in CMEA activities.

The following discussion will deal with the experience of the European member countries of the Council for Mutual Economic Assistance. These countries signed the formal Charter of CMEA in 1959 which added

to the original purpose of economic cooperation, stated in the Founding Declaration of 1949, the objectives of "speeding up economic and technical progress in [the member] countries" and "raising the level of industrialization in industrially less developed countries" (Article 1).

In turn, the resolution on "Basic Principles of the International Socialist Division of Labor", adopted in 1962, called for the rational division of labor within the CMEA in the framework of long-term agreements based on the coordination of national plans. Reference was further made to the need for the increased multilateral coordination of plans, the working-out of consolidated economic balances, and "the future creation of a Communist world economy, directed according to a uniform plan"(1965, p.379). The coordination of national plans remained one of the key objectives in the Comprehensive Programme, adopted in 1971. However, the document emphasizes the primacy of national planning bodies in the process of cooperation and that of national interests in intra-CMEA specialization; it makes no mention of a common plan.[7/]

The main achievements of the CMEA to date include the exchange of technical information, the establishment of a multinational pipeline and electricity grid, and the creation of a common freight car pool. Furthermore, differences in income levels have been reduced as growth has been more rapid in countries at lower levels of development, Bulgaria and Romania. Finally, long-term bilateral trade agreements between CMEA member countries have provided assured markets for the products of the partner countries.

With the availability of assured market outlets, the trade of the CMEA countries has continued to grow. However, the rate of expansion has slowed down, and the share of intra-area trade has declined, since the time the CMEA Charter was signed. The average annual rate of growth of imports by the CMEA countries, taken together, was 8.5 percent in the period 1959-71 as against 10.7 percent in 1953-59.[8/] The differences become larger if calculations are made in terms of constant prices and they cannot be fully accounted for by reference to the slowdown in the rate of economic growth. Thus, while the annual average rate of growth of the combined net material product of the CMEA countries fell from 10.3 percent in 1953-59 to 7.2 percent in 1959-70,

the rate of growth of the volume of total imports declined from 12.3 to 8.2 percent.[9/]

It would appear, then, that in comparison with the EEC there has been a decline in the extent to which the CMEA countries have utilized their trade potential. This result represents a continuation of trends observed in the period following the Second World War. On the basis of trade, GNP, and population figures Pryor concluded that in the years 1956 and 1962 the volume of trade of the CMEA countries was only 50-60 percent of that of comparable West European countries, while such differences had not been observed in the interwar period (1968, p.164).

Also, the share of intra-area trade in the CMEA has decreased since 1959. Excluding trade with China, which fell precipitously during the sixties, we find that the share of intra-CMEA trade in the total declined from 71 percent in 1959 to 63 percent in 1971, involving mainly a shift to trade with developed market economies. Whereas in the period 1953-59 developed market economies accounted for 21 percent of CMEA imports (excluding imports from China), their share in the total reached 27 percent in 1971.[10/] In turn, the rate of expansion of imports from developing countries slowed down during the sixties. The share of these countries in CMEA imports increased from 3.6 percent in 1953 to 7.4 percent in 1959 and reached 8.7 percent in 1971.

Various factors account for the lack of full utilization of the trade potential of the CMEA countries and for the trend towards increased imports from developed market economies. To begin with, the centralization of economic decision-making, reflected in the planners' desire to lessen the uncertainty associated with foreign trade as well as in the absence of direct trade relationships between firms, tends to limit the volume of trade.

Opportunities for trade may also be foregone because of the lack of appropriate price signals. Despite improvements in pricing with the introduction of charges for capital, domestic prices in the CMEA countries do not adequately express resource scarcities and are divorced from prices in foreign trade. Foreign-trade prices, in turn, show considerable variations in bilateral relationships,[11/] while exchange rates do not appropriately reflect intercountry differences in commodity values. Under these circumstances, there is a risk that trade in particu-

lar commodites may involve a loss rather than a gain for the countries concerned and this risk tends to discourage trade among them.[12/]

Although several of these factors discourage trade with developed market economies as well, the prices used in trade with them tend to reflect scarcity relationships in the world market. Furthermore, the need for sophisticated machinery, materials and other intermediate products which are not available, or are available in limited quantities, in CMEA countries, has given a boost to imports from developed market economies. These imports are paid for largely through the exports of foods, raw materials, fuel, and simple processed goods. In regard to Hungary, Vajda speaks of a duality of trade as "the intermediary goods imported from the West are absorbed in the production of finished goods, which are not sufficiently competitive in Western markets"(Vajda, 1971, p.53). Such products, sold within the CMEA, are regarded as 'soft goods' while foods, raw materials, and fuels that find ready markets in the developed market economies are considered 'hard goods'.

At the same time, in bilateral relationships between CMEA countries, it is attempted to attain trade balance in regard to individual commodity groups, in particular for 'hard goods' and for 'soft goods'.[13/] Moreover, countries at lower levels of industrial development increasingly demand that CMEA partner countries accept their machinery products in exchange for imported machinery (Montias, 1967, p.168).

These developments have reinforced the practice of bilateralism which tends to restrict the volume of trade and to reduce its efficiency. This is mainly because the requirements of bilateral balancing of trade induce countries to limit imports and to purchase from nations with which the country has an export surplus rather than from the lowest-cost source.

The practice of bilateralism is reflected in estimates of the extent of multilateral balancing of trade. In 1954-58, the years preceding the signature of the CMEA Charter, the five CMEA countries for which data are available had the lowest index of multilateral balancing among sixty-five countries studied by Michaely (1962). The relevant values for the 1954-58 period were: Soviet Union, 12.7; Hungary, 11.5; Poland, 9.8; Czechoslovakia, 7.3; and Bulgaria, 6.4, compared with an average of 29.2 for all other countries, taken together.[14/]

The tendency towards bilateralism has not been offset by the operation of the International Bank for Economic Cooperation (IBEC), which has been established for the purpose of carrying out clearing operations and providing credit in intra-CMEA trade. Available data indicate that the weighted average of the index of multilateral balancing in intra-CMEA trade was the highest in 1963 (5.5), the year of IBEC's establishment, and declined to 4.2 by 1970 (McMillan, 1973, p.32).

The limited impact of IBEC is explained by the lack of automatic clearing of bilateral balances and the low level of credits.[15/] With creditor and debtor countries having different interests, the practice of bilateral negotiations on yearly settlements has not been conducive to multilateral balancing within CMEA. By contrast, the use of convertible currencies in much of CMEA trade with other countries permits compensating surpluses and deficits among them.

This explains that the degree of bilateralism is far greater in trade among the CMEA countries than in their trade with other nations. For the Soviet Union in 1970 the index of multilateral balancing was 4.7 in trade with the CMEA partner countries and averaged 22.2 in trade with market economies (McMillan, 1973, p.21). Given the restrictive effects of bilateral balancing, this difference in the *modus operandi* of trade has contributed to an increase in the share of CMEA trade with developed countries where convertible currencies are in general use.

In turn, efforts have been made in intra-CMEA trade to exploit the advantages provided by economies of scale in the framework of specialization agreements that correspond to "production and development integration" in Vajda's terminology. The report on the first twenty years of the operation of the CMEA provides information on progress made in regard to specialization agreements in various industries. It is added, however, that "so far only the first steps have been made in this complex and important field and the advantages of socialist division of labour have not yet been fully utilized" (1969, p.54). And, according to one author, "these agreements did not induce substantial changes in export patterns since they were based on the existing division of labour" (Simai, p.117). The author further notes that in 1964 the share of products traded under specialization agreements in the total exports

of machinery and equipment to other CMEA countries ranged between 4.5 percent in Czechoslovakia and 20.7 percent in East Germany.[16/]

While specialization agreements have assumed importance with regard to products, such as machine tools, ball-bearings, and trucks, their growth has been limited by much the same factors that have restricted the expansion of intra-CMEA trade in general. The lack of direct contact among firms in the CMEA countries reduces information flows, and tends to exclude some promising forms of cooperation. Thus, there are few agreements on the division of the production process through the exchange of parts, components, and accessories or common ventures of industrial firms in the CMEA countries. Considerations of the availability of goods according to appropriate specifications and at the desired time also have a restraining influence as does the fact that, in the absence of scarcity prices, it is difficult to evaluate the gains from specialization. According to one author, actual or perceived conflicts in national interests manifest themselves "in an insufficient specialization and inadequate international cooperation of the engineering industries" (Kiss, 1971, p.169).[17/]

Integration in Developing Countries

During the postwar period, various attempts have been made for economic integration among developing countries. Integration schemes in the individual regions include the Latin American Free Trade Association (LAFTA), the Central American Common Market (CACM), the Andean Common Market (ACM), the Caribbean Community (CARICOM), the East African Community (EAC), the Central African Customs and Economic Union (Union Douanière et Economique de l'Afrique Centrale or UDEAC), the West African Economic Community (Communauté Economique de l'Afrique de l'Ouest or CEAO), the Regional Cooperation for Development (RCD), the Maghreb, and the Arab Common Market.[18/]

These integration schemes have generally not lived up to expectations.[19/] The Central American Common Market provides the only case where tariffs on intra-area trade were abolished and a common external tariff was adopted. As a result, trade among these countries increased rapidly, with its average annual rate of growth exceeding 30 percent between 1961 and 1968. However, following the unilateral introduction of fiscal incentives by member countries and the withdrawal of Honduras

from CACM, the rate of increase of intra-area trade among the remaining member countries declined also.

In LAFTA, the target date for completely freeing trade was repeatedly postponed and the annual negotiations on tariff reductions carried out on an item-by-item basis slowed down after a few years, with practically no progress made in recent years. In turn, tariff reductions in the Andean Common Market are proceeding according to schedule but quantitative restrictions on intra-area trade have been largely retained and the establishment of the common tariff has been postponed. Finally, in CARICOM duties on much of intra-area trade have been eliminated but, given similarities in production patterns and high transportation costs among the small islands participating in it, the prospects for the expansion of intra-area trade are not very favorable.

In Africa south of the Sahara, there has been disintegration rather than integration in recent years. With the establishment of independent states, free-trade relations existing in colonial times have not been continued. In the East African Community, the common tariff has been preserved although member countries follow different policies in regard to duty drawbacks on machinery and equipment. Also, the Treaty of 1967 permits countries with a deficit in their intra-area trade in manufactures to impose transfer taxes on such trade, and quantitative restrictions have also been applied.

UDEAC has a common external tariff, but additional taxes may be imposed by the individual member countries and differences in tax rates provide a protective element in intra-area trade. And, while agricultural trade has been freed in the West African Economic Community, tariff reductions on manufactured goods will be subject to future negotiations on an item-by-item basis.

The Regional Cooperation for Development group did not envisage general trade liberalization but only the freeing of trade on items produced by common enterprises. In turn, economic cooperation among the Maghreb countries is limited to a few fields, including standardization, telecommunications, and transport. Finally, while there is free trade in agricultural products in the Arab Common Market, the proposed preferential agreements in industry have not yet materialized.

Various factors account for the limited progress made in efforts

at "market integration" in developing countries. Firstly, item-by-item negotiations on tariff reductions encounter considerable difficulties because of the power of special interests. Secondly, differences in the level of industrial development have made agreements on trade liberalization difficult. Thirdly, in view of the distortions in relative prices due to protection, it has been difficult to determine the benefits to be derived from integration and there has been a tendency to consider changes in the trade balance as a sign of gains or losses. Last but not least, the governments of the individual countries have been reluctant to proceed with integration because they are anxious to safeguard their sovereignty.

Considerations of national sovereignty, the difficulties of estimating benefits and costs, uncertainty as regards future changes in prices and costs, and the problems encountered in intergovernmental negotiations also explain the virtual lack of success in "production-and-development-integration" in the manufacturing sector. While several agreements have been reached in regard to transportation, communications, and water resources, where benefits are relatively easily quantifiable, there are few cases of so-called integration industries in the developing countries.

In LAFTA, there are twenty agreements of product specialization among private firms, none of which are in basic industries such as metals and metal transformation, petrochemicals and fertilizers, pulp and paper, and heavy equipment. In the Andean Common Market, a sectoral programme has been established in the metal transformation industries but technical obstacles have so far impeded the establishment of firms in the branches allocated to several of the countries. There are no integration industries in CARICOM, while in the Central American Common Market only three plants are operating under the integration-industry regime that provides exclusive rights to the CACM market.

In East Africa, proposals made for the allocation of industries among the member countries have not been put into effect and duplication in new industries continues. Duplication of facilities is also observed in UDEAC and CEAO. Finally, among fifty-six joint purpose enterprises identified in RCD only three have been set up and only one of these (a plant producing bank notes) has free access to the regional market.

Trade Integration: An Evaluation

The preceding review of the experience of developed market, socialist, and developing economies suggests certain conclusions as regards the possibilities for, and the preconditions of, "market integration" and "production-and-development integration". First of all, the use of prices reflecting resource scarcities will clarify the available choices and reduce uncertainty with regard to possible gains and losses from integration. As a result, there will be less resistance to the elimination of barriers on intra-area trade and decisions on production and trade can be decentralized.

These conclusions apply irrespective of social systems. As the experience of Hungary since 1968 indicates, markets and prices can be used to advantage in socialist countries, too.[20/] At the same time, the experience of the aforementioned two countries points to the fact that decision-making on the firm level will give desirable results only in the absence of monopoly positions, since otherwise the interests of the firm and those of the national economy would differ. In such instances, intervention on the part of central authorities would be required to avoid possible distortions, should infant industry considerations limit placing reliance on foreign competition as an anti-monopoly device.

It further appears that the optimal degree of market, as against production and development integration will depend on the size of the market of the integrated area; the larger this market, the fewer will be the industries where monopoly positions may emerge because the full exploitation of economies of scale requires only a single firm. In the European Common Market, the aircraft, space, computer and electronics industries come into this category; in LAFTA, economies of scale may be appropriated in the framework of a single firm in e.g. fertilizers and automobiles; in the East African Community such will be the case also in the production of steel or paper. Thus, the desirable scope of production-and-development integration will vary inversely with the combined market size of the countries participating in an integration scheme.

Interference with allocation patterns brought about by the market mechanism will also be desirable in cases when participating countries are at different levels of industrial development, lest such dispari-

ties be perpetuated. This conclusion represents the application of the infant industry argument to the integration of nation states and will again apply irrespective of social systems as shown by the cases of Romania in the CMEA, Ireland in the EEC, and Honduras in CACM.

Production-and-development integration, as well as safeguarding the interests of countries at lower levels of development, however, require joint decisions. The taking of such decisions, in turn, entails a diminution of the national sovereignty of the individual countries. The existence of a trade-off between the (uncertain) benefits of integration and the (partial) loss of national sovereignty, then, leads to the conclusion that the chances of success of integration schemes increase with their size and the homogeneity of the would-be partner countries.

Economic Union and National Sovereignty

The issue of national sovereignty is put in an even sharper focus in the case of an economic union that involves, in addition to trade integration, the coordination of economic policy-making. The coordination of economic policies, in turn, requires political decisions which would necessitate establishing a common decision-making apparatus. In this connection, one may again cite Vajda, according to whom "Economic union is not a stage on the path leading towards political union, but a possible and desirable consequence of the latter" (1971, p.41).

The experience of the European Common Market confirms this conclusion. Recent efforts to achieve monetary integration without the coordination of economic policies have proved to be a failure. And, as the author has elsewhere noted, "progress in policy coordination, and in transforming the Common Market into an economic union, is hampered by the present institutional structure. At the same time, changes in this structure would necessitate political decisions and a degree of political integration that is not presently acceptable to the national governments" (Balassa, et al, 1974, p.7).

In Vajda's view, the lack of progress towards economic union in the European Common Market is an expression of the fact that economic interest in itself is not sufficient to moderate the concern of the nation states with their sovereignty. For the same reason, he believes that "today the development of the Council of Mutual Economic Assistance into an an economic union would be a no more realistic aim than

in the case of the European Economic Community" (1971, p.43).

Rather than attempting to make a prediction as to the likelihood that one or another integration scheme would be transformed into an economic union, in concluding one may emphasize that the conflict between national sovereignty and economic self-interest can be resolved only if there is a political interest and the political will to do so. Economic integration thus appears as part of a political process whose final outcome is determined by essentially political factors.

Notes

1. For an early survey of proposed definitions of economic integration and the introduction of the described classification scheme, see Balassa, 1961.
2. The definition of market integration is qualified by the clause "as long as this is not obstructed by social-political interests or excluded by common production agreements". In turn, the full statement on production and development integration refers to industries "which, in view of their technological development, vertical integration, the size of their investments, and the shorter-than-average life of their capital equipment, cannot be developed to an optimum size within national boundaries without upsetting the internal equilibrium of the national economy" (Vajda, 1971, p.35).
3. The decrease in demand for the imports of the nonmember countries may also lead to a deterioration in their terms of trade vis-à-vis the member countries. The latter may however benefit if integration permits the establishment of infant industries that eventually become competitive in the world market.
4. The suggested method assumes that trade diversion would tend to depress imports from nonmember countries as compared to their historical relationship with GNP in the importing countries; in turn, total imports over and above the amount corresponding to their historical relationship with GNP would indicate that purchases from partner countries have replaced domestic sources of supply. -- In the calculations, GNP as well as imports are expressed in constant prices.
5. In most industries, there has been no conflict between the exploitation of economies of scale and increased competition as the integration of national markets has permitted both to occur simultaneously in the EEC. Thus, predictions of those who feared the strengthening of monopolies have not been realized.
6. It has been reported that while 15 to 35 percent of purchases by private industry are provided by the member countries, this share rarely exceeds 5 percent in public purchases (European Communities Commission, May 3, 1973, p.4).

7. This apparent change reflects the rejection of Khruschev's proposal (*Kommunist*, August 1962) for "establishing a unified planning organ" and of the idea of planning on the CMEA level. Thus, in reporting on a symposium of CMEA specialists held in January 1969, Jozef Pajestka, the Deputy Chairman of the Polish Planning Commission noted that "the symposium assessed as unjustified concepts involving the introduction of planning on the scale of the entire socialist community — that is supranational planning" (*Zycie Warszavy*, January 12-13, 1969, cited in Shaefer, 1972, p.21).

8. Parallel developments are observed in the Soviet Union as well as in the other CMEA countries, although increases in imports were somewhat greater in the latter case. The relevant data for 1953-59 and 1959-71 are: Soviet Union, 10.1 and 7.8 percent; other CMEA countries, 11.2 and 9.0 percent.

9. Growth rates of net material product for the individual countries were averaged using 1971 values estimated by the International Bank for Reconstruction and Development (1973); current values of trade were deflated by the use of price indices computed by Marer (1972).

10. In this connection, note that the effects of relaxing the embargo that was applied by the NATO countries to the export of a variety of products to the CMEA were observable already in the 1953-59 period.

11. It has been shown that "in the framework of bilateral clearings which regulate the trade between CMEA countries, the differences in the prices of identical products sold to various partners are much greater than those having ever occurred in the history of clearing agreements" (Ausch, 1972, p.79). Also, despite the fact that the prices in intra-CMEA trade are supposed to be based on world market prices, considerable differences have been observed between the two sets of prices. In 1962, the only year for which detailed information is available, average prices in intra-CMEA trade exceeded prices in the world market by 25.9 percent in the case of machinery, 15.4 percent for raw materials, and 1.7 percent for agricultural products (Ausch-Bartha, 1959, p.109). The authors of the calculations note that the differences are even

larger if account is taken of the lower quality of machinery in intra-CMEA trade and that considerable dispersion is shown within particular commodity groups (*ibid*).

12. It has been reported that, in some instances, the foreign exchange value of imported inputs exceeded that of exports in Hungary during the nineteen-fifties (Balazsy, 1957). While such cases can be detected by the use of efficiency coefficients in foreign trade that compare domestic labor and capital costs to foreign exchange (Shagalov, 1965, p.58), the lack of appropriate scarcity prices for labor and capital reduces the practical usefulness of these coefficients. Thus, despite their formal identity, they are not equivalent to the domestic resource cost of foreign exchange introduced in the Western economic literature by Michael Bruno (1967). -- It should be added that some authors speak of "commodity inconvertibility" in reference to the fact that the CMEA countries tend to discourage trade outside of quota arrangements, in particular purchases by tourists, in part because such purchases reduce the availability of goods in domestic markets and in part because they may entail losses to the national economy due to distortions in price relationships (Holzman, 1966).

13. Tibor Kiss notes that "the practice of distinguishing 'hard' and 'soft' commodities has become general; 'hard' commodities would be exchanged only for 'hard' ones and 'soft' commodities only for 'soft' ones" (1971, p.223).

14. The index of multilateral balancing for a particular country is derived as the sum of the absolute differences between each trading partner's export and import shares, expressed in percentage terms so that the index assumes values from zero to 100 (Michaely, 1962, p.688).

15. According to the *Bulletin* of the IBEC, in 1970 credit transactions accounted for 6 percent of total transactions on clearing-rouble accounts.

16. The validity of higher figures reported for 1967 has been questioned on the grounds that the sudden increases shown may be due to a reclassification of trade and conflict with the figures used in projections for 1970-75 (Brabant, 1974, p.274). Also, specia-

lization agreements are often disregarded in practice. Thus, it has been reported that Poland exported 22 out of 29 items subject to such agreements in 1963; 24 out of 40 in 1964; 15 out of 34 in 1966; 48 out of 68 in 1967; and none out of 79 in 1969 (Gora and Knyziak, 1971, p.55).

17. The same author offers some general remarks on the factors adversely affecting intra-CMEA trade. In his opinion, "exaggerated centralization of export and import activities, adherence to a strict licence system even in the trade between CMEA countries, and the great divergences between domestic and foreign-trade prices, together with an excessive protectionism, have resulted in so high a degree of isolation of the national markets as to nearly frustrate the projects of economic integration" (p.170).

18. The member countries of the various integration schemes are: LAFTA: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela; CACM: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua; ACM: Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela; CARICOM: Antigua, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St.Kitts-Nevis-Anguilla, St. Lucia, St. Vincent, Trinidad, and Tobago; EAC: Kenya, Tanzania, and Uganda; UDEAC: Cameroon, Central African Republic, Congo-Brazzaville, and Gabon; CEAO: Ivory Coast, Mali, Mauretania, Niger, Senegal, and Upper Volta; RCD: Iran, Pakistan, and Turkey; Maghreb: Algeria, Morocco, and Tunisia; Arab Common Market: Egypt, Iraq, and Jordan.

19. For a detailed discussion, see Balassa and Stoutjesdijk (1974).

20. In summarizing the conclusion of the conference on the establishment of a system of prices in intra-CMEA trade, held with the participation of economists from the member countries, Béla Csikós-Nagy noted that "it has been accepted, almost unequivocally, that cooperation has to be developed in the direction of activating the commodity and money relationships" (1971, p.204) in CMEA. Djachenko also noted that "socially necessary expenditures of labor cannot be established administratively; they are developing and taking shape through commodity-monetary relationships" (1958, p.44).

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