ECONOMIC INTEGRATION AMONG DEVELOPING COUNTRIES

This paper examines issues relating to economic integration in developing countries. Part I analyzes the benefits and costs of regional integration through trade liberalization while Part II is devoted to the project approach to integration. The Appendix provides an evaluation of the experience of integration schemes in developing regions.

In Part I of the paper Bela Balassa has utilized the findings of his research on economic integration in developing countries and on industrial policies and economic integration in Western Africa. Ardy Stoutjesdijk presented an earlier version of Part II at anUNCTAD conference on economic integration; a slightly modified version will be Chapter I of his book Multi-Country Investment Planning: The Case of West Africa. Bela Balassa has prepared the Appendix dealing with integration schemes in developing regions with the assistance of Pieter Bottelier, Naimeh Hadjitarkhani, Carl Jayarajah, Theodore Nkodo, Garry Pursell, and Francisco Thoumi.

A companion paper, "Types of Economic Integration" by Bela Balassa, is distributed as Staff Working Paper No. 185.

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Economic Integration Among Developing Countries:
A Summary of the Issues

Policy Options for Developing Countries

1. In the early postwar period, economic integration among developing countries was considered primarily as a way of extending the policy of import substitution on a regional scale. This approach is subject to serious limitations since even regional markets will often not permit the establishment of efficient-size firms, much less competition among several such firms. Thus, regional integration oriented towards import substitution may lead to the establishment of inefficient plants and of an inefficient industrial structure, thereby postponing the time -- and increasing the difficulties -- of a reorientation of policies once the limits of import substitution have been reached.

2. A more appropriate approach is to consider regional integration as one of the policy options available to developing countries and as part of their overall strategy for economic development. Broadly speaking, there are four possible policy options that may be adopted singly or in combination: development in a national framework, regional economic integration, increased trade with developing countries in other regions, and participation in the international division of labor.

3. The opportunities for economical import substitution in the national framework are limited by the size of domestic markets. The smaller the market, the more restricted are the possibilities of establishing industries which cater exclusively to domestic demand and the higher
are the costs of production. To avoid the creation of inefficient import substituting industries, an appropriate strategy would involve encouraging the establishment of efficient industries that can produce for domestic as well as for foreign markets. Participation in the international division of labor through similar incentives to exports and import substitution and avoiding excessive protection of manufacturing industries can contribute to this goal.

Benefits and Costs of Regional Integration through Trade Liberalization

4. While adopting a policy of trade liberalization would affect a country's overall trade, developing countries may derive advantages from combining it with regional integration. Firstly, a country participating in an integration scheme can benefit from the elimination of barriers to its exports on the part of the partner countries. Secondly, there is more information on prices and costs in neighbouring countries than in faraway nations, thereby lessening uncertainty as regards the effects of trade liberalization on domestic industry. Thirdly, it will be generally easier to reach -- and to police -- agreements to forego reimposing restrictions and providing indirect subsidies to domestic industry. Lastly, the cost of infant industry protection will be lower in a regional union than in a national framework.

5. Against these benefits one should set the cost of regional integration in the form of higher prices paid for imports from the neighbouring countries, the establishment of monopoly positions in parti-
cular industries, drawing away resources from exporting to world markets, and limiting the attention accorded to other policy options. The balance of benefits and costs of regional integration in a particular case will depend on the circumstances of the situation, including market size, resource endowment, geographical location, and access to developed country markets, as well as on the policies applied in the integrated area.

6. The policies followed are of particular importance for the success of an integration scheme and its effects on the partner countries. Extending the range of industries covered by the scheme will have beneficial effects as it allows for compensating changes to take place in various industries, increases competition, and reduces investment requirements. Also, agreeing on a time-table for tariff reductions will provide time for adjustment while establishing common tariffs and coordinating of trade and exchange rate policies will reduce distortions in intra-area trade. Last but not least, the avoidance of high tariffs and the realization of this system of incentives in general, will contribute to the establishment of efficient industries in the integrated area.

7. In the case of countries at different levels of development, measures would further need to be taken to ensure the equitable distribution of the benefits and costs of integration among the member countries. Agreements on the measures to be applied in favor of member countries at lower levels of development are however difficult to reach, both because of the difficulties involved in evaluating their effects and because of their cost for the more developed countries. And, the loss of sovereignty involved in eliminating barriers to intra-area trade and coordinating trade
and exchange rate policies represents a further obstacle to regional integration.

8. Furthermore, the benefits of greater competition may not be enjoyed if the combined demand of the member countries can support only one plant in a particular industry or if their markets are undeveloped. In such instances, recourse may be had to the project approach to integration that involves reaching agreement on the establishment and operation of particular activities.

The Project Approach to Regional Integration

9. The project approach can be utilized in regard to new investments in conjunction with the application of a general trade liberalization scheme; its potential scope will be the greater the smaller the integrated area and the lower its level of economic development. In the event that the conditions for implementing a trade liberalization scheme are not fulfilled, the project approach may be applied by itself, with provisions made for intraregional trade in the products involved.

10. Integration projects may relate to regional goods and services when the choice is between production in the national and in the regional framework, or to international goods that could be procured from national and from regional sources as well as from world markets. The establishment of integration projects in regard to regional goods and services, such as transportation and communications, public utilities, education and research, may bring benefits directly as production on a regional scale
leads to cost savings through economies of scale or the better utilization of regional resources as well as indirectly through increases in intra-regional trade.

11. Cost-reductions through economies of scale provide the principal benefits also in the case of international goods, such as agriculture, mining and manufacturing products. At the same time, the measurement of benefits and costs from integration projects encounters difficulties because of the complexity of project selection under economies of scale, the uncertainty related to future prices and costs, and the difficulties of obtaining the necessary data. A possibly even more important obstacle to integration projects is the bias against such projects due to planning and administrative procedures in developing countries and their concern with national sovereignty. Finally, considerable difficulties are associated with the distribution of benefits and costs from integration projects.

12. These difficulties may be alleviated through the package approach that involves the simultaneous establishment of integration projects in all the participating countries. The adoption of such an approach may provide easily ascertainable benefits to each country and will also increase the stability of the arrangement. Stability can be further increased in the event of the joint financing of integration projects.
Economic Integration Among Developing Countries

Introduction

In the early postwar period, economic integration among developing countries was considered primarily as a way of extending the policy of import substitution on a regional scale. This approach is subject to serious limitations since even regional markets will often not permit the establishment of efficient-size firms, much less competition among several such firms. Thus, regional integration oriented towards import substitution may lead to the establishment of inefficient plants and of an inefficient industrial structure, thereby postponing the time -- and increasing the difficulties -- of a reorientation of policies once the limits of import substitution have been reached.

A different approach is taken in this paper. Economic integration will be considered as one of the policy options available to developing countries and as part of their overall strategy for economic development. Broadly speaking, there are four possible policy options that may be adopted singly or in combination: development in a national framework, regional economic integration, increased trade with developing countries in other regions, and participation in the international division of labor.

These options will be considered in Part I of the paper which deals with integration through the liberalization of trade among the participating countries. In the discussion, attention will also be given to the desirable scope and provisions of integration schemes and the distribution of their benefits and costs.
Problems related to the distribution of benefits and costs, the loss of sovereignty involved in overall integration schemes, and the lack of effective competition in industries where the exploitation of economies of scale limits the number of firms further necessitate examining the application of the project approach to integration. In Part II the opportunities and difficulties associated with this approach are identified, both with respect to individual projects and packages of projects. The Appendix provides a short discussion of the experience of various schemes.

I: Economic Integration Through Trade Liberalization of Trade

Import Substitution in National Markets

In the postwar period, a number of developing countries adopted a policy of import substitution in the framework of national markets. This choice reflected the view prevalent at the time that exportation, whether of primary goods or manufactured products, does not represent a viable alternative. It was assumed that the prospects for primary exports were unfavorable because of the slow growth of demand on the part of developed nations, and that high import barriers as well as the inability of the developing countries to produce competitively foreclosed the possibilities for exporting manufactured products.
The views expressed as regards the prospects for exporting manufactured products have proved to be overly pessimistic. The exports of manufactures from the developing countries rose four-fold during the sixties, with exports reaching $10 billion in 1970 as against the $4 billion predicted by the United Nations and their rapid expansion continued in the seventies. Also, while demand is rising at a slow rate for tropical beverages and fruits of which developing countries are the only suppliers, the growth of import demand for most other primary products exceeds that of consumption in developed nations which face limitations of domestic supply. In fact, the slow expansion of the exports of these commodities from developing countries has often been due to their own policies, resulting in a loss in their world market shares.

At the same time, the opportunities for economical import substitution in the national framework are limited by the size of domestic markets. The smaller the market, the more restricted are the possibilities of establishing industries which cater exclusively to domestic demand and the higher are the costs of production. In the manufacturing of intermediate products and durable goods in particular, efficient operations require large-scale production, with unit costs rising substantially at lower output levels. The size of the domestic market also limits the extent of product specialization in individual firms and restricts the possibilities for process specialization through manufacturing parts, components and accessories on an efficient scale. Furthermore, the sheltering of national markets reduces the extent of competition and lessens the incentive for technological improvements.
An often-used measure of the size of national markets is the value of the gross national product. Among the non-European developing countries listed in the World Bank Atlas, 62 had a GNP of less than $1 billion, 40 between $1 and $5 billion, 15 between $5 and $10 billion, three between $10 and $25 billion in 1971. But, from the point of view of the exploitation of economies of scale and domestic competition, the market for manufactured goods is relevant. No developing country has a domestic market for manufactured goods as large as that of the Netherlands, Sweden, or Belgium among the smaller developed countries, which have entered into integration schemes in order to escape the limitations imposed by their national markets.

Since possibilities for economic growth through import substitution are limited by the extent of a country's domestic market, countries of different size will need to have recourse to exports at different levels of industrial development in order to ensure the continued expansion of their manufacturing industries. In some small African countries where the consumption of manufactured goods does not exceed $100 million a year, the domestic market is not sufficiently large even for the production of relatively simple manufactured goods.

At the other end of the scale, India and Brazil established a diversified industrial structure serving domestic needs, but have encountered market limitations in a number of their industries and are now attempting to expand their exports. The shift in strategy is the most apparent in Brazil that has increasingly focused on the promotion of agricultural and manufacturing exports. In this, Brazil is following
the example of countries, such as Korea and Taiwan, which have attained high rates of economic growth applying a strategy of export promotion.

**Exports and Economic Integration**

Exports of manufactured goods may be oriented towards the markets of countries in the same region, to developing countries in other regions, or to developed nations. Providing incentives to exports would benefit sales in all foreign markets; regional integration would boost exports to countries in the same geographical area; and preferential schemes extending to other regions would stimulate exports to developing countries in those regions.

But, just as import substitution, export promotion can be carried too far; this will be the case if excessive incentives are provided to exports. Accordingly, an appropriate objective of development strategy may be seen in providing for the establishment of efficient export and import-substituting activities. Participation in the international division of labor through similar incentives to exports and import substitution and avoiding overly high protection of manufacturing industries can contribute to this goal.

While adopting such a policy would affect a country's overall trade, the establishment of the European Common Market and the European Free Trade Association indicates that even industrial countries with relatively large domestic markets derive advantages from regional integration. There are various reasons for this, several of which apply to developing countries as well.
First of all, a country participating in a regional integration scheme benefits from the elimination of barriers to its exports on the part of the partner countries. This is of special importance for developing countries whose exports of manufactured goods often suffer discrimination in developed country markets. We observe that tariffs in developed nations tend to rise with the degree of fabrication, thereby discouraging the importation of foods and raw materials in a processed form. Also, tariffs are generally higher on simple manufactures than on products requiring a high level of technical sophistication developing countries do not possess. Finally, quantitative restrictions tend to be applied mostly to products originating in the developing nations, as in the case of textiles, clothing, and shoes.

Considerations of risk and uncertainty, too, favor regional integration schemes. There is more information on prices and costs in neighboring countries than in faraway nations, thereby lessening uncertainty as regards the effects of trade liberalization on domestic industry. Uncertainty in intraregional trade is further reduced if commitments are taken to refrain from reimposing restrictions on imports or subsidies to exports. This is of special interest since developed countries have repeatedly imposed restrictions once the imports of manufactures from less developed areas have increased substantially. Also, in a regional union, it will generally be easier to reach -- and to police -- agreements to forego the use of measures which provide indirect benefits to domestic industry at the expense of their competitors in the partner countries.

In the EEC, an additional consideration has been to create large
markets for highly sophisticated industries, such as aircraft, computers, and electronics, where national markets of the member countries are too small for efficient operations, while protecting these industries from US competition. This argument applies a fortiori to developing economies which need protection for their infant industries.

In a regional union, the cost of infant protection will be lower than in individual countries, since a wider market permits the establishment of larger plants, greater specialization, as well as more competition. At the same time, the markets of the partner countries can serve as a training ground for exporting elsewhere. We may then speak of infant export activities that need to learn quality control as well as marketing techniques.

But regional integration schemes have disadvantages of their own. Integration involves a cost in the form of higher prices paid for imports from the partner countries. Also, the establishment of new industries in a regional framework may give rise to monopoly positions and inefficient, high-cost production. This will occur if excessive protection is granted to regional industries that permits high-cost operations and provides little incentive for technological improvements.

At the same time, the establishment of firms oriented towards the markets of the partner countries may draw away resources, such as capital and entrepreneurship, from exporting to world markets, where they could be put to better uses. It may also be necessary to undertake costly investments in transportation to permit a substantial expansion of intraregional trade.
Furthermore, the often involved negotiations on economic integration impinge on scarce decision-making capacity in developing countries and limit the attention given to other policy options. On a different plane, economic integration will involve a cost through the diminution of national sovereignty as agreements on the liberalization of intra-area trade and on the policy coordination necessary for the success of the integration schemes reduce the scope of action by national authorities.

The balance of the benefits and costs of regional integration in a particular case will depend on the circumstances of the situation, including market size, resource endowment, geographical location and access to developed country markets, as well as on the policies applied. In the following, attention will be given to policies that may be used to increase the benefits of integration through the liberalization of intra-area trade and to contribute to the equitable distribution of these benefits among the participating countries. Subsequently, the possibilities of preferential tariff reductions on trade among developing countries located in different areas will be examined.

The Scope of Integration Schemes

There is a case for extending the range of industries covered by integration schemes that involve the liberalization of intraregional trade. In this way, one may allow for compensating changes in various industries, lessen the power of special interests, increase competition, and reduce investment requirements. Compensating changes will smoothen the path of adjustment and it may be easier to surmount opposition from
special interests than if trade liberalization was limited to a few industries. Also, apart from the case of integration among countries at different levels of development to be discussed below, the exposure of domestic firms to competition from the partner countries would have beneficial effects in the form of improvements in the distribution of incomes through lowering excess profits and incentives for technical progress. Finally, the expansion of intra-area trade may lead to a higher degree of capacity utilization, thereby reducing the need for new investments.

Nevertheless, integration in existing industries has been opposed on the grounds that it would create serious dislocations in the individual countries. The experience of the Central American Common Market does not lend support to this view. The creation of the Central American Common Market led to a rapid expansion of trade among the member countries, with the annual rate of increase averaging 22 percent in the period 1953-61 and 32 percent in 1961-68. This increase took place largely in manufactured goods, whose share in the total reached 86 percent in 1968 and entailed intraindustry specialization through the greater exchange of products, such as textiles and shoes, thus permitting the exploitation of economies of scale without appreciable adverse effects on national industries.

The possibilities for economies of scale are even greater for the machinery, consumer durables, and intermediate goods industries where, following the European Common Market, intraindustry specialization could be accomplished through narrowing product variety and the exchange of parts and components in developing countries at higher levels of industrialization. On the other hand, the integration of countries at different
levels of development would require more adjustment and it raises the problem of the distribution of benefits and costs to be discussed below.

It should be added that the cost of dislocation can be reduced if adequate time is provided for adjustment by the spacing of tariff reductions. This can be done by agreeing on a fixed timetable on reducing, and ultimately eliminating tariffs. This would have additional benefits in lessening uncertainty for the firm and providing inducements for adaptation to the conditions of a larger market. Moreover, in adopting a fixed time schedule for tariff reductions, there is less of a chance that the progress of integration will be blocked. This has happened in LAFTA where after initial progress the opposition of vested interests has practically blocked tariff reductions in the framework of annual multilateral negotiations.

Tariff Policy in an Integrated Area

There is further a case for establishing common tariffs on extra-area imports. This is because the maintenance of national tariffs leads to distortions in intra-area trade and affects the distribution of the benefits and cost from integration. Countries with relatively low tariffs on imported raw materials and intermediate products will enjoy artificial cost advantages in the intra-area trade of finished goods, and the extent of preferences granted to partner country suppliers will be the greater the higher are national tariffs. With continuing differences in national tariffs, and the possibilities for unilateral changes in these tariffs, then, the progress of integration may be jeopardized.
In the event that a common tariff is adopted, there will be need to ensure that the height and the structure of the common external tariff is conducive to the establishment of efficient industries. There is a case for lowering duties if the level of national tariffs was judged excessive, and the creation of the common external tariff provides an opportunity to reduce its level and improve its structure. More generally, for regional integration to contribute to efficient import substitution and exporting, it would have to be accompanied by a rationalization of the system of incentives in the participating countries.

The adoption of a common tariff on imports from nonmember countries and the harmonization of other measures affecting imports and exports will eliminate distortions in competitiveness among the partner countries provided that exchange rates are free to adjust. Distortions in competitiveness will occur, however, if the speed of inflation differs among countries and devaluation takes place only intermittently. This is because under- or over-compensation in exchange rates for price changes have the same effect as changes in tariffs and subsidies. At the same time, uncertainty is created as regards future changes in the domestic currency value of foreign exchange and the sale price of competing producers.

Variations in competitiveness due to price changes uncompensated to changes in exchange rates create obstacles to regional integration since countries do not wish to expose their producers to sudden and unforeseen changes in trade flows. To avoid these adverse consequences, it would be advisable for member countries to devalue pari passu with inflation. Apart from avoiding distortions in competitiveness, agreeing on rules
concerning exchange rate changes would also permit maintaining the independence of national monetary policies.

Distribution of Benefits and Costs of Integration

Consideration needs further be given to the distribution of the benefits and costs of integration among the member countries. The presumed maldistribution of benefits and costs appears to be the single major reason for the limited success of integration efforts in less developed areas. In this connection, reference has often been made to imbalances in intra-area trade following regional integration and the unequal distribution of manufacturing industries.

Imbalances in intra-area trade may however be the result of influences other than regional integration, including differential trends in economic growth and inflation. And should integration be responsible for the imbalance, it may have been accompanied by offsetting changes in extra-area trade, so that one needs to consider the global trade position of a country rather than trade with the partner countries only. In turn, global trade imbalances may be offset by a devaluation or revaluation of the currency.

Thus, imbalances in intra-area trade per se should not be regarded as an indication of the unequal distribution of benefits. But, there is reason for concern if the imbalance is concentrated in trade in manufactured goods, reflecting the acquired superiority of certain partner countries in manufacturing that may foreclose the development of industries in other countries. In such instances, action would have to be taken to offset the advantages of countries that would otherwise benefit from their early start
in industrialization through concessions to the lesser-developed countries. This would, in turn, require striking a balance between the interests of countries at higher and lower income levels. At the same time, the concessions need to be temporary in nature to avoid the perpetuation of inefficient industries.

The experience of the European Common Market may be of interest in this connection. Upon entry, Ireland has received concessions in postponing the elimination of duties on intra-area imports while enjoying free entry for its own exports and will further benefit from investments by the European Investment Fund. Among associated countries, similar concessions have been provided to Greece and Turkey. A new associated country, Portugal, too enjoys the privilege of maintaining, and even imposing, tariffs for a prolonged period.

Trade Liberalization among Developing Countries Located in Different Regions

Alternatively, one may suggest limiting the participants in an economic integration scheme to countries at similar levels of industrial development. As this condition is often not fulfilled in regional integration schemes, consideration needs to be given to the possibility of extending reciprocal reductions in trade barriers to all developing countries at similar levels of industrialization, regardless of their geographical location.

While such a scheme would escape the difficulties due to integration among countries at different levels of industrial development, it has difficulties of its own. To begin with, the potential benefits are limited
by high transportation costs while it would involve considerable risk and uncertainty. These is uncertainty as regards the balance of cost and benefits, because of limited information on production costs and on governmental policies in countries located on different continents. Also, in the absence of agreements on policies extending to external tariffs, quotas, licenses, export subsidies and indirect incentives, the balance of advantages can be easily upset and trade will be subject to artificial distortions. At the same time, it is difficult to reach an agreement on policy coordination because the loss of sovereignty involved may not be compensated by the expected benefits. And not only do benefits promise to be larger in intraregional trade, but countries in a particular region, having similar history, customs, and even language, may possess the greater solidarity and common interests necessary for policy coordination than nations separated by great distances.

These considerations are relevant for the agreements on preferential tariff reductions among countries located in different regions that are discussed in the Appendix. They apply to a much lesser extent to schemes pertaining to production and investment in particular industries. In primary activities, petroleum, copper, coffee, and bananas are examples of joint action. In the manufacturing sector, industries requiring large investments, such as fertilizers and pulp and paper, give opportunities for coordinating new investment. They will be examined in Part II below.

Conclusion

Regional economic integration should be regarded as one of the
policy options available to developing countries in pursuing their strategy for economic development. Its potential benefits and costs should be weighted against those of other policy options, and in particular an export-oriented strategy. Regional integration benefits the member countries by ensuring access to the markets of their partners, lessening risk and uncertainty as regards the effects of trade liberalization on domestic industry, easing the task of policy coordination, and reducing the cost of infant industry protection. But it may also involve paying higher prices for regional imports, establishing monopoly positions in particular industries, drawing away resources from more productive uses, and neglecting other policy options.

The balance of the benefits and costs of regional integration in a particular case will depend on the circumstances of the situation, including market size, resource endowment, geographical location, and access to developed country markets, as well as on the policies followed. There is a case for extending the scope of industries covered by integration schemes that involve liberalizing intraregional trade, unifying tariffs on extra-area imports, and coordinating trade and exchange rate policies. Also, one should avoid excessive protection against extra-area imports and measures would have to be taken to ensure the equitable distribution of the benefits and costs of integration among the member countries.

Agreements on measures to be taken in favor of member countries at lower levels of development are, however, difficult to reach in part because of difficulties involved in evaluating the effects of these measures and because of their cost for the more developed countries. And, the loss of sovereignty involved in the elimination of barriers to intra-
area trade and the coordination of trade and exchange rate policies represents a further obstacle to integration efforts.

Furthermore, the benefits of greater competition may not be enjoyed if the combined demand of the member countries can support only one plant in a particular industry or if their markets are undeveloped. In such instances, recourse may be had to the project approach to integration that involves reaching agreement on the establishment and the operation of particular industries.

The project approach can be utilized in regard to new industries in conjunction with the application of a general trade liberalization scheme; its potential scope will be the greater the smaller the integrated area and the lower its level of industrial development. In the event that the conditions for implementing a trade liberalization scheme are not fulfilled, the project approach may be applied by itself, with provisions made for intraregional trade in the products involved. This approach will be discussed in Part II of the paper.
II THE PROJECT APPROACH TO ECONOMIC INTEGRATION

Definitions and concepts.

One of the principal aims of integration schemes among developing countries is the establishment of projects which serve a wider than national market. Such projects may emerge either through the free operation of market forces in a region where trade barriers have been removed, or as a result of an explicit agreement between two or more countries which may or may not be part of a regional trade liberalization scheme. Projects of this nature will be referred to as integration projects.

In discussing economic integration, it is useful to bear in mind that different classes of goods and services are not equally mobile. A well-known distinction is that between internationally tradable and non-tradable goods and services; in turn, Mennes, Tinbergen, and Waardenburg distinguish among local, regional, national, continental, and international or world goods and services. Both classification schemes are based on a variety of economic and technical considerations, among which transportation costs are the most important. In the following, a distinction will be made among national, regional (i.e. multi-country) and international goods and services.

National goods and services, including perishables, construction, housing, retail trade, most government and private services, are normally not traded among countries. They can, therefore, be excluded from the

discussion of integration projects. By contrast, regional and international goods and services both qualify as candidates for integration projects. Regional goods and services may be provided on a national basis as well as jointly for a group of contiguous countries; they can not as a rule be imported from world markets. This class of goods and services may include electricity, railways, roads, irrigation, etc. International goods and services, in turn, may be procured on a national and regional basis as well as from world markets. They comprise most agricultural, mining and manufactured products.

The Scope for Integration Projects: regional goods and services.

Integration projects in this category may be found in transportation and communications, public utilities, education and research, and a few other fields that are specified below. They bring economic benefits if production on a regional scale leads to cost savings compared to their production on a national scale, taking into account production as well as distribution costs. Cost savings may be achieved directly through large-scale operations, fuller utilization of existing capacity, greater specialization in production, joint management, and the co-ordinated use of jointly-owned resources. Benefits may also be reaped indirectly, e.g. by investments in infrastructure that are principally designed to promote trade within the region.

Transportation provides examples of direct and indirect benefits from integration projects. First, cost savings may be achieved through co-ordinated planning, construction and/or operation of transportation
facilities (e.g. a joint airline, a regionally integrated railway network with identical railway gauges, regional shipping companies, and an integrated highway system). Second, co-ordinated investments in transportation may have beneficial effects of an indirect nature in promoting trade among the partner countries.

Cost savings and, in particular, quality improvements may also be achieved by the co-ordinated planning and operation of regional communications networks. This would require, among others, tariff agreements, as well as the rationalization of signalling systems in the case of telecommunications.

Among public utilities, electric power production and the development and management of water resources offer scope for integration projects. Both types of projects supply output that is normally not internationally tradable unless distances are short. In such cases, integration projects may offer benefits by exploiting economies of scale through regional co-operation. In some instances, gains can also be obtained through utilizing those resources from within the region that lead to the lower production costs; the latter may occur if several possible sites exist within a region for hydro-electric power generation, but one site is more suitable than others.

In the category of water supply projects, the principal case for co-ordinated action is with respect to the development of international river basins. A number of schemes of this nature exists (e.g. the Lower Mekong Basin), with the major potential gains to be derived from improved flood control, and more intensive use of the water resources for irrigation
purposes. In turn, projects located on international waters may cause problems of environmental pollution in other countries, making desirable the co-ordination of action.

Joint projects in the field of education and research can lead to cost savings due to the better utilization of indivisible factors such as teaching and research staff and equipment, and may result in qualitative improvements in education and research as well. Regional universities, and technical colleges, and research into area-specific problems, jointly financed and managed by the participating countries, come into this category. Integration projects in the category of research are not necessarily restricted to regional arrangements and successful global undertakings exist, e.g. the International Rice Research Institute.

The list of categories of integration projects among regional goods and services given sofar is by no means exhaustive, and a variety of other fields should be mentioned where scope for such projects exists. These include projects aiming at regional computer facilities, the promotion of tourism, the promotion of regional exports through regional trade promotion centers, the development of mineral resources, and the provision of meteorological services.

The Scope for Integration Projects: international goods and services.

This category of projects consists chiefly of agricultural, mining and industrial activities; their principal characteristic is that they can be internationally traded so that their availability in the region is not contingent upon production within the region; if produced within the region, they can also be exported to overseas markets.
In agriculture, there are examples of countries agreeing to limit the expansion of production in order to improve their terms of trade (e.g. coffee). Such agreements are usually of a global nature; they are considered to be outside the scope of this study. There are also possibilities for agreements on specialization in agricultural production between countries with different resource endowments. However, since economies of scale in agricultural production can be exploited in the national framework, integration projects in agriculture are usually linked with processing.

If regional planning permits the identification and establishment of efficient facilities, for example to process cocoa, cotton, rubber, as well as forest products and livestock, such projects are properly classified as integration projects. To the extent such facilities are dependent on the supply of inputs from the region as a whole, agreements among the participating countries may be required to guarantee compatible agricultural produce. Often, a country can exploit its geographical location by processing the exports of a landlocked country, which are allowed duty-free into the country. If the landlocked country were to process its agricultural produce for exports, the transit country could impose import duties on the processed product. This issue has arisen a few times in practice, for example in West Africa with respect to livestock produced in the inland states of Mali and Niger.

Many co-operative efforts among developing countries have as their main objective the promotion of industrial growth, and most existing integration agreements devote special attention to industrial development.
This is primarily due to the belief that the widening of the domestic market through regional integration enables the capturing of economies of scale that characterize most industrial activities, leading to lower average costs of production.

Lower average costs of production can be the result of higher rates of capacity utilization in the case of already existing plants. In such instances, partner countries may be induced to forego investments in similar activities. Secondly, cost savings may be achieved by the exploitation of economies of scale. The simplest form is the one that leads to the establishment of production units of a larger scale than would have been possible on the basis of the domestic market alone. Moreover, the wider market may permit the exploitation of the advantages associated with specialization, most of which are also related to economies of scale. Specialization can take place either at the product or the process level. Petrochemicals, fertilizer and machinery provide possibilities for product specialization, with countries producing different varieties within a product category. Process specialization occurs if a group of countries agree to specialize in different components for the manufacture of machinery or transport equipment.

Finally, it may be useful to point out that the project approach in the case of international goods need not be restricted to the markets of contiguous countries, and that a wider approach is feasible given the possibility of international trade. The extreme case is that of world-wide sectoral investment planning; an example of an application of this approach was recently discussed in the Board. The major problem facing this particular approach is its implementation: if it is difficult to reach agreement

/*/ IBRD, IFC, IDA, Fertilizer Requirements of Developing Countries, May 15, 1974.
among a few neighboring countries on one or more integration projects, it may be expected to be even more so among a larger group of countries.

The Measurement of Costs and Benefits

In the preceding sections, we have described the scope for integration projects in the various sectors of the economy, and the nature of the benefits that may be derived from such projects. In spite of the potential gains that can be associated with integration projects, few of such projects have in fact been established. In an attempt to identify the reasons for the limited success of the integration project approach, it appears useful to draw a distinction between two sets of problems, one related to the evaluation of the costs and benefits of integration projects, the other being associated with the establishment and operation of such projects. In this section, we shall discuss the evaluation problems.

The selection and appraisal of integration projects raises a number of complex technical problems. One of the main arguments in favor of integration projects is the exploitation of economies of scale that many activities exhibit. However, until recently, no efficient planning techniques were available to select optimal projects in the presence of economies of scale. Such a technique is now available in the form of mixed-integer programming, but its application requires technical expertise which is available in few developing countries.*/

*/ A research project at the Development Research Center (RPO 224 - Programming in the Manufacturing Sector) which is now in its final phase, has resulted in the formulation and solution of a number of mixed-integer programming models for specific industrial activities. These models are formulated such that they are easily applicable elsewhere, either for one country or for a group of countries. Moreover, the project has resulted in improved solution procedures for such models, reducing the cost of their use considerably.
In addition to the technical problems associated with project planning in the presence of economies of scale, complications are introduced by the explicit recognition of risk and uncertainty in project analysis. The latter tends to weaken the case for large production units, even under economies of scale. As a plant designed to meet requirements for a regional market faces greater uncertainty than one that caters for a national market only, since regional co-operation may be discontinued, the expected benefits of an integration project are correspondingly lower.

Besides the methodological problems of integration project selection and evaluation, a data problem exists. To make an adequate case for integration projects, detailed estimates of the net benefits associated with them in comparison to alternative modes of production are required. To measure these net benefits, production cost data for various scales of production are required, as well as detailed information on the geographical dispersion of demand and transportation cost. Yet, statistical data are rarely collected on the basis of a group of countries, and most data collection efforts are geared toward the domestic economy. Differences in data coverage and classification often render the construction of regional data sets a difficult problem, further complicating the task of accurately measuring the costs and benefits of integration projects.

The measurement of costs and benefits of integration projects is more complicated in the case of projects in the category of international goods and services than for regional goods and services. For the latter, project analysis takes place in an environment which is fully controlled by the region itself, imports from outside the region being excluded by
definition. As a result, fairly firm estimates can be made of the net gains or losses associated with any specific production structure. In contrast, for international goods, imports from world markets provide an alternative to production on national or regional scale; to estimate the gains and losses of an integration project in this category, a projection of import prices is required. Given the uncertainty associated with future world market prices, the assessment of potential costs and benefits of regional production becomes more complicated.

Reaching agreement on integration projects.

Perhaps the most important obstacle to agreements on integration projects is the bias prevalent in most countries in favor of national projects. This is reflected first of all in the orientation of the economic planning machinery in most countries which focuses primarily on the design and implementation of national investment programs. If a regional bureaucracy exists, it is most often inadequately staffed, lacking both the political power and the financial resources to constitute an effective counterpart to nationally-oriented institutions.

Even if the political will is there, integration project agreements are difficult to reach because of disputes concerning the distribution among countries of costs and benefits associated with a given project. Unless the location of a project is dictated by natural resource constraints, it is difficult to get countries to agree on the location of an integration project. The more important a project, the more difficult such negotiations may be, and it may either be impossible to achieve agreement, or the allocation
agreeable to all is so inefficient that the total net gain of integration projects is wiped out. Judging by the experience of the last decade, problems of this nature have arisen most frequently in the case of the "foot-loose" industries.

Apart from the problem of which country provides the location for a given integration project, it may be difficult to reach agreement on what countries wish to distribute equitably, and in what manner. Like any other project, an integration project generates value added, employment, requires foreign exchange outlays and domestic capital, may generate foreign exchange earnings, and provides opportunities for tax revenues; moreover, the project may have important externalities. The distributional formula agreeable to partner countries, therefore, contains many elements.

Disputes may furthermore arise over regional transfer prices of the output of integration projects. This is closely related to the fact that the approach to economic integration based on integration projects frequently leads to the establishment of monopolies. If restrictions are placed on competing imports, a privately managed integration project will follow pricing and output policies that may not be consistent with economic policy objectives in partner countries. Without government interventions, therefore, there may be a trade-off between the exploitation of economies of scale by establishing relatively few productive units, and an organization of supply that results in the achievement of given policy objectives.

These difficulties are of especial importance in the case of international goods. As was explained before, the assessment of net gains or losses for a project in this category is more difficult than for a project in the category of regional goods and services because of the
uncertainty related to developments in the world market. This problem may be particularly important if different countries have different perceptions of the future.

Also, integration projects in the regional category may be more stable over time than projects in the international category. In the case of an integration project relating to a regional good or service, the alternative of national production exists but cannot be realized instantly. Lengthy gestation periods are usually required to attain full operation of a new project. However, in the case of integration projects in the category of international goods and services, project cooperation can be terminated at once, by activating the import alternative. The above factors have in particular hampered the establishment of integration projects in the industrial sector. Import prices for industrial goods often vary by source and over time, while wide fluctuations in ocean shipping rates complicate c.i.f. import price projections even further. Under such conditions, it is extremely difficult to make plausible quantitative estimates of the potential net gains to be derived from integration projects in this sector, and countries have understandably been reluctant to agree to a production structure that may prove to be inefficient in the medium and long-term. If the latter occurs, one of two situations may obtain. First, the producing country may lose its regional market, and end up with an underutilized plant. Second, the regional market is maintained, but all participating countries suffer net losses because of relatively high-cost regional production. The former
alternative is more likely to occur in practice and this distinguishes integration projects sharply from national projects. If a national project turns out to be based on an erroneous projection of c.i.f. imports prices, and is relatively high-cost, domestic pressures to prevent the shut-down of the project will be severe, usually resulting in higher protection from imports than originally envisaged. In the case of an integration project, such pressures from the project’s host country can be assumed to be less effective in the partner countries.

The package approach.

Some of the difficulties associated with reaching agreements on the individual integration project approach can be reduced by adopting the so-called package approach. This approach specifically and explicitly aims at facilitating the negotiation and enhancing the stability of an integration agreement by assuring that each participating country obtains at least one integration project from among a package of such projects. The condition that each country hosts at least one project aims at replacing complicated distributional formulas associated with individual project allocations among countries. Moreover, greater stability is achieved once an allocation of projects has been agreed upon because unilateral withdrawal from the regional scheme inflicts losses on the withdrawing country itself.

An important condition to be fulfilled for the successful application of the package approach is that the project planning exercise results in comprehensive information on the effects of alternative allocative schemes on partner countries. Issues that need to be addressed include the following.
Some projects in the "package" will usually be more efficient than others due to the region's comparative advantage. Countries with efficient projects in the category of international goods and services may be better off than countries with projects in the category of regional goods and services, as the latter can not, by definition, be exported outside the region. In general, it may be stated that the package approach is more likely to achieve its goal of stability in the regional market arrangement if the projects included are relatively efficient compared to national projects, in the case of regional goods and services, and compared to imports, for international goods and services. If high protective barriers are necessary for some or all of the projects included in the category of international goods and services, it is conceivable that the cost of trade diversion to a partner country is so high as to offset the loss associated with under-utilization of the capacity of its integration projects following withdrawal from the scheme.

Even though it appears that the package approach poses less serious problems of distribution of costs and benefits that the individual project approach, several such problems remain. If an allocation of projects is decided upon, for example, it may not be the most efficient one from the point of view of the region as a whole. Special arrangements may need to be made to ensure that each project is implemented, to ensure that the ex ante allocation of projects materializes. This may be particularly important if a project is allocated in a relatively unattractive part of the regional market, and it turns out to be difficult to find capital and managerial talent to establish the project. However, basically, these problems are not more severe than they are in the case of individual projects.
A number of dynamic problems can be identified that are related more directly to the package approach. First, the original allocation of projects may have been agreeable to all partner countries, but while in operation some projects appear so inefficient that problems arise relating to the distribution of costs and benefits. Similarly, although the initial allocation of projects appeared acceptable, an incorrect projection of import prices, or demand, renders some projects less efficient that predicted. Finally, as demand for different products is likely to increase at different rates, some of the projects in the package may become independent of the regional market for efficient operation at an earlier stage than others, leading to instability over time.

One way in which these particular problems may be overcome is to consider the joint financing of projects in the package by partner countries, in addition to outside financing. This would result in spreading the financial risk of the operation of integration projects among partner countries, which may result in greater solidarity among them in the face of unforeseen adverse circumstances affecting one or more integration projects.*/

Conclusion.

The integration project approach may offer substantial benefits to countries that are not yet able to compete in world markets, and wish to establish an efficient production structure in activities that are subject to economies of scale. In spite of its apparent advantages, however, this strategy has met with limited success, and very few integration projects have been established.

*/ For a specific proposal along these lines, see: I. M. D. Little, "Regional international companies as an approach to economic integration", Journal of Common Market Studies, Vol. 5, 1966.
projects have in fact been established. A number of reasons can be identified to explain this state of affairs.

First, there is a strong bias in favor of national projects and national development objectives; even if regional bureaucracies exist, they are usually powerless and without adequate resources. To remove this bias, one necessary condition to be fulfilled is that convincing quantitative estimates are made of the net benefits of integration projects to partner countries. Project planning techniques have now been developed for project selection and appraisal in the presence of economies of scale, and fairly detailed estimates can be made of the relative costs and benefits of alternative production structures.

Secondly, a major stumbling block during attempts at reaching an agreement on integration projects relates to the distribution of costs and benefits of such projects among partner countries. In the case of an individual integration project, discussions of this nature are often very difficult, and only if the net benefits of a specific integration project appear large to each participating countries, may agreement be possible.

To alleviate some of the problems associated with the negotiation of integration project agreements, the package approach appears an attractive alternative. Although this approach does not provide a panacea for all problems associated with integration projects, it would appear that the fact that each participating country hosts at least one project facilitates
not only the process of reaching an agreement on integration projects, but also increases its stability. Enhanced stability can be expected as any country that decides to withdraw from the integration scheme inflicts losses upon itself by losing access to the regional market for its integration project(s). For these reasons, the package approach - perhaps combined with some arrangement to provide for the joint financing of projects - may be recommended.
APPENDIX

INTEGRATION SCHEMES AMONG DEVELOPING COUNTRIES

This Appendix contains a brief description of individual integration schemes among developing countries. The descriptions cover the main characteristics of these schemes, provisions made for the liberalization of trade among the policy making countries (unless otherwise noted, the movement of capital and labor has not been liberalized), the establishment of common institutions and policies, experience with integration industries, provisions for less developed member countries, and an evaluation of the experience of the integration scheme in question. Data on population, gross national product, per capita incomes and trade shares refer to 1972 and have been taken from the World Bank and IMF statistics. Data on the share of manufacturing in the gross domestic product generally refer to the same year and originate from UN statistics. The description of several of the schemes is to a large extent based on background papers prepared by Bank staff members.¹/

1. Latin American Free Trade Association

Main Characteristics

The Latin American Free Trade Association (LAFTA) was established by the Treaty of Montevideo in 1960. The original member countries were Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay; Colombia.

¹/ The background papers are available from their authors whose names are shown in parenthesis: Andean Common Market (Francisco Thoumi), Central American Common Market (Francisco Thoumi), Caribbean Free Trade Association (Carl Jayarajah), East African Community (Pieter Bottelier), and Central African Customs and Economic Union (Theodore Nkodo).
and Ecuador joined immediately afterwards while Venezuela and Bolivia became members in 1966 and 1967, respectively. In 1972, the combined population of the participating countries was 252 million, the gross national product $168 billion, and the share of intra-area trade in total exports 10 percent.

There are considerable differences as regards the size and the level of industrial development of the individual member countries. In terms of GNP, Brazil leads with $52 billion, followed by Mexico ($41 billion) and Argentina ($31 billion); at the other end of the scale, the gross national product of Ecuador is $2 billion and of Bolivia $1 billion. Ecuador and Bolivia also have the lowest shares of manufacturing in the gross domestic product (15-16 percent) and per capita incomes ($360 and $200, respectively). The share of manufacturing in GDP is 28 percent in Argentina and Venezuela, 26 percent in Chile, 23 percent in Mexico, 22 percent in Peru, and 20 percent in Brazil. Finally, incomes per head exceed $1000 a year only in Argentina and Venezuela, followed by Chile and Uruguay at around $800.

Trade Liberalization

The declared aim of LAFTA is to free trade among the member countries; there are no provisions for the establishment of a common external tariff. The liberalization of trade was to take place in the framework of annual negotiations on an item-by-item basis for products on national lists (items on which a particular country grants tariff reductions to all others) and on a common list (items on which all member countries agree to liberalize
The process of negotiations slowed down after a few years and hardly any progress has been made since: The Draft Protocol of Caracas (1969) postponed the target date for completely freeing intra-area trade from 1973 to 1980 and deferred negotiations on the common list to 1974. There is little expectation that these deadlines would be met.

Common Institutions and Policies

Common institutions include the Conference of the Contracting Parties, the Permanent Executive Committee, the Council on Financial and Monetary Policy, the Industrial Development Committee, Sectoral Committees and the Secretariat, located in Montevideo. LAFTA does not have a regional bank; however, the Inter-American Development Bank has provided financing to several regional projects.

The IDB's projects are mostly in transportation. But efforts to further the integration of transport systems have met with limited success. The Water Transport Agreement has been ratified by only three countries and the Road Transport Agreement is not yet in force. Nor has progress been made in the coordination of monetary, fiscal, and exchange rate policies. Furthermore, individual countries have introduced export subsidies in the form of tax rebates that also apply in intra-area trade.

In the international monetary field, however, a multilateral clearing agreement is in effect, involving the quarterly multilateral settlement of balances and, since 1969, credit lines of $20 million to finance temporary deficits. An agreement has further been reached to move towards the establishment of a Latin American market for bank acceptances.
Integration Industries

The Montevideo Treaty provides for the conclusion of complementarity agreements, intended to promote industrial integration through the coordination of plans for specialization and expansion in particular industries. Twenty complementarity agreements have been signed so far and several further agreements are under negotiation.

The agreements pertain mainly to products in the electronics and electrical communications, office equipment, consumer durables, and chemical industries. Apart from the Andean Group of countries that will be considered separately, there are no complementarity agreements, however, in any of the basic industries, such as steel, nonferrous metals, metal transformation, fertilizers, pulp and paper, and heavy equipment. Complementarity agreements have become a vehicle for accords on product specialization by private enterprises, without involving the public sector. They generally include only a few countries, mostly the three largest. The effects of the agreements on trade among the member countries has thus far been limited.

Provisions for Less Developed Member Countries

The Montevideo Treaty established a category of "less developed members" to comprise Ecuador, Paraguay and, subsequently, Bolivia. These countries can reduce their tariffs at a slower pace and benefit from special tariff concessions granted by the other member countries. These provisions apply temporarily also to Uruguay.

With the slowing-down in the process of trade liberalization, the
value of the tariff concessions received by less-developed member countries has however remained small. Nor have they derived important benefits from special treatment in some complementarity agreements.

**Evaluation**

Various factors explain the slowing down in the liberalization of intra-area trade. They include the inadequacies of the system of annual item-by-item negotiations on tariff reductions, the uncertainties relating to national tariff subsidy, and exchange rate policies, the fear on the part of the smaller members of economic domination by the large countries, as well as the increasing interest of the large countries, especially Brazil and Mexico, in exports to the developed nations. The general measures taken for this purpose (export incentives and the establishment of the crawling peg in Brazil and Colombia) appear to have contributed more to the recent expansion of intra-LAFTA trade than tariff concessions and complementarity agreements. At the same time, increases in intra-LAFTA trade have only succeeded in re-establishing its share in the total observed in the mid-fifties.

In turn, the system of complementarity agreements is administratively and operationally complex, involving protracted negotiations. Also, the agreements relate to a narrow range of products and no effort has been made to ensure complementarity in the industrial structure of the individual countries. Finally, the requirements of efficient exporting are not considered in complementarity agreements which are oriented exclusively towards regional markets.
2. **Andean Common Market**

**Main Characteristics**

The Andean Common Market (ACM) was established by the Cartagena Agreement in 1969 with the participation of Bolivia, Chile, Colombia, Ecuador, and Peru; Venezuela joined in early 1973. ACM is a subregional arrangement within LAFTA that aims at a greater degree of integration, involving among other things the establishment of a common external tariff and sectoral programs. The combined population of the ACM countries, Venezuela included, is 70 million and the gross national product $42 billion. Intra-area trade accounts for 7 percent of the total exports of the member countries.

There are considerable differences in per capita incomes and in levels of industrialization within the ACM. Income levels are the highest in Venezuela ($1240 per head in 1972), followed by Chile ($800), Peru ($520), Colombia ($400), Ecuador ($360), and Bolivia ($200). However, incomes in Ecuador have risen substantially following increases in petroleum production and prices; oil price increases have also importantly raised incomes in Venezuela.

The share of manufacturing in the gross domestic product is 26 percent in Chile, it is 18-20 percent in the larger countries (Colombia, Peru, and Venezuela), and 14-15 percent in Bolivia and Ecuador. The latter two countries have also by far the smallest national markets, a GNP of $2 billion in Ecuador and $1 billion in Bolivia as against $7 to $14 billion in the other member countries.
Trade Liberalization

Barriers to intra-area trade are to be eliminated in ACM according to an agreed-upon timetable. Trade in commodities on LAFTA's "common list", mostly traditional exports, were freed 180 days after the Cartagena Agreement went into effect. Among commodities not presently produced in the region, trade liberalization in goods included under sectoral programming is to be determined in conjunction with these programs (see below) whereas trade in products not subject to sectoral programs were freed in 1971. Barriers to trade in commodities produced in the region are scheduled to be eliminated in stages by 1980 in Chile, Colombia, Peru, and Venezuela, and by 1985 in Bolivia and Ecuador. However, each country can exclude a large number of items from the liberalization program (among the more developed member countries, the number of exceptions is 250 in Colombia, Chile, and Venezuela, and 450 in Peru); the elimination of tariffs on these commodities has been postponed until 1985.

The Cartagena Agreement calls for the establishment of a Minimum Common External Tariff (MCET) and, subsequently, a Common External Tariff (CET). MCET has the purpose of providing a margin of preference to partner country producers while tariffs on intra-area trade are being reduced. MCET tariff averages range from 33 percent on chemicals to 67 percent on textiles, with a simple average of 48 percent in the manufacturing sector. It is lower than the average tariff of the member countries, but it nevertheless involves raising duties on numerous items, especially in Bolivia and Colombia whose tariffs are the lowest in the group. According to the compilation of the Junta, there are 986 such items in Colombia;
their number is likely to be even larger in Bolivia that has the lowest tariffs in ACM. But the main impact of MCET lies in the ending of tariff exemptions which have been widely employed in the region, in particular in Chile and Peru.

On items where rates of national tariffs are lower than the MCET, they have to be raised to this level by 1975 in Chile, Colombia, Peru, and Venezuela and by 1980 in Bolivia and Ecuador. In turn, it had been originally planned that CET would be reached in stages by 1980 in Colombia, Chile, Peru, and Venezuela, and in 1985 in Bolivia and Ecuador. However, in face of disagreements as to the level and structure of CET, the date of its approval has been postponed and this is likely to affect the time schedule of its adoption.

Common Institutions and Policies

The Commission, consisting of representatives of the member country governments, is the main decision-making body of ACM, while the Junta headed by three members appointed by the Commission, is the executing agency. Furthermore, the Andean Development Corporation was created in 1970 to provide funds for investment in infrastructure and to industry under sectoral programs.

ACM aims eventually to harmonize exchange rate, monetary, and fiscal policies. For the time being, periodical meetings of central banks serve the objective of cooperation and the ACM countries participate in the LAFTA clearing mechanism.

Programs for infrastructure are in preparation to cover transportation, communication, and energy. It is also planned to establish a common
marketing system of agricultural exports. However, apart from sectoral programs, the most important step taken in policy harmonization has been the establishment of a statute on direct foreign investment. The statute bans foreign investment from certain sectors of the economy and calls for "Andeanization" through increasing the participation of domestic capital to 51 percent in others; subsidiaries of foreign firms that do not provide for "Andeanization" will not benefit from the freeing of intra-area trade. The statute also regulates the amount of profits, royalties and license fees that can be paid abroad and prohibits market limitations on exports. While the statute's provisions are rather strict, countries interested in promoting foreign investment are reported to find ways to circumvent them.

Integration Industries

The Cartagena Agreement calls for sectoral programs in the framework of which new industries would be allocated among the member countries. Sectoral programs are to be established in the automotive, petrochemical, pulp and paper, steel, telephone-related electronic products, and metal fabrication industries (metalmeccanica). These sectors were selected on the basis of their existence in the larger Latin American countries (Argentina, Brazil, and Mexico), the primary purpose of the program being import substitution.

Thus far the only approved sector program has been in metal fabrication. This program has been established by projecting demands up to 1980 and distributing industries among the member countries in agreed-upon proportions. The allocation of industries has not been preceded by
feasibility studies which are being carried out now. They show problems due to the lack of availability of inputs and complementary processes which bring into question the rationality of the scheme. In turn, among industries where the establishment of sectoral programs has been proposed, several member countries are proceeding to set up their own plants for producing automobiles while Peru and Venezuela are planning to develop national petrochemical industries.

Provisions for Less Developed Member Countries

As noted above, Bolivia and Ecuador have been granted a period of adjustment five years longer than the other member countries to eliminate barriers to intra-area trade, to align their tariffs with the Minimum Common External Tariff, and to adopt the Common External Tariff. These countries enjoy additional exceptions as regards the list of commodities to be freed in intra-area trade and have received tariff concessions on a number of commodities in the markets of the more developed member countries.

Bolivia and Ecuador also receive special treatment in the allocation of industries under sectoral programs, and are to be the main beneficiaries of loans by the Andean Development Corporation. However, by reason of their undeveloped industrial structure, they have not yet been able to establish plants in the metal fabrication sector in accordance with their allocation.
Evaluation

While data for a sufficiently long period are not yet available, it appears that the establishment of ACM has led to a considerable expansion of intra-area trade. However, this increase proceeded from a low base and in part represents the transformation of smuggling into legal trade, as well as exports from Colombia in response to the tax incentives provided to export activities in general. At the same time, the licensing of imports continues to provide an obstacle to intra-area trade especially in Chile and Peru.

The establishment of the Common External Tariff and the implementation of sectoral programs will provide a test of the intention of the member countries in the next several years. If CET is not reduced below the average of member country tariffs, ACM will have levels of protection higher than Brazil and Mexico, contributing to high-cost import-substitution within the area. Considering the relatively small size of even the combined markets of the ACM countries, a lowering of tariffs and the orientation of sectoral programs towards exporting would seem necessary to ensure the establishment of an efficient industrial structure.
3. The Central American Common Market

Main Characteristics

The Central American Common Market (CACM) was established in 1960 with the participation of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua; Honduras effectively withdrew in 1970 but is likely to rejoin in the near future. The combined population of CACM, Honduras included, is 16.0 million, the gross national product $6.6 billion and the share of intra-area trade in the total 21 percent.

In terms of per capita incomes, the ranking is Costa Rica ($620), Nicaragua ($470), Guatemala ($420), El Salvador ($340), and Honduras ($320). Honduras is even farther behind as far as the level of industrialization is concerned. The share of manufacturing in its gross domestic product hardly reaches 13 percent as compared to 19 percent in Costa Rica, El Salvador, and Nicaragua, and 16 percent in Guatemala. Finally, Honduras has the smallest national market, with a GNP of $0.9 billion; the largest being Guatemala with $2.4 billion.

Trade Liberalization

Tariffs on intra-area trade were eliminated by 1968 and a Common External Tariff was established; 21 items were, however, excluded from trade liberalization and 32 items from the establishment of the Common External Tariff. Also, free trade status is granted only to commodities classified as being of "Central American origin", excluding items which are only assembled, packed or bottled in the region. The origin of about
50 products, ranging from rice to cosmetics, has been challenged since the Common Market's establishment. Decisions by the Executive Council charged with the administration of the CACM Treaty, do not reflect a consistent policy. Air conditioners, refrigerators, and pharmaceuticals were determined to be of Central American origin although value added in the area is small whereas automobiles, radios, and television sets were excluded from this category.

Among the commodities excluded from free intra-area trade, temporary restrictions apply to eleven products, including, sugar, wheat-based products, tobacco, cigarettes, certain paper manufactures, glass containers, and petroleum products while restrictions are intended to be permanent on ten products, comprising cattle, cheese, coffee, some fruit juices, alcoholic beverages, certain jute textiles, and matches. There is an informal agreement among national producers to exclude trade in beer.

The rates of the Common External Tariff fall in-between the average and the highest national duties, thus entailing a rise in the entire tariff structure. According to calculations by the 1971 Bank mission to Central America, the averages of national tariffs and of the CET were 64 and 106 percent on non-durable consumer goods, 27 and 40 percent on durable consumer goods, 31 and 38 percent for intermediate products, and 9 and 11 percent on capital goods. In 1968, an additional 30 percent across-the-board surcharge was applied for balance-or-payments reasons and in some instances tariffs have been raised at the request of new producers or of producers who charged "undue competition" from imports.

Exceptions to the common tariff apply to 13 percent of extra-area imports. The uniformity of protection levels has been further eroded
as a result of fiscal incentives to firms which provide exemptions from duties on imported inputs. The lack of uniform application of import surcharges by the member countries and the unilateral introduction of a surcharge in Costa Rica has had similar effects.

Common Institutions and Policies

The institutional framework of CACM includes the Economic Council, consisting of the Ministers of Economic Affairs in the member countries, the Executive Council, with the participation of Deputy Ministers of Economic Affairs, the Permanent Secretariat (SIECA) and the Central American Bank for Economic Integration (CABEI). Other regional institutions are the Central American Monetary Council, the Central American Coordinating Committee on Market and Price Stabilization (on grains), the Central American Clearing House, the Stabilization Council, the Central American Institute of Public Administration, the Central American Technological Research Institute for Industry, the Standing Committee on Agricultural Research.

Following its establishment, CABEI concentrated on infrastructure projects designed to contribute to trade and industrial development in the area. Subsequently, it has increasingly shifted to lending to industrial projects and its loans to Central American industry during the nineteen-sixties equalled that of all the five national development banks combined. Thus far, it has not participated actively in equity investments and it has not been a promotor of projects, limiting its lending to projects submitted to it.
Improvements in the road network and in communications have taken place under the aegis of integration in Central America while there has been little coordination in agricultural policies. Although agreement has been reached on the coordination of national pricing policies on grains, this has not yet been implemented as the Coordinating Committee does not have the machinery to ensure the implementation of its decisions.

Nor has progress been made in the coordination of monetary and fiscal policies. However, the establishment of several institutions has contributed to cooperation in international monetary relations. They include the Central American Clearing House (1961), Monetary Council (1964), and the Monetary Stabilization Fund (1969). The main impact of these institutions has been to alleviate temporary shortages of foreign exchange in the member countries.

Finally, national authorities have provided increasing incentives to new investment in the form of tax and tariff exemptions, chiefly to attract new industries. In the absence of coordination in CACM, the administration of these incentives has been characterized by competition among the member countries in providing advantages to national as well as to foreign firms. The Central American Fiscal Incentives Agreement, ratified in 1969, would reduce the extent of incentives as well as competition in granting incentives, although maintaining their national administration for a period of seven years and using national rather than regional criteria in determining eligibility. The Agreement has not yet been implemented.
Integration Industries

The Treaty establishing CACM provides for the establishment of integration industries, defined as industries which require access to the CACM market in order to operate even at minimum capacity. The distribution of integration industries among the participating countries was to be undertaken in the framework of "rounds" of negotiations. Apart from duty-free entry in the markets of member countries, integration industries were to receive fiscal incentives as well as an assurance that additional plants would not be established within CACM.

There are only three plants operating under the integration industry regime: tyres and tubes in Guatemala, chlorated insecticides and chlorine caustic soda in Nicaragua. The lack of success is explained by the cumbersome negotiating procedures, conflicts among the member countries, and the absence of positive authority on the part of CACM institutions.

As the failure of the integration industry regime had become apparent, a simpler system was sought to induce the development of new industries on a regional scale by granting additional protection to plants that guarantee sufficient capacity to supply 50 percent of regional demand. Few plants have been established under this scheme, possible because of the availability of generous national fiscal incentives.

Provisions for Less Developed Member Countries

The Treaty establishing CACM does not provide preferential treatment to countries at lower levels of development. However, Honduras has
claimed of not having received its share in the benefits of integration. In view of Honduras's complaint, member governments agreed that it should receive special treatment from CABEI as well as in provisions on fiscal incentives. However, Honduras' share in CABEI loans hardly exceeds its share in the combined GNP of the member countries and Honduras effectively withdrew before the agreement on fiscal incentives could have been applied. A new agreement is under negotiation with Honduras but its provisions have not yet been finalized.

Evaluation

The establishment of CACM contributed to the rapid expansion of intra-area trade and an acceleration of the economic growth in the member countries. Increases in trade were concentrated in manufactured goods, with the annual rate of growth averaging 32 percent between 1961 and 1968. The rise of trade in manufactures involved largely intra-industry specialization in the form of the exchange of different varieties of nondurable consumer goods and their imputs. However, the rate of growth of intra-area trade declined following the dispute between Honduras and El Salvador in 1969.

Also the rise in intra-area trade and industrial development in CACM took place behind high tariff walls, permitting high-cost production and/or high profits. This may explain that the expansion of intra-area trade has not been followed by a rise in the extra-area exports of manufactures and that the growth of industry has slowed down in recent years as possibilities for import substitution have been increasingly exhausted. For efficient industrial growth, it would be necessary to
restructure CET so as to avoid protecting high-cost import substituting industries, to provide incentives to the exports of manufactures, to harmonize and rationalize the systems of fiscal incentives in operation in the member countries, and to coordinate policies affecting foreign investment. Some of these recommendations have been made in SIECA's 1972 report aimed at revitalizing CACM, which is under discussion by member governments.
4. **Caribbean Community**

**Main Characteristics**

The Caribbean Free Trade Association (CARIFTA) was established in 1968, with the participation of Barbados, Guyana, Jamaica, Trinidad and Tobago, as well as the members of the East Caribbean Common Market (Antigua, Dominica, Grenada, Montserrat, St. Kitts-Nevis-Anguilla, St. Lucia, St. Vincent, and Belize). In 1974 the member countries of CARIFTA established the Caribbean Community (CARICOM) to further the process of their economic integration.

The combined population of CARICOM is 4.6 million and its combined GNP $3.3 billion. Considerable differences in economic size are shown within CARIFTA, although even the largest country (Jamaica, with a GNP of $1.6 billion) is small in absolute terms. By comparison, the small islands constituting ECCM have gross national products ranging from $5 to $45 million. They also generally have lower per capita incomes ($200-$500) than the larger countries; incomes per head are the highest in Trinidad and Tobago ($970).

The share of manufacturing in the gross domestic product is also the highest in Trinidad and Tobago (16 percent) as compared to 13 percent in Jamaica, 11 percent in Guyana, and 10 percent in Barbados. It is only 2-4 percent in the small islands, the exception being Dominica where the share of manufacturing is 8 percent. Finally, the share of intra-area trade in the total trade of the member countries is 7 percent.
Trade Liberalization

The Caribbean Free Trade Agreement provided for the immediate elimination of duties on intra-area trade, with exceptions made for 16 products on the Reserve List where the less developed members (the ECCM countries) can phase out duties over a period of ten years; in the case of 3 of these 16 products the other member countries are permitted to eliminate duties over a five-year period. Further exceptions are made for products which were receiving protection under contractual agreements prior to CARIFTA's establishment and for petroleum refining in Guyana. Finally, special provisions apply to agricultural products covered by the Agricultural Marketing Protocol, the Fats and Oils, and the Sugar Agreement (see below).

The agreement also provides for the equalization of indirect taxes on imports and on domestic goods as well as for the elimination of quantitative restrictions on intra-area trade. Free trade is applied to "CAREFTA products" that meet agreed criteria and drawbacks cannot be granted of duty paid on imported materials when the finished good is exported to another CARIFTA country. Finally, government subsidies and direct tax concessions on exports to other CARIFTA countries have been abolished.

The members of East Caribbean Common Market began the implementation of the ECCM Common External Tariff in 1972. Under the CARICOM Treaty, a common tariff and a harmonical system of quantitative restrictions on extra-area imports will be adopted by all member countries. There have been no substantial changes in measures of liberalizing intra-area trade.
Common Institutions and Policies

Policy decisions on substantive issues are taken by the Conference of the Heads of State while the Council of Ministers is responsible for the implementation of the Agreement. Day-to-day operations are carried out by the Regional Secretariat and the Secretariat for ECCM members. In turn, the Caribbean Development Bank lends to both members and non-member countries in the Caribbean area while the Caribbean Investment Cooperation has been established to provide financial assistance to the ECCM countries. Finally, several specialized institutions existed before CARIFTA's establishment (Regional Shipping Council, West Indies Shipping Corporation, Meteorological Council, University of West Indies) and others have been created since (Council of Legal Education, Commonwealth Caribbean Technical Assistance Agreement, Caribbean Examinations Council, and the Statistical Coordinating and Advisory Committee).

In the field of infrastructure, the reorganization of West Indian shipping service is being carried out. In agriculture, a Marketing Protocol has been adopted for 22 products, covering the fixing of minimum prices in intra-area trade, the periodic determination of exportable surpluses and import requirements, export allocation, and ban on imports from third countries while regional supplies are available. Similar marketing arrangements apply to fats and oils and to sugar. Also, CARICOM Treaty calls for formulating a regional agricultural development program.

Payments agreements between central banks are designed to maintain the parity of exchange rates. The CARICOM Treaty also provides for Cooperation and consultation on monetary and exchange rate policy, tax
harmonization and double taxation agreements, as well as the harmonization of fiscal incentives to domestic and foreign industry.

The Caribbean Development Bank (CARIMBANK) was established in 1970 and began operating in 1971. It provides loans to infrastructure, agricultural, and industrial projects. There is a Special Fund and an Agricultural Fund reserved for assistance to less developed countries and these countries have a separate development agency. CARIMBANK is also concerned with institution building that involves strengthening credit institutions in the less developed member countries.

Integration Industries

The CARIFTA Agreement made no reference to the establishment of integration projects or sectoral programs. In turn, the CARICOM Treaty calls for the joint development of regional natural resources, regional cooperation in the development of tourism, and regional industrial programming.

Provisions for Less Developed Member Countries

Note has been taken above of concessions provided to less developed member countries in extending the period for the elimination of duties on commodities placed on the Reserve List. These countries can also postpone the adjustment of indirect taxes on certain products and are allowed to offer more generous tax incentives than the more developed member countries. Furthermore, they are given priority in purchases of
agricultural products and raw materials by the developed member countries.

The less developed members are provided with loans from the Special and the Agricultural Funds of CARIMBANK. In 1971, the first year of its operations, 19 out of 21 CARIMBANK loans were made to the less developed members. They have been the subject of CARIMBANK's activities in institution building in the domestic credit field and of studies financed by CARIMBANK in industrial opportunities. They will also be the beneficiaries of the Caribbean Development Corporation's financial activities.

Evaluation

The value of intra-area trade in CARIFTA doubled between 1967 and 1971 as compared with a 39 percent increase in the total trade of the member countries. However, in absolute terms, as well as in proportion to GNP, intra-CARIFTA trade remains small. The expansion of intra-area exports from the larger, more developed member countries have been concentrated in manufactured products that benefited from the elimination of tariffs. In turn, the less developed member countries continue to export foodstuffs and raw materials.

With increased protection and fiscal incentives, a further expansion of intra-CARIFTA trade can be anticipated. However, the possibilities for import substitution in the regional framework are severely limited by the small size of the market and high transportation costs. It would seem necessary therefore to avoid excessive protection that would encourage high-cost import substitution at the expense of exports. There is further
need to find a solution to the problems of the less developed member countries in CARIFTA which, despite the special treatment received, seem to attract little industry.
5. **East African Community**

**Main Characteristics**

The East African Community (EAC) was created by the Treaty for East African Cooperation signed in 1967 by the governments of Kenya, Uganda, and Tanzania. Its aim was to provide for the continuation of the common service organizations established under British rule and to safeguard the *de facto* customs union among the countries concerned.

The combined population of EAC is 36 million, the gross national product $5.3 billion, and in 1972 the share of intra-area trade in their total trade exports was 12 percent. Among the member countries, Kenya has the largest domestic market, with a GNP of $2.1 billion, the highest per capita income ($170) and the largest share of manufacturing in GDP (11 percent); the relevant figures for Tanzania are $1.6 billion, $120 and 9 percent; for Uganda, $1.6 billion, $150, and 7 percent.

**Trade Liberalization**

The history of the East African Common Market dates back to 1917 when Uganda and Kenya formed a customs union; this was joined by Tanganyika in 1922. After independence in the early sixties, the concentration of import substituting industries in Kenya caused increasing concern in the other member countries. The Kampala Agreement of 1964 called for the allocation of specific industries among the member countries (see below) in order to achieve greater balance in intra-area trade flows. But the Agreement was not implemented and the continuing imbalance in trade led to the imposition of trade restrictions.
To halt the trend towards disintegration, the Treaty of 1967 permits transfer taxes to be imposed by countries with a deficit in intra-area trade in manufactured goods on the importation of these goods from the partner countries, with a maximum of 50 percent of the Common External Tariff. In practice, this means that Uganda and Tanzania tax imports from Kenya, and Tanzania taxes some imports from Uganda.

Member countries may also impose quantitative restrictions on various basic staple foods and major export crops and may apply quantitative restrictions to imports in case of overall balance-of-payments equilibrium. Also, the import licensing systems in effect in Kenya and Tanzania are said to discriminate against each other's exports. In particular, Tanzania gives priority to imports from China over Kenyan goods. Finally, the political situation between Tanzania and Uganda has led to restrictions on their mutual trade.

The Common External Tariff continues to be preserved. But, there is no common policy on duty drawbacks for imported machinery and materials, leading to differences in effective rates of protection. Also, import licensing is operated independently by the individual member countries.

Common Institutions and Policies

The Common Market Council is called upon to settle problems arising from the interpretation of the Treaty's provisions on the Common Market while the Common Market Tribunal has been given the role of adjudicating cases when the Common Market Council fails to settle the matter. However, the Council's decision on import licensing has not been implemented and increasingly fewer cases are referred to it. The Common Market Tribunal has not yet started functioning.
The Common Market is part of the East African Community that also encompasses the common services and so-called general fund services. The principal executive body of the EAC is the East African Authority consisting of the Presidents of the three member countries; it has not met since the military take-over in Uganda in 1971. There are also five councils (Common Market, Communications, Economic Consultative and Planning, Finance, and Research and Social Council) and three Secretariats responsible for Common Market and Economic Affairs, Finance and Administration, and Communications and Research. The Secretariats, together with the Customs and Excise Department, the agricultural research organization, various natural resource and medical research organizations, and meteorological services are part of the general fund services.

The East African common services are operated by the Harbours Corporation, Post and Telecommunications Corporation, Airways Corporation, and Railways Corporation. The former two are financially sound. By contrast, the Airways Corporation has run into financial trouble because of mismanagement and the Railways Corporation because of large wage increases in the face of maintaining low and ill-structured railway rates.

The East African Development Bank was established in 1968 to provide loans to manufacturing industries. The three member countries contribute equally to its capital but Tanzania and Uganda each are supposed to receive nearly two-fifths of its loans. However, at the end of 1971, Kenya had 46 percent of the loans as compared to 33 percent for Tanzania and 21 percent in Uganda.

The East African Research Organization carries out research in agriculture, forestry, fisheries, and veterinary medicine. As regards agricul-
ture, the Treaty calls for the coordination of national policies but these have in fact become more disparate through the setting up of national marketing boards. In turn, national marketing policies, together with restrictions applied under the Treaty, interfere with the freedom of trade in agricultural products.

Integration Industries

The Kampala Agreement called for the allocation of new industries among the member countries. While Tanzania set up a tire factory and a radio assembly line to cater to the East African market, Kenya also established a tire factory and both Kenya and Uganda set up radio assembly plants. Subsequently, the Common Market and Economic Affairs Secretariat initiated work on pre-investment studies for the identification of industries where scale factors would not make operation economically feasible except on the East African scale. Consultants undertook studies and made recommendations for the establishment of plants in the steel industry, truck assembly, and a fertilizer-chemicals complex. These proposals were endorsed on a technical level by the East African Committee of Planners but have not been officially considered on the political level.

Treatment of Less Developed Member Countries

Following the failure of the Kampala Agreement, the transfer tax mechanism was introduced to give an extra margin of protection to Tanzanian and Ugandan industries on a temporary basis, provided that certain conditions are fulfilled. Tanzania is currently taxing 53 items imported from Kenya (about
16 percent of manufactured imports from that country) and 28 items imported from Uganda (10 percent) while Uganda levies transfer taxes on 32 items imported from Kenya (14 percent). As a rule, transfer taxes have been imposed at the maximum rate of 50 percent of CET.

Although the imposition of transfer taxes has undoubtedly improved Tanzania's and Uganda's balance of trade in manufactured goods, it is generally believed that these taxes are of lesser importance than the other trade restrictions and administrative obstacles in the two countries. At the same time, while Tanzania's trade balance with Kenya has improved, that of Uganda has deteriorated. It would seem that these results have been dominated by the drastic changes in economic environmental conditions that have taken place in the member countries, with nationalization in Tanzania and the expulsion of Indians in Uganda.

Evaluation

The provisions of the Treaty notwithstanding, intra-EAC trade as a proportion of total exports declined from 18 percent in 1967 to 14 percent in 1972. Still, intra-area trade in manufactured goods continues to be of importance, accounting for 60 percent of the total exports of manufactures by the member countries. This trade is of especial significance for Kenya that accounts for 64 percent of intra-EAC exports of manufactured goods. By contrast, Kenya effectively subsidizes the operation of common services in the member countries.

Differences in the political and the economic climate represent the single largest obstacle to the functioning of the East African Community. Still, with improvements in the relationships between Tanzania
and Uganda, there is hope for the continuing operation of the Common Market, provided that a solution is found to the problem of the distribution of benefits from integration. This would probably require, in addition to amendments to the transfer tax scheme, the allocation of new industries that could support only a single plant in EAC. Also, the rate structure of the railways would need to be improved and overstaffing in the common services reduced.
6. Central African Customs and Economic Union

Main Characteristics

In June 1959, the four former French colonies in Central Africa, the Central African Republic (CAR), Chad, Congo-Brazzaville, and Gabon, signed a Treaty establishing the Equatorial Customs Union (Union Douanière Equatoriale or UDE) to safeguard the existing customs arrangement, the common transport and communications system, and the common central bank. The Republic of Cameroon became an associated member of UDE in 1961. A new treaty was signed in 1964, establishing the Central African Customs and Economic Union (Union Douanière et Economique de l'Afrique Centrale or UDEAC) which was intended also to provide for the coordination of industrial development in the region. Failure to achieve agreement in this respect subsequently led to the withdrawal of Chad and CAR; however, CAR has later rejoined UDEAC.

The combined population of the member countries is 9.4 million, its GNP $2.3 billion, and the share of intra-area trade in total exports 6 percent. Cameroon accounts for 65 percent of the population and 54 percent of GNP in UDEAC and it has the highest share of manufacturing in the gross domestic product (14 percent). Gabon is the smallest, with a population of 0.5 million and a GNP of $0.4 million; however, due to its mineral wealth, Gabon has by far the highest income per head in the region ($880). Per capita incomes are $300 in Congo, $200 in Cameroon, and $160 in CAR.
Trade Liberalization

The UDE Treaty called for the free movement of goods and capital and for the establishment of a common external tariff; these provisions have been by-and-large retained by UDEAC. Intra-area trade in agricultural products is not subject to taxation. A single tax (taxe unique), levied at the production stage, applies to most manufactures. The products of firms having single tax status are freely traded within the area; all other products are subject to import taxes and quantitative restrictions. 92 firms have single tax status, of which 50 are located in Cameroon, 21 in Congo, 16 in CAR, and 5 in Gabon. Among the 92 firms, 17 produce foodstuffs, beverages and tobacco, 17 textiles and clothing, 38 other consumer goods, and 20 intermediate goods and equipment.

The rates of the single tax vary from one product to another and according to the country of production; they are agreed upon jointly by the member countries. Tax rates range from zero to 64 percent; for most commodities, they vary between 10 and 35 percent. While the rates of the single tax were supposed to have been harmonized by the end of 1972, differences in the rates persist as consuming countries use the rate-setting process to protect their domestic industries.

The unification of taxes on extra-area imports was put into effect in January 1966. Customs and fiscal duties and the import turnover tax are levied at the same rate in the member countries; countries may impose additional taxes on imports but cannot change the rates applied without prior consultation with the UDEAC authorities. Goods originating in the EEC and the former French colonies are exempt from customs duty but are
subject to the other forms of import taxation.

Rates of customs duty vary between nil and 30 percent, the rates of the fiscal duty range between nil and 260 percent, with most items taxed at rates of 20 to 30 percent; the import turnover tax is uniformly 10 percent of the c.i.f value of merchandise plus customs and fiscal duties. The additional tax is levied on few commodities in Congo and CAR, on a number of goods in Cameroon, and on practically all imports in Gabon. Rates vary between 5 and 10 percent in CAR and Congo, from 10 to 15 percent in Cameroon, and are uniformly 5 percent in Gabon; higher rates apply to alcoholic beverages and tobacco products.

Imports from outside the EEC and the former French colonies are subject to licensing in accordance with an annual import program agreed upon by the individual countries and French representatives. Also, quantitative import restrictions are applied to certain goods that can be produced domestically. Finally, taxation on exports is under the jurisdiction of the individual member countries, although provisions are made for consultations within UDEAC.

Until 1971, customs clearance was effected at the point of entry into the union, subject to subsequent reimbursement of the tax receipts to the country of final destination. Due to disputes that have arisen, import taxes are now paid directly to the consuming country. In turn, receipts from the single tax are redistributed to the consuming countries.

Common Institutions and Policies

Principal decisions on matters relating to integration are taken at the meetings of the Council of the Heads of States, while a Management
Committee, consisting of two ministers from each country, handle matters in the interim. A General Secretariat is responsible for the implementation of the decisions while the Accounting Agency undertakes the redistribution of the tax proceeds.

The Treaty calls for the harmonization of transport policies but this has not progressed beyond the study stage. In turn, the Agence Transéquatoriale des Communications was dissolved in 1969 when Congo decided to nationalize the assets located on its territory and create a state-owned transport company. Subsequently, Congo signed bilateral agreements with CAR, Chad, and Gabon for transit traffic on its territory. There seems to have been little coordination in new transport projects.

The member countries continue in a monetary union and have a joint central bank, Chad included. The central bank (Banque des Etats de l'Afrique Centrale or BEAC) issues currency and carries out foreign exchange transactions. There are no restrictions on capital movements. Finally, there is no regional investment bank.

In the fiscal field, member countries have agreed that tax bases and rates cannot be changed unilaterally but the harmonization of tax rates is made difficult because of intercountry differences in the budgetary situation. Fiscal harmonization would require fiscal transfers as provided by the UDE Treaty through the Solidarity Fund. However, in UDEAC contributions to the Solidarity Fund have been cut drastically and it is now intended to compensate only for errors in import declarations and, partially, for receipts and payments in transit trade.

In 1965, member countries adopted a common investment code that sets the maximum incentives to firms which sell in two or more member countries.
In granting these privileges, the Executive Committee of UDEAC is to take into consideration the location of raw materials, the volume of capital investment already realized in the member states, and differences in the economic position of the members, but it has not been specified how and to what extent these various criteria are taken into account. Finally, while firms which provide for the domestic market only can receive incentives under the national investment code, these incentives cannot exceed those provided under the common code.

Integration Industries

The UDEAC Treaty includes provisions for the coordination of industrial development and the allocation of industry without specifying how these objectives would be attained. These are a few regional projects: the oil refinery at Port Gentil (Gabon), of which each member country subscribed a part of the capital, a sugar factory (Congo), and a match factory (Cameroon). However, Cameroon and Congo have announced their intention to build oil refineries and Cameroon and Chad plan to replace sugar imported from Congo by domestic production. There is considerable duplication of facilities in the food processing and nondurable consumer goods industries also.

In September 1973, the Commission on a Common Industrial Policy made recommendations for undertaking market studies on the creation of common industries for the production of fertilizers, automobile batteries, pharmaceutical products, and petrochemical products. However, the Commission has found the establishment of a financing organization "premature". The report of the Commission will be submitted to the Council of the Heads of States.
Treatment of Less Developed Member Countries

Apart from fiscal compensation payments to CAR, there are no fiscal measures benefiting the less developed member countries in UDEAC although such compensation was provided through the Solidarity Fund in UDE. Furthermore, in the absence of a common industrial development policy, the less developed countries do not receive preferential treatment in regard to industrial location.

Evaluation

While trade among the member countries increased at a rapid rate, it has remained small as a proportion of total exports or gross national product. Given the preponderant place of Cameroon in UDEAC, it is questionable if further progress can be made in integration without offering concessions to the other member countries. Progress in integration would also require the political will of member country governments to accept a diminution of their sovereignty.
7. West African Economic Community

Main Characteristics

There are a variety of integration schemes in West Africa. They include the Entente, comprising Dahomey, Ivory Coast, Niger, Togo, and Upper Volta, the Organization for the Utilization of the Senegal River, with the participation of Mali, Mauritania, and Senegal, and the Organization for the Integrated Development of the Luptako-Gourma Region, including Mali, Niger, and Upper Volta. These organizations deal with particular questions and will not be discussed here. Nor will we examine plans for an Economic Community of West African States (Communauté Economique des Etats de l'Afrique de l'Ouest or CEDEA) whose future is uncertain. Rather, we will concentrate on the West African Economic Community (Communauté Economique de l'Afrique de l'Ouest or CEAO).

The CEAO has taken the place of the West African Customs and Economic Union (Union Douanière et Economique de l'Afrique de l'Ouest or UDEAO - established 1966) whose predecessor was the West African Customs Union (Union Douanière de l'Afrique de l'Ouest, or UDAO - established 1959). The Treaty establishing CEAO was signed by the heads of state of Ivory Coast, Mali, Mauritania, Niger, Senegal, and Upper Volta in April 1973. Dahomey (which was a member of UDEAO) and Togo also participated in the negotiations but did not sign the Treaty and adopted an observer status. The provisions of the Treaty on intra-area trade will come into force on January 1, 1975; in the meantime, the UDEAO Treaty and the various bilateral trade agreements between member governments will apply.

* Garry Pursell has contributed to the writing of this section.
The combined population of the CEA0 is 25.7 million, the gross national product $4.2 billion. Apart from Mauritania (1.2 million), the population of the member countries is in the range of 4 to 5.5 million. However, due to disparities in per capita incomes (Ivory Coast, $340; Senegal, $260; Mauritania, $180; Niger, $90; Mali and Upper Volta, $70) they show large differences in the gross national product. GNP is $1.8 and $1.0 billion, respectively, in the more developed countries, Ivory Coast and Senegal; it is $0.4 billion in Mali, Niger, and Upper Volta and $0.2 billion in Mauritania. Recorded intra-area trade accounts for 8 percent of total exports; there is also substantial unrecorded trade.

Trade Liberalization

The UDEAO Treaty called for freeing intra-area trade from quantitative restrictions and setting duties on products originating in the member countries ("produits originaires") and one-half of the rate applied to imports from the EEC. The UDEAO Treaty was supplemented by a series of bilateral trade agreements. While in limiting tariff concessions to specified products and quantities, several of these agreements contain provisions that are more restrictive than the UDEAO Treaty, in other cases they go beyond it. For example, the Ivory Coast-Senegal agreement exempts all primary products as well as certain manufactured products traded between the two countries from import duties, and treats imports of other manufactured products more favorably than UDEAO.

The implementation of the UDEAO Treaty and the various bilateral agreements has been far from complete, however. Firstly, few quantitative
restrictions have been removed; and new restrictions have been imposed (particularly by the inland countries and by Senegal). Secondly, tariffs have been raised by increasing the tariff base (the so-called "valeur mercuriale"). Thirdly, differences of interpretation have arisen regarding the definition of products originating from within UDEAO.

The lack of harmonization of the Investment Code and other regulations affecting imports have created further difficulties, especially that exports, in particular in the Ivory Coast, benefit from a temporary admission or drawback regime on inputs imported from outside UDEAO, including machinery and materials, whereas such concessions are not generally available on goods destined for domestic consumption. This situation has, in turn, given impetus to quantitative limitations on bilateral trade in some products.

The establishment of the CEAO has been intended to surmount some of the difficulties encountered by UDEAO. As far as the liberalization of intra-area trade is concerned, it has provided for the elimination of quantitative restrictions by January 1, 1974, the removal of duties on primary products by January 1, 1975, the abolition of restrictions on services among the member countries over a twelve-year period, and the introduction of the Regional Cooperation Tax (Taxe du Cooperation Regionale or TCR) on manufactured goods as of January 1, 1975.

Under the Treaty, manufactures traded among the member countries should bear the same tariff as imports from the EEC, except when replaced by the TCR which provides preferential treatment. TCR is to be negotiated bilaterally on a product-by-product basis, and its rate on a particular product may vary from country to country. These require the unanimous
approval of the Council of Ministers; the TCR system will become operative on January 1, 1975. Earlier agreements on bilateral trade will remain in force but their incompatibilities with the TCR will be progressively reduced.

The member countries of UDEAO have made no progress towards establishing a common external tariff; if anything, differences in national tariffs increased over time. The CEAO Treaty calls for harmonizing customs nomenclature and regulations among the member countries within three years and for establishing a common external tariff within 12 years. Preferential agreements between member states and third countries may however continue and new preferential arrangements may be established with non-member African states, provided that preferences under such agreements do not exceed those granted to member states.

Common Institutions and Policies

Major issues affecting CEAO will be decided at meetings of the Conference of the Heads of State and, in the interim, by the Council of Ministers. CEAO has a General Secretariat, a Community Development Fund, and a Court of Arbitration. All member countries except Mali and Mauritania are members of the West African Monetary Union; that also includes Dahomey and Togo. As members of the Monetary Union, they have a joint central bank (Banque Centrale des Etats de l'Afrique de l'Ouest or BCEAO) which issues a common currency and carries out foreign exchange transactions. It has recently established a Development Bank.

Community activities in the field of regional economic cooperation
will be financed from the Community Development Fund (Fonds Communautaire du Développement or FCD). FCD itself will be financed from the proceeds of the Regional Cooperation Tax on industrial commodities that will also be a source of compensatory payments to countries that give tariff concessions on manufactured goods imported from within CEAO. Member countries will contribute the difference between the duty applying on imports from the EEC countries and the TCR and, following a deduction made for the Community Development Fund, they will receive payments in proportion to their intra-area imports of manufactured goods. The Ivory Coast and Senegal will make net contributions under this arrangement while the other countries will be net recipients of the funds provided.

In primary activities, provision has been made for cooperation in the production and marketing of livestock, meat, and meat products and the products of inland and sea fishing. Additional provisions deal with the Community promotion of agricultural and industrial development, intra-area trade, and the coordination and development of transportation and communications. Finally, the harmonization of investment codes is envisaged, with special reference to foreign investment.

Integration Industries

Neither the UDAO or UDEAO Treaties made any provision for the coordination of industrial development policies. In fact, since 1960 economic development in the coastal countries of the region has been characterized by the duplication of plants. While the member countries are not obligated to avoid duplication in the future, the CEAO Treaty gives the Secretariat a general mandate to recommend measures for increased specialization. In particular, it is
envisioned that the Secretariat would make proposals for integration projects, to be preferably established in the least industrialized countries, and to be financed or subsidized by the Community Development Fund. In order to deal with these matters a Community Development Office (Bureau Communautaire de Développement or BCDI) is to be established within the Secretariat.

Treatment of the Less Developed Member Countries

The less developed member countries will be assisted by the Community Development Fund, by compensatory payments based on the value of intra-area trade in manufactures, as well as by the promotion of trade in livestock, meat, and its by-products.

Evaluation

As noted above, the CEAO's predecessors have met with little success. The CEAO's own future will in turn depend on the willingness and ability of the coastal and the inland countries to reach agreement on the TCR as well as on the exploitation of possibilities for trade among the coastal countries, particularly between the Ivory Coast and Senegal. At the same time, the limited commitments taken in regard to trade in manufactures and the lack of an obligation to refrain from duplication in new plants do not augur well for the expansion of manufacturing industry in a regional framework.
8. **Other Regional Integration Schemes**

**Maghreb Group**

A draft integration treaty was prepared for liberalizing trade among Maghreb countries, comprising Algeria, Morocco, and Tunisia (Libya withdrew in 1970), but it has not been signed. Economic cooperation is limited to the operation of the Committee on Standardization, the Alfa Marketing Group, the Postal and Telecommunications Committee, and the Transport and Communications Committee. There is also a Maghreb Center for Industrial Studies while the Maghreb Permanent Consultative Committee is presently inactive. Given Algeria's apparent desire to develop its manufacturing industries on a national basis and political differences among the three countries, it is questionable that progress will be made in the near future.

**Arab Common Market**

Proposals for an Arab Common Market, with the participation of the United Arab Republic, Iraq, and Jordan, have been put forward by the Council of Arab Economic Unity. Apart from tobacco, there is free trade in agriculture, but a preferential trade regime in industry has not yet materialized. In turn, there is a Joint Committee on Transport and plans have been made for establishing a payments union and a Bank for Arab Economic Integration. The success of the scheme is tied up with the solution of the Middle East situation.

* Notes by Naimeh Hadjitarkhari have been helpful in the writing of this section.
Regional Cooperation for Development

In 1964, Iran, Pakistan and Turkey agreed to create "Joint Purpose Enterprises" in industries "requiring a market larger than any one member country can provide to ensure economic production". According to the Treaty on Regional Cooperation for Development, these enterprises would be financed jointly by the member countries and established in the public or in the private sector. Their products would be sold in the framework of long-term purchasing agreements at internationally competitive prices and quality. RCD does not provide for preferential intra-area trade.

Fifty-six Joint Purpose Enterprises have been reportedly identified and their location agreed upon, mainly in the chemical, petrochemical, engineering, and electrical industries. Three projects have been realized so far: the production of bank notes and ball bearings in Pakistan and an aluminium smelter in Iran. The most important of these -- the Iranian aluminium plant-- was established with the participation of Pakistan but Pakistan subsequently withdrew and there is no agreement on trade in aluminium. Some of the other plants that are not in joint ownership also have the RCD label but they produce for national markets and there is increasing duplication of production facilities among the three countries.

As a result, intra-area trade has declined in absolute terms since 1964 and accounts for only 0.7 percent of total exports. This has in turn led to proposals for liberalizing trade within the area. These proposals were endorsed by the RCD Ministerial Council in January 1973 but it is not yet clear what form trade liberalization would take if it were in fact implemented. Nor have agreements on setting up a joint international airline and joint petroleum organization been implemented. Finally, the RCD
Union for Multilateral Payments Agreements does not involve the provision of credit in the event of balance-of-payments difficulties.

The economic and political interests of the three RCD countries are rather divergent. Turkey has established preferential ties with the European Common Market and aspired to eventually reach full membership status; Iran has accelerated the process of industrialization in a national framework utilizing revenue from oil; While Pakistan relies chiefly on the exploitation of labor-intensive manufactures. Correspondingly, the future of RCD is in doubt.

Association of South-East Asian Nations

The Association of South-East Asian Nations (ASEAN) was established in 1967, with the participation of Indonesia, Malaysia, Philippines, Singapore, and Thailand, for the purpose of contributing to the economic development of the member countries through "active collaboration and mutual assistance". Committees were set up to investigate the possibilities for collaboration in food production, civil air transport, meteorology and communications, shipping, and trade liberalization. Apart from the exchange of information, these committees have accomplished little; in fact, the joint airline of two of the countries (Malaysia and Singapore) has recently split up.

In turn, ECAFE has organized studies for the allocation of industries in the region. The studies have led to recommendations for the establishment of firms to produce steel, petrochemicals, fertilizers, agricultural machinery, and small engines. These recommendations have been criticized on the ground that they would not lead to an efficient industrial pattern; thus, the Philippines are supposed to produce petrochemicals although oil is produced in Indonesia. Their implementation is in doubt.
9. Preferential Agreements Among Developing Countries Located in Different Regions *

Tripartite Agreement

In 1967, India, the United Arab Republic, and Yugoslavia signed an agreement to provide tariff concessions on trade in products specified in a Common List. The Common List originally consisted of 77 tariff items; in 1969 an additional 57 items were added. These products are traded among the three countries at a preferential tariff rate amounting to 50 percent of their MFN tariff.

Trade in the items subject to tariff concessions reached $85 million in 1970-71, with the United Arab Republic being the largest importer ($32 million) and India the largest exporter ($38 million). However, trade under the Agreement accounts for a very small proportion of the total exports of the participating countries. In 1970-71, this proportion was 3 percent for the United Arab Republic and 2 percent for India and Yugoslavia. And, with a decrease in trade in the items subject to tariff concessions by one-half, the share of this trade in the expanding overall exports of the three countries declined to a considerable extent in the year following. Also, trade among the three countries essentially represents utilizing excess capacity without new capacity being created for expanding trade. This is explained by the fact that trade among the three countries is obstructed by the application of quantitative restrictions and various domestic policy measures which have a protective effect. Considering also the high transportation costs due to distance and, more importantly, to the absence of regular shipping routes, it is doubtful...

* Notes by Naimeh Hadjitarkhani have been helpful in the writing of this section.
that the extension of the preferential agreement would greatly contribute to the growth of trade among the three countries.

**Agreement among Sixteen Developing Countries**

Among the thirty-five developing countries that participated in negotiations on preferential tariff reductions under GATT auspices, sixteen signed an agreement at the end of 1971. The countries in question are: Egypt, Greece, Israel, Syria, Tunisia, Turkey, and Yugoslavia in the Mediterranean area; India, Korea, Pakistan, and the Philippines in Asia; and Brazil, Chile, Mexico, Peru, and Uruguay in Latin America.

The agreement provides for preferential tariff reductions on products included on national lists. By and large, the products correspond to sub-items of the Brussels Tariff Nomenclature and are not manufactured in the importing countries. The extent of preferences is, in the majority of cases, 40-50 percent of the MFN tariff.

While data on the relative importance of the imports of the commodities subject to preferences is not available, trade among the participating countries accounts for only 5 percent of their total trade. This share is the highest in Uruguay (19 percent) that exports foods to Brazil; it is 14 percent in Egypt and it does not reach 10 percent in any other country, with it being practically zero in Korea. The bulk of trade among the participating countries is in primary products.

Given the high transportation costs and national policies protecting domestic production, including quantitative restrictions, the impact of the preferential scheme on trade among the participating
countries is likely to remain small. At the same time, rather than replacing high-cost domestic production, increases in trade will mainly divert imports from developed nations, involving a rise in the cost of imports.
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Economic Integration among Developing Countries

Reprinted from the Journal of Common Market Studies 14
(September 1975)
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(continued on inside back cover)
ECONOMIC INTEGRATION AMONG DEVELOPING COUNTRIES*

BY BELA BALASSA AND ARDY STOUTJESDIJK

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In the early postwar period, economic integration among developing countries was considered primarily as a way of extending the policy of import substitution on a regional scale. This approach is subject to serious limitations since even regional markets will often not permit the establishment of efficient-size firms, much less competition among several such firms. Thus, regional integration oriented towards import substitution may lead to the establishment of inefficient plants and of an inefficient industrial structure, thereby postponing the time—and increasing the difficulties—of a reorientation of policies once the limits of import substitution have been reached.

A different approach is taken in this paper. Economic integration will be considered as one of the policy options available to developing countries and as part of their overall strategy for economic development. Broadly speaking, there are four possible policy options that may be adopted singly or in combination: development in a national framework, regional economic integration, increased trade with developing countries in other regions, and participation in the international division of labour.

I. ECONOMIC INTEGRATION THROUGH THE LIBERALIZATION OF TRADE

Import Substitution in National Markets

In the postwar period, a number of developing countries adopted a policy of import substitution in the framework of national markets. This choice reflected the view prevalent at the time that exportation, whether of primary goods or manufactured products, does not represent a viable alternative. It was assumed that the prospects for primary exports were unfavourable because of the slow growth of

* This paper was prepared for the International Bank for Reconstruction and Development. It should not, however, be deemed to represent the Bank's views.
demand on the part of developed nations, and that high import barriers as well as the inability of the developing countries to produce competitively foreclosed the possibilities for exporting manufactured products.

Views expressed as regards prospects for exporting manufactured products have proved to be overly pessimistic. Exports of manufactures from developing countries rose four-fold during the 1960s, with exports reaching $10 billion in 1970 as against the $4 billion predicted by the United Nations and their rapid expansion continued in the 1970s. Also, while demand is rising at a slow rate for tropical beverages and fruits of which developing countries are the only suppliers, the growth of import demand for most other primary products exceeds that of consumption in developed nations which face limitations of domestic supply. In fact, the slow expansion of the exports of these commodities from developing countries has often been due to their own policies, resulting in a loss in their world market shares.

At the same time, the opportunities for economical import substitution in the national framework are limited by the size of domestic markets. The smaller the market, the more restricted are the possibilities of establishing industries which cater exclusively to domestic demand and the higher are the costs of production. In the manufacturing of intermediate products and durable goods in particular, efficient operations require large-scale production, with unit costs rising substantially at lower output levels. The size of the domestic market also limits the extent of product specialization in individual firms and restricts the possibilities for process specialization through manufacturing parts, components and accessories on an efficient scale. Furthermore, the sheltering of national markets reduces the extent of competition and lessens the incentive for technological improvements.

An often-used measure of the size of national markets is the value of the gross national product. Among the non-European developing countries listed in the World Bank Atlas, 62 had a GNP of less than $1 billion, 40 between $1 and $5 billion, 15 between $5 and $10 billion, three between $10 and $25 billion in 1971. But, from the point of view of the exploitation of economies of scale and domestic competition, the market for manufactured goods is relevant. No developing country has a domestic market for manufactured goods as large as that of the Netherlands, Sweden, or Belgium among the smaller developed countries, which have entered into integration schemes in order to escape the limitations imposed by their national markets.
Since possibilities for economic growth through import substitution are limited by the extent of a country's domestic market, countries of different size will need to have recourse to exports at different levels of industrial development in order to ensure the continued expansion of their manufacturing industries. In some small African countries where the consumption of manufactured goods does not exceed $100 million a year, the domestic market is not sufficiently large even for the production of relatively simple manufactured goods.

At the other end of the scale, India and Brazil established a diversified industrial structure serving domestic needs, but have encountered market limitations in a number of their industries and are now attempting to expand their exports. The shift in strategy is the most apparent in Brazil that has increasingly focused on the promotion of agricultural and manufacturing exports. In this, Brazil is following the example of countries, such as Korea and Taiwan, which have attained high rates of economic growth applying a strategy of export promotion.

Exports and Economic Integration
Exports of manufactured goods may be oriented towards the markets of countries in the same region, to developing countries in other regions, or to developed nations. Providing incentives to exports would benefit sales in all foreign markets; regional integration would boost exports to countries in the same geographical area; and preferential schemes extending to other regions would stimulate exports to developing countries in those regions. But, as with import substitution, export promotion can be carried too far; this will be the case if excessive incentives are provided. Accordingly, an appropriate objective of development strategy may be seen in providing for the establishment of efficient export and import-substituting activities. Participation in the international division of labour through similar incentives to exports and import substitution and avoiding overly high protection of manufacturing industries can contribute to this goal.

While adopting such a policy would affect a country's overall trade, the establishment of the European Common Market and the European Free Trade Association indicates that even industrial countries with relatively large domestic markets derive advantages from regional integration. There are various reasons for this, several of which apply to developing countries as well.

First of all, a country participating in a regional integration scheme benefits from the elimination of barriers to its exports on the
part of the partner countries. This is of special importance for developing countries whose exports of manufactured goods often suffer discrimination in developed country markets. We observe that tariffs in developed nations tend to rise with the degree of fabrication, thereby discouraging the importation of foods and raw materials in a processed form. Also, tariffs are generally higher on simple manufactures than on products requiring a high level of technical sophistication developing countries do not possess. Finally, quantitative restrictions tend to be applied mostly to products originating in the developing nations, as in the case of textiles, clothing and shoes.

Considerations of risk and uncertainty favour regional integration schemes. There is more information on prices and costs in neighbouring countries than in faraway nations, thereby lessening uncertainty as regards the effects of trade liberalization on domestic industry. Uncertainty in intraregional trade is further reduced if commitments are taken to refrain from reimposing restrictions on imports or subsidies to exports. This is of special interest since developed countries have repeatedly imposed restrictions once the imports of manufactures from less developed areas have increased substantially. Also, in a regional union, it will generally be easier to reach—and to police—agreements to forego the use of measures which provide indirect benefits to domestic industry at the expense of their competitors in the partner countries.

In the EEC, an additional consideration has been to create large markets for highly sophisticated industries, such as aircraft, computers and electronics, where national markets of the member countries are too small for efficient operations, while protecting these industries from US competition. This argument applies a fortiori to developing economies which need protection for their infant industries. In a regional union, the cost of infant protection will be lower than in individual countries, since a wider market permits the establishment of larger plants, greater specialization, as well as more competition. At the same time, the markets of the partner countries can serve as a training ground for exporting elsewhere. We may then speak of infant export activities that need to learn quality control as well as marketing techniques.

But regional integration schemes have disadvantages of their own. Integration involves a cost in the form of higher prices paid for imports from the partner countries. Also, the establishment of new industries in a regional framework may give rise to monopoly positions and inefficient, high-cost production. This will occur if excessive protection is granted to regional industries that permits high-cost operations and provides little incentive for technological
improvements. At the same time, the establishment of firms oriented towards the markets of the partner countries may draw away resources, such as capital and entrepreneurship, from exporting to world markets, where they could be put to better uses. It may also be necessary to undertake costly investments in transportation to permit a substantial expansion of intraregional trade.

Furthermore, involved negotiations on economic integration impinge on scarce decision-making capacity in developing countries and limit the attention given to other policy options. On a different plane, economic integration will involve a cost through the diminution of national sovereignty as agreements on the liberalization of intra-area trade and on the policy coordination necessary for the success of the integration schemes reduce the scope of action by national authorities.

The balance of the benefits and costs of regional integration in a particular case will depend on the circumstances of the situation, including market size, resource endowment, geographical location and access to developed country markets, as well as on the policies applied. In the following, attention will be given to policies that may be used to increase the benefits of integration through the liberalization of intra-area trade and to contribute to the equitable distribution of these benefits among the participating countries. Subsequently, the possibilities of preferential tariff reductions on trade among developing countries located in different areas will be examined.

The Scope of Integration Schemes
There is a case for extending the range of industries covered by integration schemes that involve the liberalization of intraregional trade. In this way, one may allow for compensating changes in various industries, lessen the power of special interests, increase competition, and reduce investment requirements. Compensating changes will smoothen the path of adjustment and it may be easier to surmount opposition from special interests than if trade liberalization was limited to a few industries. Also, apart from the case of integration among countries at different levels of development to be discussed below, the exposure of domestic firms to competition from the partner countries would have beneficial effects in the form of improvements in the distribution of incomes through lowering excess profits and incentives for technical progress. Finally, the expansion of intra-area trade may lead to a higher degree of capacity utilization, thereby reducing the need for new investments.

Nevertheless, integration in existing industries has been opposed
on the grounds that it would create serious dislocations in the individual countries. The experience of the Central American Common Market does not lend support to this view. The creation of the Central American Common Market led to a rapid expansion of trade among the member countries, with the annual rate of increase averaging 22 per cent in the period 1953–61 and 32 per cent in 1961–68. This increase took place largely in manufactured goods, whose share in the total reached 86 per cent in 1968 and entailed intraindustry specialization through the greater exchange of products, such as textiles and shoes, thus permitting the exploitation of economies of scale without appreciable adverse effects on national industries.

Possibilities for economies of scale are even greater for machinery, consumer durables, and intermediate goods industries where, following the European Common Market, intraindustry specialization could be accomplished through narrowing product variety and the exchange of parts and components in developing countries at higher levels of industrialization. On the other hand, integration of countries at different levels of development would require more adjustment and it raises the problem of the distribution of benefits and costs to be discussed below.

It should be added that the cost of dislocation can be reduced if adequate time is provided for adjustment by the spacing of tariff reductions. This can be done by agreeing on a fixed timetable on reducing, and ultimately eliminating tariffs. This would have additional benefits in lessening uncertainty for the firm and providing inducements for adaptation to the conditions of a larger market. Moreover, in adopting a fixed time schedule for tariff reductions, there is less of a chance that the progress of integration will be blocked. This has happened in LAFTA where after initial progress the opposition of vested interests has practically blocked tariff reductions in the framework of annual multilateral negotiations.

**Tariff Policy in an Integrated Area**

There is further a case for establishing common tariffs on extra-area imports. This is because the maintenance of national tariffs leads to distortions in intra-area trade and affects distribution of the benefits and cost from integration. Countries with relatively low tariffs on imported raw materials and intermediate products will enjoy artificial cost advantages in intra-area trade in finished goods, and the extent of preferences granted to partner country suppliers will be greater the higher are national tariffs. With continuing differences in national tariffs and the possibilities for unilateral
changes in these tariffs, then, the progress of integration may be jeopardized.

In the event of a common tariff being adopted, there will be need to ensure that its height and structure are conducive to the establishment of efficient industries. There is a case for lowering duties if the level of national tariffs was excessive, and the creation of a common external tariff provides an opportunity for reduction and rationalization. More generally, for regional integration to contribute to efficient import substitution and exporting, it would have to be accompanied by a rationalization of the system of incentives in the participating countries.

Adoption of a common tariff on imports from nonmember countries and the harmonization of other measures affecting imports and exports will eliminate distortions in competitiveness among the partner countries provided that exchange rates are free to adjust. Distortions in competitiveness will occur, however, if the speed of inflation differs among countries and devaluation takes place only intermittently. This is because under- or over-compensation in exchange rates for price changes has the same effect as changes in tariffs and subsidies. At the same time, uncertainty is created as regards future changes in the domestic currency value of foreign exchange and the sale price of competing producers.

Variations in competitiveness due to price changes uncompensated by changes in exchange rates create obstacles to regional integration since countries do not wish to expose their producers to sudden and unforeseen changes in trade flows. To avoid these adverse consequences, it would be advisable for member countries to devalue pari passu with inflation. Apart from avoiding distortions in competitiveness, agreement on rules concerning exchange rate changes would also permit maintaining the independence of national monetary policies.

**Distribution of Benefits and Costs of Integration**

Further consideration needs to be given to the distribution of benefits and costs of integration among member countries. The presumed maldistribution of benefits and costs appears to be the single major reason for the limited success of integration efforts in less developed areas. In this connection, reference has often been made to imbalances in intra-area trade following regional integration and the unequal distribution of manufacturing industries.

Imbalances in intra-area trade may however be the result of influences other than regional integration, including differential trends in economic growth and inflation. And should integration
be responsible for the imbalance, it may have been accompanied by offsetting changes in extra-area trade, so that one needs to consider the global trade position of a country rather than trade with the partner countries only. In turn, global trade imbalances may be offset by a devaluation or revaluation of the currency. Imbalances in intra-area trade per se should not be regarded as an indication of the unequal distribution of benefits. But, there is reason for concern if the imbalance is concentrated in trade in manufactured goods, reflecting the acquired superiority of certain partner countries in manufacturing that may foreclose the development of industries elsewhere. In such instances, action would have to be taken to offset the advantages of countries that would otherwise benefit from their early start in industrialization through concessions to the lesser-developed countries. This would, in turn, require striking a balance between the interests of countries at higher and lower income levels. At the same time, the concessions need to be temporary in nature to avoid the perpetuation of inefficient industries.

The experience of the European Common Market may be of interest in this connection. Upon entry, Ireland has received concessions in postponing the elimination of duties on intra-area imports while enjoying free entry for its own exports and will further benefit from investments by the European Investment Fund. Similar concessions have been provided by agreements with Greece, Turkey and Portugal.

**Trade Liberalization among Developing Countries Located in Different Regions**

Alternatively, one may suggest limiting the participants in an economic integration scheme to countries at similar levels of industrial development. As this condition is often not fulfilled in regional integration schemes, consideration needs to be given to the possibility of extending reciprocal reductions in trade barriers to all developing countries at similar levels of industrialization, regardless of their geographical location. While such a scheme would escape the difficulties due to integration among countries at different levels of industrial development, it has difficulties of its own. To begin with, the potential benefits are limited by high transportation costs while it would involve considerable risk and uncertainty. There is uncertainty as regards the balance of cost and benefits, because of limited information on production costs and on governmental policies in countries located on different continents. Also, in the absence of agreements on policies extending to external tariffs, quotas, licenses, export subsidies and indirect incentives, the balance
of advantages can be easily upset and trade will be subject to artificial distortions. At the same time, it is difficult to reach an agreement on policy coordination because the loss of sovereignty involved may not be compensated by the expected benefits. And not only do benefits promise to be larger in intraregional trade, but countries in a particular region, having similar history, customs, and even language, may possess the greater solidarity and common interests necessary for policy coordination than nations separated by great distances.

**Conclusion**

Regional economic integration should be regarded as one of the policy options available to developing countries in pursuing their strategy for economic development. Its potential benefits and costs should be weighted against those of other policy options, and in particular an export-oriented strategy. Regional integration benefits the member countries by ensuring access to the markets of their partners, lessening risk and uncertainty as regards the effects of trade liberalization on domestic industry, easing the task of policy coordination, and reducing the cost of infant industry protection. But it may also involve paying higher prices for regional imports, establishing monopoly positions in particular industries, drawing away resources from more productive uses, and neglecting other policy options.

The balance of benefits and costs of regional integration in a particular case will depend on market size, resource endowment, geographical location, and access to developed country markets, as well as on policies followed. There is a case for extending the scope of industries covered by integration schemes that involve liberalizing intraregional trade, unifying tariffs on extra-area imports, and coordinating trade and exchange rate policies. Also, one should avoid excessive protection against extra-area imports, and measures would have to be taken to ensure the equitable distribution of the benefits and costs of integration among the member countries.

Agreements on measures to be taken in favour of member countries at lower levels of development are, however, difficult to reach in part because of difficulties involved in evaluating the effects of these measures and because of their cost for the more developed countries. And, the loss of sovereignty involved in the elimination of barriers to intra-area trade and the coordination of trade and exchange rate policies represents a further obstacle to integration efforts. Furthermore, the benefits of greater competition may not be enjoyed if the combined demand of the member countries can sup-
port only one plant in a particular industry or if their markets are undeveloped. In such instances, recourse may be had to the project approach to integration that involves reaching agreement on the establishment and the operation of particular industries.

The project approach can be utilized in regard to new industries in conjunction with the application of a general trade liberalization scheme; its potential scope will be the greater the smaller the integrated area and the lower its level of industrial development. In the event that the conditions for implementing a trade liberalization scheme are not fulfilled, the project approach may be applied by itself, with provisions made for intraregional trade in the products involved. This approach will be discussed in Part II.

II. THE PROJECT APPROACH TO ECONOMIC INTEGRATION

Definitions and Concepts
One of the principal aims of integration schemes among developing countries is the establishment of projects which serve a wider than national market. Such projects may emerge either through the free operation of market forces in a region where trade barriers have been removed, or as a result of an explicit agreement between two or more countries which may or may not be part of a regional trade liberalization scheme. Projects of this nature will be referred to as integration projects.

In discussing economic integration, it is useful to bear in mind that different classes of goods and services are not equally mobile. A well-known distinction is that between internationally tradable and non-tradable goods and services; in turn, Mennes, Tinbergen and Waardenburg distinguish among local, regional, national, continental and international or world goods and services.¹ Both classification schemes are based on a variety of economic and technical considerations, among which transportation costs are the most important. In the following, a distinction will be made among national, regional (i.e. multi-country) and international goods and services.

National goods and services, including perishables, construction, housing, retail trade, most government and private services, are normally not traded among countries. They can, therefore, be excluded from the discussion of integration projects. By contrast, regional and international goods and services both qualify as candidates for integration projects. Regional goods and services may be

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provided on a national basis as well as jointly for a group of contiguous countries; they can not as a rule be imported from world markets. This class of goods and services may include electricity, railways, roads, irrigation, etc. International goods and services, in turn, may be procured on a national and regional basis as well as from world markets. They comprise most agricultural, mining and manufactured products.

The Scope for Integration Projects: regional goods and services
Integration projects in this category may be found in transportation and communications, public utilities, education and research, and a few other fields that are specified below. They bring economic benefits if production on a regional scale leads to cost savings compared to their production on a national scale, taking into account production as well as distribution costs. Cost savings may be achieved directly through large-scale operations, fuller utilization of existing capacity, greater specialization in production, joint management, and the coordinated use of jointly-owned resources. Benefits may also be reaped indirectly, e.g. by investments in infrastructure that are principally designed to promote trade within the region.

Transportation provides examples of direct and indirect benefits from integration projects. First, cost savings may be achieved through coordinated planning, construction and/or operation of transportation facilities (e.g. a joint airline, a regionally integrated railway network with identical railway gauges, regional shipping companies, and an integrated highway system). Second, coordinated investments in transportation may have beneficial effects of an indirect nature in promoting trade among the partner countries.

Cost savings and, in particular, quality improvements may also be achieved by the coordinated planning and operation of regional communications networks. This would require, among others, tariff agreements, as well as the rationalization of signalling systems in the case of telecommunications. Among public utilities, electric power production and the development and management of water resources offer scope for integration projects. Both types of projects supply output that is normally not internationally tradable unless distances are short. In such cases, integration projects may offer benefits by exploiting economies of scale through regional cooperation. In some instances, gains can also be obtained through utilizing those resources from within the region that lead to the lower production costs; the latter may occur if several possible sites exist within a region for hydro-electric power generation, but one site is more suitable than others.
In the category of water supply projects, the principal case for coordinated action is with respect to the development of international river basins. A number of schemes of this nature exist (e.g. the Lower Mekong Basin), with the major potential gains to be derived from improved flood control, and more intensive use of the water resources for irrigation purposes. In turn, projects located on international waters may cause problems of environmental pollution in other countries, making desirable the coordination of action.

Joint projects in the field of education and research can lead to cost savings due to the better utilization of indivisible factors such as teaching and research staff and equipment, and may result in qualitative improvements in education and research as well. Regional universities, and technical colleges, and research into area-specific problems, jointly financed and managed by the participating countries, come into this category. Integration projects in the category of research are not necessarily restricted to regional arrangements, and successful global undertakings exist, e.g. the International Rice Research Institute.

The list of categories of integration projects among regional goods and services given so far is by no means exhaustive, and a variety of other fields should be mentioned where scope for such projects exists. These include projects aiming at regional computer facilities, the promotion of tourism, the promotion of regional exports through regional trade promotion centres, the development of mineral resources, and the provision of meteorological services.

The Scope for Integration Projects: international goods and services
This category of projects consists chiefly of agricultural, mining and industrial activities; their principal characteristic is that they can be internationally traded so that their availability in the region is not contingent upon production within the region; if produced within the region, they can also be exported to overseas markets.

In agriculture, there are examples of countries agreeing to limit the expansion of production in order to improve their terms of trade (e.g. coffee). Such agreements are usually of a global nature; they are considered to be outside the scope of this study. There are also possibilities for agreements on specialization in agricultural production between countries with different resource endowments. However, since economies of scale in agricultural production can be exploited in the national framework, integration projects in agriculture are usually linked with processing.
If regional planning permits the identification and establishment of efficient facilities, for example to process cocoa, cotton, rubber, as well as forest products and livestock, such projects are properly classified as integration projects. To the extent such facilities are dependent on the supply of inputs from the region as a whole, agreements among the participating countries may be required to guarantee compatible agricultural produce. Often, a country can exploit its geographical location by processing the exports of a landlocked country, which are allowed duty-free into the country. If the landlocked country were to process its own agricultural produce for exports, the transit country could impose import duties on the processed product. This issue has arisen a few times in practice, for example in West Africa with respect to livestock produced in the inland states of Mali and Niger.

Many cooperative efforts among developing countries have as their main objective the promotion of industrial growth, and most existing integration agreements devote special attention to industrial development. This is primarily due to the belief that the widening of the domestic market through regional integration enables the capturing of economies of scale that characterize most industrial activities, leading to lower average costs of production.

Lower average costs of production can be the result of higher rates of capacity utilization in the case of already existing plants. In such instances, partner countries may be induced to forego investments in similar activities. Secondly, cost savings may be achieved by exploitation of economies of scale. The simplest form is one that leads to the establishment of production units of a larger scale than would have been possible on the basis of the domestic market alone. Moreover, the wider market may permit the exploitation of advantages associated with specialization, most of which are also related to economies of scale. Specialization can take place either at the product or the process level. Petrochemicals, fertilizer and machinery provide possibilities for product specialization, with countries producing different varieties within a product category. Process specialization occurs if a group of countries agree to specialize in different components for the manufacture of machinery or transport equipment.

Finally, it may be useful to point out that the project approach in the case of international goods need not be restricted to the markets of contiguous countries, and that a wider approach is feasible given the possibility of international trade. The extreme case is that of world-wide sectoral investment planning; an example of an appli-
cation of this approach was recently discussed in the Board. The major problem facing this particular approach is its implementation: if it is difficult to reach agreement among a few neighbouring countries on one or more integration projects, it may be expected to be even more so among a larger group of countries.

The Measurement of Costs and Benefits

In the preceding sections, we have described the scope for integration projects in the various sectors of the economy and the nature of the benefits that may be derived from such projects. In spite of the potential gains that can be associated with integration projects, few of such projects have in fact been established. In an attempt to identify the reasons for the limited success of the integration project approach, it appears useful to draw a distinction between two sets of problems, one related to the evaluation of the costs and benefits of integration projects, the other being associated with the establishment and operation of such projects. In this section, we shall discuss the evaluation problems.

The selection and appraisal of integration projects raises a number of complex technical problems. One of the main arguments in favour of integration projects is the exploitation of economies of scale that many activities exhibit. However, until recently, no efficient planning techniques were available to select optimal projects in the presence of economies of scale. Such a technique is now available in the form of mixed-integer programming, but its application requires technical expertise which is available in few developing countries.

In addition to technical problems associated with project planning in the presence of economies of scale, complications are introduced by the explicit recognition of risk and uncertainty in project analysis. The latter tends to weaken the case for large production units, even under economies of scale. As a plant designed to meet requirements for a regional market faces greater uncertainty than one that caters for a national market only, since regional cooperation may be discontinued, the expected benefits of an integration project are correspondingly lower.

2 IBRD, IFC, IDA, Fertilizer Requirements of Developing Countries, May 15, 1974.

3 A research project at the Development Research Center (RPO 224—Programming in the Manufacturing Sector) which is now in its final phase, has resulted in the formulation and solution of a number of mixed-integer programming models for specific industrial activities. These models are formulated such that they are easily applicable elsewhere, either for one country or for a group of countries. Moreover, the project has resulted in improved solution procedures for such models, reducing the cost of their use considerably.
Besides methodological problems of integration project selection and evaluation, a data problem exists. To make an adequate case for integration projects, detailed estimates of net benefits associated with them in comparison to alternative modes of production are required. To measure these net benefits, production cost data for various scales of production are required, as well as detailed information on the geographical dispersion of demand and transportation cost. Yet, statistical data are rarely collected on the basis of a group of countries, and most data collection efforts are geared toward the domestic economy. Differences in data coverage and classification often render the construction of regional data sets a difficult problem, further complicating the task of accurately measuring the costs and benefits of integration projects.

Measurement of costs and benefits of integration projects is more complicated in the case of projects in the category of international goods and services than for regional goods and services. For the latter, project analysis takes place in an environment which is fully controlled by the region itself, imports from outside the region being excluded by definition. As a result, fairly firm estimates can be made of the net gains or losses associated with any specific production structure. In contrast, for international goods, imports from world markets provide an alternative to production on national or regional scale; to estimate the gains and losses of an integration project in this category, a projection of import prices is required. Given the uncertainty associated with future world market prices, the assessment of potential costs and benefits of regional production becomes more complicated.

Reaching Agreement on Integration Projects

Perhaps the most important obstacle to agreements on integration projects is the bias prevalent in most countries in favour of national projects. This is reflected first of all in the orientation of the economic planning machinery in most countries which focuses primarily on the design and implementation of national investment programmes. If a regional bureaucracy exists, it is most often inadequately staffed, lacking both the political power and the financial resources to constitute an effective counterpart to nationally-oriented institutions.

Even if political will is there, integration project agreements are difficult to reach because of disputes concerning the distribution among countries of costs and benefits associated with a given project. Unless the location of a project is dictated by natural resource constraints, it is difficult to get countries to agree on the location of
an integration project. The more important a project, the more
difficult such negotiations may be, and it may either be impossible
to achieve agreement, or the allocation agreeable to all is so in-
efficient that the total net gain of integration projects is wiped out.
Judging by the experience of the last decade, problems of this nature
have arisen most frequently in the case of the ‘foot-loose’ industries.

Apart from the problem of which country provides the location
for a given integration project, it may be difficult to reach agree-
ment on what countries wish to distribute equitably, and in what
manner. Like any other project, an integration project generates
value added, employment, requires foreign exchange outlays and
domestic capital, may generate foreign exchange earnings, and pro-
vides opportunities for tax revenues; moreover, the project may have
important externalities. The distributional formula agreeable to
partner countries, therefore, contains many elements.

Disputes may furthermore arise over regional transfer prices of the
output of integration projects. This is closely related to the fact that
the approach to economic integration based on integration projects
frequently leads to the establishment of monopolies. If restrictions
are placed on competing imports, a privately managed integration
project will follow pricing and output policies that may not be
consistent with economic policy objectives in partner countries.
Without government interventions, therefore, there may be a trade-
off between the exploitation of economies of scale by establishing
relatively few productive units and an organization of supply that
results in the achievement of given policy objectives.

These difficulties are of especial importance in the case of inter-
national goods. As was explained before, the assessment of net gains
or losses for a project in this category is more difficult than for a
project in the category of regional goods and services because of the
uncertainty related to developments in the world market. This
problem may be particularly important if different countries have
different perceptions of the future.

Also, integration projects in the regional category may be more
stable over time than projects in the international category. In the
case of an integration project relating to a regional good or service,
the alternative of national production exists but can not be realized
instantly. Lengthy gestation periods are usually required to attain
full operation of a new project. However, in the case of integration
projects in the category of international goods and services, project
cooperation can be terminated at once, by activating the import
alternative. The above factors have in particular hampered the
establishment of integration projects in the industrial sector. Import
prices for industrial goods often vary by source and over time, while wide fluctuations in ocean shipping rates complicate c.i.f. import price projections even further. Under such conditions, it is extremely difficult to make plausible quantitative estimates of the potential net gains to be derived from integration projects in this sector, and countries have understandably been reluctant to agree to a production structure that may prove to be inefficient in the medium and long-term. If the latter occurs, one of two situations may obtain. First, the producing country may lose its regional market, and end up with an underutilized plant. Second, the regional market is maintained, but all participating countries suffer net losses because of relatively high-cost regional production. The former alternative is more likely to occur in practice and this distinguishes integration projects sharply from national projects. If a national project turns out to be based on an erroneous projection of c.i.f. imports prices, and is relatively high-cost, domestic pressures to prevent the shutdown of the project will be severe, usually resulting in higher protection from imports than originally envisaged. In the case of an integration project, such pressures from the project's host country can be assumed to be less effective in the partner countries.

The Package Approach

Some of the difficulties associated with reaching agreements on the individual integration project approach can be reduced by adopting the so-called package approach. This approach specifically and explicitly aims at facilitating the negotiation and enhancing the stability of an integration agreement by assuring that each participating country obtains at least one integration project from among a package of such projects. The condition that each country hosts at least one project aims at replacing complicated distributional formulas associated with individual project allocations among countries. Moreover, greater stability is achieved once an allocation of projects has been agreed upon because unilateral withdrawal from the regional scheme inflicts losses on the withdrawing country itself.

An important condition to be fulfilled for the successful application of the package approach is that the project planning exercise results in comprehensive information on the effects of alternative allocative schemes on partner countries. Some projects in the 'package' will usually be more efficient than others due to the region's comparative advantage. Countries with efficient projects in the category of international goods and services may be better off
than countries with projects in the category of regional goods and services, as the latter can not, by definition, be exported outside the region. In general, it may be stated that the package approach is more likely to achieve its goal of stability in the regional market arrangement if the projects included are relatively efficient compared to national projects, in the case of regional goods and services, and compared to imports, for international goods and services. If high protective barriers are necessary for some or all of the projects included in the category of international goods and services, it is conceivable that the cost of trade diversion to a partner country is so high as to offset the loss associated with underutilization of the capacity of its integration projects following withdrawal from the scheme.

Even though it appears that the package approach poses less serious problems of distribution of costs and benefits than the individual project approach, several such problems remain. If an allocation of projects is decided upon, for example, it may not be the most efficient one from the point of view of the region as a whole. Special arrangements may need to be made to ensure that each project is implemented, to ensure that the *ex ante* allocation of projects materializes. This may be particularly important if a project is allocated in a relatively unattractive part of the regional market, and it turns out to be difficult to find capital and managerial talent to establish the project. However, basically, these problems are not more severe than they are in the case of individual projects.

A number of dynamic problems can be identified that are related more directly to the package approach. First, the original allocation of projects may have been agreeable to all partner countries, but while in operation some projects appear so inefficient that problems arise relating to the distribution of costs and benefits. Similarly, although the initial allocation of projects appeared acceptable, an incorrect projection of import prices, or demand, renders some projects less efficient than predicted. Finally, as demand for different products is likely to increase at different rates, some of the projects in the package may become independent of the regional market for efficient operation at an earlier stage than others, leading to instability over time.

One way in which these particular problems may be overcome is to consider joint financing of projects in the package by partner countries, in addition to outside financing. This would result in spreading the financial risk of the operation of integration projects among partner countries, which may result in greater solidarity.
among them in the face of unforeseen adverse circumstances affecting one or more integration projects.  

Conclusion

The integration project approach may offer substantial benefits to countries that are not yet able to compete in world markets, and wish to establish an efficient production structure in activities that are subject to economies of scale. In spite of its apparent advantages, however, this strategy has met with limited success, and very few integration projects have in fact been established. A number of reasons can be identified to explain this state of affairs.

First, there is a strong bias in favour of national projects and national development objectives; even if regional bureaucracies exist, they are usually powerless and without adequate resources. To remove this bias, one necessary condition to be fulfilled is that convincing quantitative estimates are made of the net benefits of integration projects to partner countries. Project planning techniques have now been developed for project selection and appraisal in the presence of economies of scale, and fairly detailed estimates can be made of the relative costs and benefits of alternative production structures.

Secondly, a major stumbling block during attempts at reaching an agreement on integration projects relates to the distribution of costs and benefits of such projects among partner countries. In the case of an individual integration project, discussions of this nature are often very difficult, and only if the net benefits of a specific integration project appear large to each participating country, may agreement be possible.

To alleviate some of the problems associated with the negotiation of integration project agreements, the package approach appears an attractive alternative. Although this approach does not provide a panacea for all problems associated with integration projects, it would appear that the fact that each participating country hosts at least one project facilitates not only the process of reaching an agreement on integration projects, but also increases its stability. Enhanced stability can be expected as any country that decides to withdraw from the integration scheme inflicts losses upon itself by losing access to the regional market for its integration project(s). For these reasons, the package approach—perhaps combined with some arrangement to provide for the joint financing of projects—may be recommended.

4 For a specific proposal along these lines, see: I. M. D. Little, 'Regional international companies as an approach to economic integration', Journal of Common Market Studies, Vol. 5, 1966.

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