Percy S. Mistry

Regional Integration Arrangements in Economic Development

Panacea or Pitfall?

FONDAD
The Hague

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

ISBN: 90-74208-08-8

© Copyright 1996 by Percy S. Mistry and the Forum on Debt and Development. Permission must be obtained from them prior to any further reprints, republications, photocopying, or other use of this work.

The views expressed in this book do not necessarily represent those of the Forum on Debt and Development.

Additional copies may be ordered from FONDAD at
Noordeinde 107 A, 2514 GE The Hague, the Netherlands
Tel: 31-70-3653820 Fax: 31-70-3463939 E-mail: fondad@pi.net

Contents

Abbreviations 7
Preface 9

1 **A Retrospective on Regional Integration Arrangements**

Introduction 11
A Tour d'Horizon of RIAs Around the World 12
The Role of Regionalism in the Emerging World Order 20

2 **The Role of RIAs in Fostering Economic Development**

Introduction 23
Lessons from the Past 23
The Inadequacy of Classical Theoretical Constructs 25
Orthodox (Static) Gains from RIAs 26
Unorthodox (Dynamic) Gains from RIAs 28
Political Commitment to RIAs and the Issue of Credibility 33
Equity and Regional Policy 33

3 **Reducing Non-Tariff Barriers**

Barriers to Trade Gains 36
Barriers to Production 41
Barriers to Cross-Border Investment 44
Other Barriers 45

4 **The Experience of Developed vs. Developing Countries**

Why First-Generation RIAs Failed in Developing Countries 48
Lessons for the Future 52

5 **Second-Generation RIAs in the Developing World**

Determinants of Success 54
Linking Up with Large Trade Blocs 56

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

6 **Options for Creating Regional Trade Preferences Among Developing Countries**

The Role of Bilateral Agreements 58
The Role of Customs Unions 59
The Role of Preferential and Free Trade Areas 61

7 **Regionalisation vs. Globalisation: The Issues**

Regionalism as a Mezzanine Step 63
Trade Blocs 65
GATT Rules 67
Theoretical Objections and Practical Benefits 69

8 **Synopsis and Conclusions**

The Road Ahead for Developing Countries 72
The Political Dimension 74
The Role of Donors 75
Learning from Experience 76
Distribution of Costs and Benefits 77
Regional Adjustment Programmes 78
External Linkages 80
A Pragmatic Approach to Strengthening RIAs in Developing Countries 81

Annexes 85

Bibliography 95

Abbreviations

ACP	Africa, Caribbean and the Pacific
AFTA	ASEAN Free Trade Area
ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South-East Asian Nations
CACM	Central American Common Market
CAP	Common Agricultural Policy (of the European Union)
CARICOM	Caribbean Community
CARIFTA	Caribbean Free Trade Association
CEAO	Economic Community of West Africa
CET	Common External Tariff
CFA	Communauté Financière Africaine
CMEA	Council for Mutual Economic Assistance
COMESA	Common Market for Eastern and Southern Africa
CU	customs union
EAC	East African Community
EC	European Community
ECO	Economic Cooperation Organisation
ECU	European Currency Unit
EFTA	European Free Trade Association
EMS	European Monetary System
EU	European Union
FDI	foreign direct investment
FTA	free trade area
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	gross domestic product
IFIs	international financial institutions
IMF	International Monetary Fund
IOC	Indian Ocean Commission
LAC	Latin America and the Caribbean
LAFTA	Latin American Free Trade Association
MERCOSUR	Southern Common Market
MFN	most-favoured nation
MIGA	Multilateral Investment Guarantee Agency (of the World Bank)
MMA	Multilateral Monetary Agreement
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organisation
NICs	newly industrialised countries
OAU	Organisation of African Unity
OECD	Organisation for Economic Co-operation and Development (which comprises 23 developed country members as well as Mexico and Turkey)
PECC	Pacific Economic Cooperation Conference
PTA	Preferential Trade Area (for Eastern and Southern Africa)
RIAs	regional integration arrangements
RoW	rest of the world
RSA	Republic of South Africa

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

SAARC	South Asian Association for Regional Cooperation
SACU	Southern African Customs Union
SADC	Southern African Development Community (former SADCC + South Africa)
SADCC	Southern African Development Coordination Conference
SAFTA	South Asian Free Trade Area
SAPs	structural adjustment programmes
SAPTA	South Asian Preferential Trade Arrangement
SDR	Special Drawing Right (in the IMF)
TCR	regional cooperation tax
TRIMS	trade-related investment measures
UDEAC	Customs and Economic Union of Central Africa
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Preface

Regional economic integration is a complex and much debated issue among analysts and policymakers in almost every corner of the world. Recently, it has gained particular interest and momentum with the European Union's envisaged deepening – the introduction of a single currency – and widening – the inclusion of East European countries – of its integration process. Excitement, or fear, about the prospects of regional integration has been spurred further by the surge of the "new regionalism" in Latin America and the emergence of spectacular mega-initiatives such as the Asia Pacific Economic Cooperation (APEC) agreement between the United States, Japan, China, Canada, Mexico, Australia and a dozen other countries bordering the Pacific Ocean.

The challenge that the new wave of regional integration efforts poses to developing as well as industrial countries has led the Forum on Debt and Development (Fondad) to embark on a three-year research project which aims to explore how regional integration as well as multilateral cooperation can be promoted, in a mutually reinforcing manner, at the same time. This study, written by one of the stimulating forces in the project, Indian economist and investment banker Percy S. Mistry, is one of the results. Earlier drafts served as a framework paper to guide and inspire the thinking of participants in Fondad conferences.

In the book, Mistry reviews issues arising from experience with arrangements for regional economic cooperation and integration in developing and developed regions of the world. Given the plethora and complexity of the issues involved – ranging from trade, finance and monetary matters to institutional, social and political affairs – the author has chosen a broad approach. However, at various points Mistry also presents some of his more detailed insights and policy suggestions.

Following an introductory retrospective on the history and role of regional economic integration arrangements (RIAs), the study deals with: the costs and benefits of RIAs in facilitating development; the reasons for the successes and failures of *first-generation* RIAs in different parts of the World; arguments about whether *second-generation* RIAs are likely to facilitate or impede global multilateral cooperation; and finally, the main lessons for developing countries that can be drawn from past and present-day experience.

Fondad is grateful to VSB Fonds Den Haag en Omstreken and the Dutch Ministry of Foreign Affairs for making the publication of this study possible.

Jan Joost Teunissen
Director
August 1996

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

1 A Retrospective on Regional Integration Arrangements

Introduction

Even with the limited objective in mind of using resources more efficiently by reconfiguring the geography in which they are deployed, the "urge to merge" has afflicted an overwhelming majority of countries throughout the world. At present, almost every member of the Organisation for Economic Cooperation and Development, and virtually every developing country as well, is either engaged in, or flirting with, some form of regional integration.

Regional integration arrangements (RIAs) are not new. Many of their features, e.g. free trade areas and monetary unions, emerged and were continually refined under colonial rule between 1850 and 1950 in much of what is now the developing world. The genesis of RIAs in Europe is ascribed to the Anglo-French accord of 1860. That agreement impelled other European countries to sign similar accords with France in a fashion reminiscent of the recent rush on the part of countries to emulate Mexico and Israel in signing free trade agreements with the United States. RIAs existed under the British and French empires in South and East Asia, the Middle East, in sub-regions of Africa and in the Caribbean.[1] These were predated by arrangements which bound together the former colonies of Spain in Central and South America. In Asia, such arrangements also existed between colonial Japan, and colonised Korea and Formosa (now Taiwan) between 1890 and 1945.[2]

Perhaps the most successful form of RIA that evolved and culminated in full economic and political union on a voluntary, democratically determined basis, was the progressive expansion and formation of the United States of America between 1820 and 1920. This unique experience, however, is not usually seen as an example of an RIA among sovereign nations as such but as exemplifying the evolution and expansion of a federation welding together fractious, semi-sovereign, constituent provincial states.

---

1 The structures of the British, French and Spanish imperial arrangements were, in their early stages, essentially incomplete RIAs and the countries included were not geographically contiguous. In these arrangements the economic concept of a region was different from one that cartographers would normally employ; extending to all territories of empire but with differences in different areas. Yet they had many of the features of RIAs: e.g. monetary unions, common currencies, common fiscal administrations, customs unions, convergent fiscal policies, internal conventions on cross-border investments and the like.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

Between 1915 and 1945 colonial RIAs, which had become entrenched world-wide, gradually became looser and less pervasive. That period witnessed two World Wars, a global depression and the breakdown of the British and French empires. The aftermath of the Second World War saw a different economic order emerge. It was characterised, between 1945 and 1975, by: the economic hegemony of the United States; the establishment and consolidation of the *East Bloc* as a countervailing military – if not economic – power; and the emergence of a raft of independent nation states obsessed with exercising their new sovereignty and, unfortunately, much less concerned about the efficiency of resource use. Many RIAs evaporated under the heat of US vs. Soviet competition to draw emerging developing countries within their respective spheres of political, military and economic influence as *Pax Americana* and *Pax Sovietica* replaced *Pax Britannica*.

A Tour d'Horizon of RIAs Around the World

In the aftermath of the Second World War, the world has been characterised by several different types of RIAs in developed and developing regions. These are discussed briefly below according to the geographical (and economic) parts of the world in which they occurred.

First World

In the *first world*, the most ambitious and successful RIA, of course, is the still evolving European Union (EU). Beginning humbly as a coal and steel community between six countries, it is now virtually a full economic union involving fifteen developed Western European countries. Four of these (Greece, Ireland, Portugal and Spain) acceded when they were still classified as middle-income developing countries. Their economies and standards of

---

2 Various attempts at regional integration, though not necessarily achieved through cooperation, date even much further back in history, to the time of ancient empires whose relatively superior technology permitted conquests of terrain beyond their borders and resulted in relatively quick, if somewhat brutal, economic integration (largely because life was not quite so complicated or politically correct then). They were not driven explicitly by the needs of popular democracies aiming to improve their standards of living through the benefits of comparative advantage, market expansion, rationalised industrialisation, efficient import-substitution, static and dynamic trade creation, externalities and scale-economies. Perhaps for that reason, these endeavours are not generally viewed as falling into the category of respectable RIA efforts by economists, even though they are by historians; especially military historians. Insofar as recorded history can be relied on, few of these initiatives were triggered by voluntary efforts on the part of the states involved at achieving economic integration; except in the rare cases of a successful arranged marriage among royal families leading to the durable cementing of dowry-endowed territories. This quaint approach to RIAs has, alas, disappeared in modern times.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

living have progressed rapidly since they joined the European Union although their absorption, as is often supposed, has not been a matter of easy digestibility. Together these four accounted for 20% of the European Union's population when they joined, but for only 8% of its total GDP. They now account for about 11% of regional GDP. With its recent enlargement (in 1995) through the entry of Austria, Finland and Sweden, the European Union now embraces 375 million people and a total GDP (1994) of around US$8 trillion.

The North American Free Trade Agreement (NAFTA) embracing the US, Canada and Mexico has aroused even more interest in the developing world than the European Union with regard to the potential of RIAs. NAFTA has excited imagination because it is perceived as an unprecedented bonding arrangement between highly developed and developing states in the same region, presaging a different future with new possibilities for such arrangements. While NAFTA is certainly unusual in that respect it is not unprecedented. As observed, the European Union achieved the same conjunction a decade earlier when Southern European countries joined it. Like the European Union, NAFTA embraces about 370 million people with a collective 1994 GDP of about US$7.5 trillion. In this arrangement, Mexico accounts for about 23% of NAFTA's total population but only 4% of regional GDP. The development disparity between Mexico and its partners in NAFTA is thus much greater than that between the Southern and Northern European countries when the former became members of the European Union.

The key characteristic of both the European Union and NAFTA, and the reason why these two blocs may eventually succeed in evolving towards some form of economic union, is the relatively high proportion of intra-regional trade, investment and capital flows already occurring in both blocs relative to their total trade. In NAFTA, however, the question of unimpeded labour mobility across internal borders may prevent full labour market integration for some time, even as other factor markets integrate. The same could be true of the European Union if it were to widen, by embracing new Eastern European members, before it deepened. Recent events suggest that the prospects for further deepening under the timetable of the Maastricht Treaty, especially in achieving monetary union, may be set back and be achieved much later than was earlier anticipated.

Second World

In what was formerly the *second world*, members of the former East Bloc were bound together under the Council for Mutual Economic Assistance (CMEA). Though CMEA was primarily an arrangement among geographically contiguous countries in the Soviet Union and Eastern Europe, it

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

embraced three (non-regional) *third world* members, i.e. Cuba, Mongolia and Vietnam. CMEA's role as an RIA in the post-war world has perhaps been understated because it was a statist rather than a market arrangement. Even so, for nearly thirty years CMEA engendered reasonably rapid growth in its member economies. Its usefulness came to an end when the limitations of rigid command economies – in responding to technological developments, meeting evolving domestic consumer demands, and holding their own under rapidly changing global product-market conditions – became painfully manifest.

CMEA was clearly not an RIA voluntarily entered into by free, democratic states exercising free choice. Its role in the former Soviet empire was not so different from the trade, exchange and monetary regimes which prevailed in the former British, French and Spanish colonial empires. The only difference was that *laissez faire* market economics played no role at all in determining CMEA's design.

Four former CMEA members (The Czech Republic, Slovakia, Hungary and Poland) – commonly known as the *Visegrad* countries – are presently attempting a new form of RIA among themselves before joining the European Union, which is their ultimate aim. So are the three Baltic Republics which are simultaneously developing associated RIAs with the European Union and the Nordic community.

Third World

The developing, *third world* has experimented with a number of RIAs of varying looseness. Some existed prior to the independence of many young countries which were colonies for a longer period than they have been sovereign. Pre-independence RIAs in former colonies of Southeast Asia (Malaysia-Singapore and Indo-China), Africa, the South Pacific (with Antipodean linkages) and the Caribbean were quite successful in terms of their limited objectives.

Certainly these RIAs supported a reasonable domestic macroeconomic policy framework for growth and prosperity in the individual colonies. But the gains derived from these arrangements did not necessarily lead to equitable growth in these economies, nor to effective or appropriate industrialisation. Even less did they benefit indigenous populations, though they yielded substantial benefits for owners of plantations and mines who were mainly metropolitan investors in imperial capitals.

A few pre-independence RIAs continued in a different form although they were viewed by post-colonial governments as part of the unwanted baggage of an exploitative, market colonialism which had no place in new societies. The new governments – mostly inexperienced and prone to populist policies –

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

closed their economies, while continually relaxing their fiscal and monetary regimes in the face of successive external shocks. Consequently, economic resilience and adjustment response capacity were systematically destroyed over a prolonged period, resulting in inefficiency and uncompetitiveness of productive structures throughout the developing world.

The RIAs – especially the monetary arrangements – previously in force, if properly administered, might have exerted a brake on such excesses. In retrospect, and with the benefit of hindsight, such a brake might have been quite useful, given what has happened in too many developing countries, especially in Africa, South Asia and the Eastern Caribbean. Some newly independent governments, believing that aspects of these colonial RIAs were beneficial, tried to replicate particular features under new voluntarily agreed RIAs. But because of a lack of political will few of the post-independence RIAs were long-lived.

Africa and the Middle East

Of the seventeen RIAs which existed in 1990 around the world, eight were in Africa where experiments with first-generation RIAs yielded desultory results; with the exception of the *franc zone* (the Communauté Financière Africaine, CFA) and the Southern African Customs Union (SACU). The monetary unions of the franc zone were stable and enforced sound monetary policies. But they became overly rigid in resisting parity adjustment for too long, thus impairing the adjustment and growth prospects of their members through the 1980s. A long-delayed devaluation of the CFA franc finally occurred in early 1994 after much damage had been done. SACU was based on keeping smaller satellites in orbit around the South African apartheid regime. It was more successful than the franc zone RIAs, perhaps because South Africa under apartheid was willing to pay a visible budgetary price[3] to acquire a modicum of political respectability in its immediate neighbourhood.

The Indian Ocean Commission (IOC), a loose RIA among islands off the East African coast, has also had modest success. But other African arrangements in East and Central Africa and in Southern Africa outside of SACU, heavily backed by donors, have proven ineffectual. Some have

3 Recently, the South African government has drawn attention to the high price it has paid for supporting the SACU arrangement. That is only true in a visible budgetary sense although that is a partial and distorted perspective. In an overall economic sense South Africa's private, heavily protected manufacturing sector has gained much by retaining these captive markets under SACU with South African transfer payments to its captive neighbours often amounting to little more than hidden export subsidies for its own relatively inefficient manufacturing industries.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

subsequently come apart. Their net economic benefits, in terms of incremental economic and developmental gains derived by the member states, probably did not offset even the cost of the large and elaborate bureaucracies set up to administer them.

After their demise, new arrangements were put in place in the form of a Preferential Trade Area for Eastern and Southern Africa (PTA) and the Southern Africa Development Coordination Conference (SADCC). Neither of these arrangements has achieved very much despite substantial donor support. Yet both have recently transformed themselves into more ambitious economic communities. PTA has now become the Common Market for Eastern and Southern Africa (COMESA) while SADCC has evolved into a Southern African Development Community (SADC) with South Africa joining in early 1995. Both hope to achieve more in the future although their widely overlapping membership has generated concerns about whether two organisations are needed to achieve much the same purpose.

Despite the obvious failures and limited successes of first-generation RIAs in Africa there is, in the 1990s, a renewal of interest – fostered to some degree by the example of the European Union – in strengthening these arrangements through efforts at widening and deepening them.

Further north, optimistic aims for the Mahgreb Customs Union set up in 1960 and for the even wider Arab Common Market have not materialised. Still, even more ambitious plans for achieving closer economic integration among the Arab countries of North Africa, the Arabian peninsula in West Asia and the Middle East remain alive. The financial and labour markets of the Gulf countries are closely intertwined. But given the nature of their oil economies there is little intra-regional trade among them, although they cooperate actively on regional issues within the framework of the Gulf Cooperation Council.

The Middle Eastern peace accord opens new vistas for economically beneficial regional cooperation in an area where that was inconceivable just a short while ago. With the emergence of a Palestinian state, RIAs involving Israel with its former neighbouring enemies are now being seriously discussed. Despite the unexpected longevity of present regimes in Iran and Iraq, such developments could transform the economic scene in West Asia and Arabia, as could the inevitable pressures for democratisation and political liberalisation in the Gulf kingdoms. But the translation of economic potential into political reality in this volatile, combustible cauldron may take some time yet.

Latin America and the Caribbean

Prior to the Second World War, there were no RIAs among the independent countries of Latin America and the Caribbean (LAC). Now nearly all of

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

them are involved in one type of RIA or other; indeed some are involved in several. The development of RIAs in LAC was based on philosophical underpinnings which provided the foundation for most of the first-generation RIAs in developing countries. In 1960, Raoul Prebisch envisaged RIAs in LAC as being aimed at building inward-looking, protected trade blocs with barriers to the outside world. Regional integration was to be a means of undertaking more complex import-substitution on a regional scale in establishing industries that were too large and complex for smaller domestic markets to develop or absorb.[4] Such thinking led to a spate of RIAs in the 1960s with the formation of the Latin American Free Trade Association (LAFTA) and the Central American Common Market (CACM) in 1960, the Caribbean Free Trade Association (CARIFTA) in 1968, and the Andean Group in 1969.

In 1971 Bela Belassa took a different view.[5] Arguing that market enlargement through integration could bring benefits to LAC over and above those obtainable through trade liberalisation alone, he suggested combining RIAs with *unilateral* trade liberalisation and recommending policies that would ensure full exploitation of the benefits of both. Belassa's thesis was that trade liberalisation would enhance the benefits of RIAs by reducing the prospects for inefficient industrialisation in LAC countries. That view was not immediately popular; partly because as has been suggested,[6] the early protectionist RIAs in LAC achieved substantial growth in *intra-regional* trade.[7]

Between 1960 and 1980, such trade grew by a multiple of: (a) 20 in LAFTA where members' trade with the rest of the world (RoW) grew by a factor of 10; (b) 40 in CACM compared with growth in trade with RoW by a factor of 9; (c) 17 in CARIFTA compared with an increase in total trade by a multiple of 10; and (d) 50 within the Andean Group compared with only an 8-fold growth in exports to RoW. All these arrangements were supported by payments and settlements facilities to economise on the use of scarce foreign exchange in settling intra-regional trade accounts. But even with high growth

4 Prebisch, R. (i) *The Economic Development of Latin America and its Principal Problems*, UN-ECLAC, New York, 1950 and (ii) *Towards a Dynamic Development Policy for Latin America*, UN, New York, 1964, p. 69.

5 Belassa, B., *Regional Integration and Trade Liberalisation in Latin America*, World Bank, Economic Staff WP No. 120, Washington DC, 22 October 1971.

6 Massad, C., *A New Integration Strategy*, CEPAL Review No. 37, CEPAL, Santiago, April 1989.

7 Although intra-regional trade expansion is necessary for significant advantages from integration to accrue, such expansion by itself is not an adequate criterion for judging the success of RIAs. Judgements based on intra-regional trade expansion alone can: (a) be misleading if such expansion occurs from an extremely low base, as it did in most of LAC; and (b) reflect both trade creation and trade diversion.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

in intra-regional LAC trade in the first two decades, these arrangements did not endure.[8]

All the RIAs in Latin America set up between 1960 and 1970 unravelled in the mid-1970s and virtually disintegrated during the 1980s in the face of adverse external circumstances, a regional debt crisis of cataclysmic proportions, fading political will, violent intra-regional conflict (especially in Central America), and a changing ethic of open competition. As Carlos Massad (1989) noted, in the 1980s it became '... a matter of each individual country's seeking integration with the outside world rather than with its neighbours, and financing the process with external indebtedness.'

All the LAC arrangements were resuscitated and reinforced in the late 1980s and early 1990s under different names with different rules and aims. These RIAs: (a) have become more ambitious and comprehensive in aiming at closer integration rather than being limited only to cooperation; (b) are outward-looking, and aimed at promoting efficiency and competitiveness; (c) carry greater political commitment and conviction; and (d) are more robustly designed and constructed. Chile and Mexico have entered into an economic cooperation agreement, while Argentina, Brazil, Paraguay, and Uruguay (i.e. the Southern Cone countries) have formed a common market (MERCOSUR) which by 1995 had integrated at a rate much faster than first envisaged.

Asia

Two examples of formal RIAs were attempted in opposite corners of Asia. The first was the Regional Cooperation for Development arrangement among Iran, Pakistan and Turkey. This quickly became defunct and was succeeded by the Economic Cooperation Organisation (ECO), which also proved to be of little value. The second was a more successful and durable arrangement involving the Association of South-East Asian Nations (ASEAN) in 1969.

From being a *security-focused* arrangement ASEAN is now evolving towards an *economic* Asian Free Trade Area which is being widened with the inclusion of Vietnam. Also in East Asia a *Greater China region* has emerged through free flows of trade and investment between the People's Republic of China, Hong Kong and Taiwan under non-formal RIAs among these territories. Of course the smaller two are not recognised as sovereign states by the People's

8 At the end of the day, in 1983 intra-bloc trade as a proportion of total exports was only 22% in CACM, 10% in the Latin American Integration Association (LAIA, the successor to LAFTA) and 9% in the Caribbean Community (CARICOM), which succeeded CARIFTA (Robson: 1993).

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Republic of China despite their independent profiles as trading entities of global significance.

ASEAN is deemed to have been successful, at least partially, because it was not geared to achieving free trade or economic union objectives at the outset. It focused instead on being a regional *political* platform for: (a) increasing the bargaining power of its member states in international negotiations; and (b) intra-regional conflict resolution on a peaceful basis. ASEAN took nearly a decade after its formation to act on achieving any serious form of regional *economic* cooperation. Interestingly, as RIAs in other parts of the world were beginning to unravel, ASEAN in its slow and cautious way gained gradually in strength year by year mainly by setting low expectations and invariably exceeding them.

Intra-ASEAN trade has grown dramatically, faster than in any other developing region. This has happened largely as a result of close inter-linkages between businesses owned in its member states by the overseas Chinese community, without ASEAN as a regional body doing all that much to accelerate or encourage it. Intra-ASEAN trade growth is, of course, somewhat distorted by the unusually large amount of trans-shipment, entrepot trade that occurs through Singapore for various reasons. Other members have now agreed to Thailand's proposal to create the ASEAN Free Trade Area (AFTA) which may have very high potential for generating intra-regional efficiencies and growth because its members meet all the requisite preconditions for successful economic integration.

South Asia has been slower than East Asia to develop effective RIAs mainly because of the unresolved conflict between India and Pakistan over Kashmir. Yet the South Asian Preferential Trade Arrangement (SAPTA) among members of the South Asian Association for Regional Cooperation (SAARC) is lurching hesitantly towards becoming a South Asian Free Trade Area (SAFTA).[9] The opportunities for SAARC and SAFTA to realise their full economic potential will remain constrained until the Indo-Pakistani dispute is definitively resolved. When that happens regional economic arrangements will probably revert to the state which existed prior to 1947, when virtually the entire sub-continent was a single economic (and politically united) area.

Pacific, Indian Ocean and North Atlantic

Though negligible compared to other developed country groupings, a free trade area also exists in the *Antipodes* between Australia and New Zealand under the Australia-New Zealand Closer Economic Relations Trade Agreement

9 See: The Economic Times of India, *India likely to offer more tariff reliefs under SAPTA*, Bombay, India, Thursday, 15 June 1995.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

(ANZCERTA), which has been the most successful example of an RIA in the Southern Pacific.

Perhaps as a defensive response to emerging trade blocs in the two largest markets of the world (NAFTA and the European Union), there was early concern that the formation of another giant trade bloc might be triggered in Asia; a market which promises to become even larger than the European Union and NAFTA in the not-too-distant future. Indeed, precisely such a trade bloc was suggested by the Prime Minister of Malaysia in 1992.

Partly to forestall such a possibility, a new type of *inter-bloc* RIA has emerged to link the Asian and NAFTA regions with the formation of the Asia Pacific Economic Cooperation Forum (APEC). Its main purpose is to advance GATT-consistent trade liberalisation between NAFTA members and their cohorts including Japan as well as the other East Asian, Antipodean and Latin American countries bordering the Pacific Rim.

Following the creation of APEC, the Gulf Cooperation Council has proposed a similar arrangement with the European Union. In a related vein, an interesting new initiative involving the Indian Ocean Rim has also emerged in early 1995 which may provide an umbrella RIA among the countries of South Asia, Eastern and Southern Africa, East Asia and Australia.

More recently, the concept of a North Atlantic Free Trade Area (a kind of super-NAFTA) between NAFTA and the European Union is gaining momentum among European and American politicians.

The Role of Regionalism in the Emerging World Order

As a result of a number of dynamic forces, countries around the world are at a cross-roads as the next millennium approaches. The 1990s evoke disconcerting shadows of the 1890s. A century ago instability and flux prevailed over the crumbling of an established order of national and global governance, defined by competitive tensions among waning (imperial European) and emerging global powers (the US and Japan). As is happening now, that order was eroded by innovations in technology, transport, munitions and communications. In the 1990s it is becoming clear that innovations in the same fields have enabled the continued globalisation of markets for ideas, money, commodities, other goods and services (but not yet for labour) on a scale and at a pace which has far outrun the capacity of established political and social systems to cope.

A global production and marketing structure is now taking shape with increasing rapidity and pervasiveness. Global products and brands produced by transnational corporations are becoming entrenched in a global consumption culture. That culture is, in turn, being supported by emerging, but still imperfect, global markets in information, technology, commodities,

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

services, media, communications, transport and finance. The emerging international system requires effective overall governance; ideally it demands a framework for stimulating and regulating not just trade and capital flows but other forms of economic and non-economic interaction as well.

The construction of such a framework is proceeding in an inefficient and unsatisfactory manner. While national governments lack the political will to address global issues in an appropriate way, the framework for governance is being left to a patchwork quilt of existing supranational institutions. These institutions – the United Nations, the World Bank, IMF, GATT/WTO, NATO, etc. – have proven unable to evolve responsively in ways that reflect emerging global shifts in economic and political power. That structural weakness is leading to a drift away from a multilateralism that does not work, and toward a less structured system of global governance which appears as if it may, for an interregnum of unknown duration, be based on interactions among regional blocs rather than among nation-states. In that sense the emergence of the *new regionalism* may well be an intermediate step towards the evolution of a *new multilateralism*.

What is becoming clear is that nationally oriented institutional structures and systems of governance, created through the last two centuries to guide, regulate and channel productive human endeavour, are no longer adequate. Nation-states are undergoing kaleidoscopic changes of the kind that the former Soviet Union, Yugoslavia, Ethiopia, Somalia and the Sudan may be precursors to, although the temptation to over-interpret what has been happening in these countries and simplistically extrapolate it to the rest of the world should be eschewed.

What is equally clear is that the horizons of economics and finance are widening, i.e. going *meso* and *macro*, while the focus of polities and societies seems to be narrowing, i.e. going *micro*, along precisely the ethnic lines which nation-states were, for unfortunately too short a while, successful in suppressing. The nation-state as shaped through the 19th and 20th centuries is being squeezed by the opposing forces of *macro*-markets and *micro*-ethnicity. Consequently, the *raison d'être* that justified its formation and maintenance is coming increasingly under question.

Successful regional integration among nations, carried to its logical conclusion, may inevitably spell the end of constituent nations as sovereign, or even as relevant, entities if their distinct ethnic groups prefer devolution. Conversely, the future of presently large and ethnically diverse states in the developing world (India, Nigeria, even China) is in question. They may only have a viable future as more loosely federated economic unions of ethnically distinct states, which are permitted to exercise more independent political decision-making on a far wider range of matters than they can under their present constitutional structures.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Fibrillations, tremors and aftershocks of different intensities keep being generated after the end of the Cold War in various parts of the world, not least in the erstwhile *second world*. How that formerly integrated politico-economic system will eventually settle is as yet unclear with the shape of its future steady-state remaining difficult to define. Some parts of it (the Visegrad four, the Baltic three and some of the independent republics of former Yugoslavia) will probably integrate with the European Union in the distant future. Other parts may come together under reconfigured RIAs among members of the former Soviet Union. Yet others may become members of RIAs in West, Central and East Asia.

Elsewhere, new geopolitical realities – e.g. the emergence of post-apartheid South Africa as an acceptable member of the African sovereign community, and similarly of Vietnam, Laos and Cambodia in Southeast Asia – have combined to create major external challenges and new regional opportunities in the developing world. All of these developments point to a new and enhanced role for regionalism to play in the future evolution of international economic and political relations. Yet that role is often seen as a threat rather than the opportunity which it actually may be.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

2 The Role of RIAs in Fostering Economic Development

Introduction

Available evidence suggests that free trade areas, customs unions, and partial preferential trade areas that have been established at different times in different regions of the developing world have in their previous incarnations generated only limited immediate, tangible benefits, inevitably eroding political support for their continuation. Poor sequencing and ill-chosen instruments and structures have in some cases contributed to failure. Where RIAs have succeeded in generating gains, the distribution of such benefits has often been perceived to be inequitable by the less-developed members of the group.

For these and other reasons, most RIAs among developing countries have lacked credibility in the eyes of their own governments, bilateral aid donors, international agencies and private investors (domestic and foreign). Of course, exogenous factors, such as the oil, debt and commodity crises, and their international repercussions, have contributed to the failure of RIAs in the developing world. The specific policy responses to the financial crises produced by such shocks, have aggravated extant economic maladjustments and distortions and rendered earlier RIAs in continents such as Africa and Latin America even less effective and indeed, inappropriate.

Lessons from the Past

The *new regionalism* which is emerging appears to be built on the recognition that past failures must be avoided. Second-generation RIAs are therefore different from those devised in the 1960s and 1970s in some important ways. These arrangements: (a) involve greater diversity among regional members; (b) have different objectives with an outward-orientation; (c) go beyond simple trade liberalisation in goods subject to GATT regulations to include liberalisation of trade in services, investment, technical and regulatory standards, customs formalities and government procurement practices; (d) are more outward-looking in aiming to achieve or maintain the global competitiveness of the region as a whole and that of its members; (e) are based on partnership among members which have already carried out significant unilateral trade liberalisation; and (f) have developed a more North-South character instead of the North-North and South-South arrangements which characterised earlier integration efforts.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Moreover, the policy conditions for making the new regionalism work to accelerate progress in the developing world are more favourable today than they have been for four decades. Yet there is no wide consensus either on the kinds of RIAs that should emerge among developing countries or on what types of accompanying institutional structures would be appropriate. Nor is there agreement on the geographical scope and sequencing of regional cooperation either on a world scale, or in particular developing regions. More importantly, little thought has been given as to how RIAs in the developing world might be endowed with long-term credibility, even though such credibility is a crucial determinant of any RIA's ability to bring about a restructuring of production on which significant gains might ultimately depend.

What is much clearer now than it was before is that the success of RIAs needs to be envisioned in a context that involves economic as well as non-economic considerations. It is also clear that if RIAs are to yield significant developmental benefits to their members they must be based on the right choices of partners. Such choices cannot be rooted in lofty political aspirations or in popular and evocative notions of solidarity – as they often have in the developing world – but in opportunities based on realistic and attainable economic objectives. The main lesson that the experience of first-generation RIAs in developing countries teaches is that adopting a framework for cooperation inappropriate to economic realities is a certain recipe for subsequent failure.

There have been many false starts with RIAs in the developing world. There is no need to add to them. Market integration may be too ambitious to attempt immediately in most of the developing world. Yet even opportunities for simple investment coordination in specific sectors within any region can only be fully capitalised on if institutional structures emerge which enable progressive movement towards wider and deeper RIAs. For the same reason, these opportunities can only be properly evaluated in the context of an overall rationale which envisages less ambitious forms of economic cooperation in the short run leading eventually to full regional integration in the long run.

An appropriate strategy for the design of RIAs in any developing region must have as its starting point not just the significant political and economic changes taking place in that region, but also the rethinking that is taking place on the appropriate role of regionalism itself. In assessing that role it is becoming clear that the prisms through which RIAs have traditionally been viewed in terms of their success or failure are too unidimensional, probably faulty and imperfectly constructed. They need to be changed.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

The Inadequacy of Classical Theoretical Constructs

Second-generation RIAs have become multi-dimensional in character. But regional integration theory and analysis continue to be underpinned by the two basic Vinerean concepts of *trade creation* and *trade diversion*.[10] These concepts emphasise the welfare effects of trade flows among nation states and the manner in which such flows might be affected by RIAs. But these concepts lose their relevance as useful analytical constructs with the increasing globalisation of production and investment.

Gains from trade creation can accrue to non-member countries whose firms have a physical presence in the region concerned or may benefit from other inter-firm arrangements (technology licensing, cross shareholdings, strategic alliances etc.) with firms inside the region. Conversely, regional firms with a large presence outside the region might be affected by the effects of trade diversion on non-member countries in which they are located.

More importantly, the mere presence of RIAs can generate direct and portfolio investment impulses with their own primary and secondary effects. The consequences of investment flows and accompanying flows of hard and soft technology are not taken into account by classical Vinerean analysis, even though such flows may in many instances be more important than trade flows *per se*.

The relentless market-driven globalisation of production structures, even in the absence of RIAs or multilateral arrangements, makes it less possible to draw clear-cut analyses or conclusions about exactly which countries benefit, and which ones lose, from trade-creating or diverting and investment-creating or diverting effects of RIAs in a particular region. For example, it could be strongly argued that American and Japanese transnational companies located in Europe, but servicing the interests of their domestic or global shareholders, may be among the main beneficiaries from closer integration in the European Union.

The Vinerean framework for analysis focuses only on static efficiency gains. It is too partial and inadequate for evaluating the *unorthodox* or *dynamic* gains derived from: efficiency effects, externalities, sectoral investment coordination, incremental foreign investment, regional adjustment or macro-policy coordination. It therefore does not permit a proper assessment of the full costs and benefits of RIAs. Present theory does not just fail to incorporate the dynamic economic consequences of RIAs. It is incapable of providing the right kind of framework within which to assess their not inconsiderable *non-economic* costs and benefits.

---

10 See, for example, de la Torre, A. and M.R. Kelly, *Regional Trade Arrangements*, IMF Occasional Paper No 93, Washington D.C., March 1992.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

A more holistic theory of regional integration therefore needs to be developed to take these effects into account. But that is easier said than done. The blending of the economics of regionalism, with their international relations dimensions, employing an amalgam of economic theory with political science theory into a cohesive framework has often been conceived but remains elusive. Yet it is just such a framework which needs to be developed in order to assess properly the real value of second-generation RIAs.

Orthodox (Static) Gains from RIAs in Developing Countries

The basic justification for encouraging RIAs among developing countries is rooted in the belief that developmental benefits can be captured by using certain policy instruments and investment opportunities beyond those that can be obtained by their unilateral use. But, it does not follow that such benefits will automatically be enhanced by a progression from cooperation to integration (for a definition of the terms 'cooperation' and 'integration', see Annex I) or, in other words, from looser to tighter RIAs.

It cannot even be assumed that, *a priori*, RIAs will always lead to welfare gains through enhanced efficiency, for the region as a whole, for its individual members, or even in terms of global welfare. In general terms, the expected developmental benefits from RIAs and particularly from full integration can be derived from:

(a) gains from reducing allocative, administrative, efficiency and transaction costs associated with market distortions and barriers resulting from national policies;

(b) gains from coordination when economies of scale can be realised in public sector operations, or significant beneficial external repercussions can result from coordinated policy or coordinated investment in infrastructure.

These two sources embrace the usual arguments for RIAs: achieving economies of scale; taking advantage of externalities associated with market expansion; achieving allocation efficiencies through trade creation; turning short-term trade diversion disadvantages into long-term trade creation potential by capturing dynamic efficiency; and so on. One self-evident constraint on the pursuit of such developmental gains through RIAs is that account must be taken of regional equity considerations. The costs and benefits of RIAs must be – and be seen to be – equitably distributed. All partners must gain if RIAs are to endure and deepen – a principle which every successful regional arrangement recognises and which unsuccessful ones did not do enough to respect.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

The potential for achieving substantial trade gains from market integration in most developing regions clearly exists. Theoretical modelling shows for example that a welfare-enhancing free trade agreement can always be designed (Kemp and Wan: 1976). In a practical sense, that does not depend – as is often theoretically asserted – on whether members of an RIA are at the same level of development and have the same economic weight. Clearly, significant inequalities among the economic capacities of members create complications which need to be accommodated through regional policy, but they do not necessarily preclude efficient or effective RIAs from being designed.

The traditional motivation for RIAs has been the pursuit of *allocational efficiency gains* from market integration. The primary instrument for achieving this outcome has been trade liberalisation through market forces, sometimes modified by parallel inter-governmental agreements on industrial specialisation or fiscal mechanisms to promote the spreading of industrial development. Such market-focused approaches are expected to have a favourable effect on the allocational efficiency of participating economies through rationalisation of their extant and emergent economic structures. This effect is usually reflected through trade creation, expansion, investment rationalisation and production integration. RIAs are also expected to give rise to expanded domestic and foreign investment inflows into the integrated area as a result of investment creation.

The removal of tariff barriers under RIAs should – theoretically at least – result in the growth of intra-regional trade. Whether it actually results in efficient trade creation – i.e. movement of trade from high-cost to low-cost producers within the region – or inefficient trade diversion – movement from low-cost extra-regional producers to high cost intra-regional producers – depends on: the pre-integration level of tariff rates among regional members; the level of post-integration external tariffs compared with prior tariffs in each member country; the elasticities of demand for the imports on which duties are reduced; and the elasticities of supply of exports from regional members and foreign sources.

Trade creation is more likely to result from integration when: (a) each member's pre-integration tariffs on the products of other members are high; (b) production structures of members' economies are roughly similar in their output mix but different in the pattern of relative prices at which similar products are produced; (c) external tariffs applied by the region's members are common and low in comparison with pre-integration tariffs; and (d) the production structures of members are sufficiently responsive to permit intra-regional import-substitution at the same or lower cost than the cost of the same products from extra-regional sources. When any of these conditions is not met trade diversion may occur. The risk of trade diversion increases with

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

each additional condition that is not met. When all these conditions are not met trade diversion will certainly result.

RIAs can have both *static* and *dynamic* efficiency effects. Static effects occur from the relative size of trade creation gains versus trade diversion losses. These gains occur on the supply side because production efficiencies result from the more effective reallocation of resources toward high-yield, low-cost production. On the demand side they occur because consumer welfare is enhanced by lower prices and greater choice. Static gains can also arise when RIAs achieve a lowering of product costs as a consequence of lowering transport costs, especially when trade is intra-regionally oriented.

Other sources of static gains involve reductions in rents from preferential market access that regional exporters enjoy. When RIAs accord priority to industrialisation, static gains can sometimes be derived from a reduction in the costs of highly protected, domestic-market-oriented industries while at the same time achieving the desired level of industrial activity, albeit at the expense of some continued inefficiency.

Unorthodox (Dynamic) Gains from RIAs in Developing Countries

RIAs can often lead to more than one off increases in regional income and welfare resulting from static efficiency gains.[11] *Dynamic efficiency* effects can lead to sustained increases in the rate of real income growth within a region. Such effects can arise through: economies of scale in trade-supporting industries and services which are caused by market enlargement;[12] spillover

11 Efficiency gains could be captured by enlarging markets and overcoming functional losses in allocative, administrative, and transaction costs associated with: small market size; market distortions; and barriers to the movement of productive factors, as well as of goods and services, resulting from protective national policies. Efficiency gains from regional market integration usually occur (and occur first to the private sector) as a result of market-based trade liberalisation which rationalises national economic structures, expands and rationalises investment flows, and integrates production to achieve cost-efficiency.

12 Scale gains would result in major industrial or infrastructural project investments. Large cost savings can be realised in most developing regions through coordinated investments in the physical – and perhaps even the social and institutional – infrastructure of geographically contiguous countries. Such gains could be particularly large from rationalising investments in power generation, transmission and distribution, road systems, rail networks, airline systems, airline regulation and airport management authorities, shipping and sea-port management, river basin management, and investments in health care and educational facilities. Such gains would also derive from investments in commercial agriculture and agro-industry; manufacturing, mining and construction industries which might need large regional markets to justify their local establishment. As de Melo *et al.* point out, scale economies by themselves do not provide a rationale for regional integration. They only strengthen the case for integration when an intermediate objective – usually that of industrialisation – has to be met. If industrialisation is the main objective, then scale gains provide a rationale for preferring regional integration over unilateral trade liberalisation. Scale economies only therefore reinforce the case for integration providing such a case already exists.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

effects resulting from wider knowledge transfers across the region on both an *intra*-industry and *inter*-industry basis;[13] increased competition; increased levels of investment; stepped up pace of technological change; and consumption smoothing during business cycles.

Potential dynamic gains are increased to the extent that RIAs go beyond reductions in tariff barriers towards achieving greater flexibility and integration in labour and other factor markets, financial markets (to permit adjustment and industrial restructuring to occur through privatisations, mergers, acquisitions and divestitures), and in the liberalisation of other constraints to free circulation of goods, services and factors within a region. Dynamic gains can be enhanced by the harmonisation of macroeconomic policies which lower the risks and uncertainties – and thus costs – for regional investors.

Acknowledging that dynamic benefits *can* accrue from RIAs and enumerating these possibilities is of course easier than specifying and measuring their individual effects for any particular regional bloc. At a general level, statistical evidence on relationships between the dynamic effects of RIAs on output growth, and on intra-regional trade expansion, is inconclusive. But there is some evidence from cross-country studies to suggest that market integration has achieved greater success among large developed economies than among small developing ones in capturing dynamic efficiencies.

Such evidence points, for example, to the positive effects of RIAs on extra-regional trade expansion by providing a training ground for regional firms. Regional market integration behind a common external tariff (CET) can provide breathing room for productive enterprises in many developing regions to become internationally competitive by first becoming regionally competitive through the process of restructuring, merger, acquisition and privatisation. Economies of scale and spillover effects can provide a rationale for RIAs based on a temporarily high CET. In buying time for firms to move down their cost curves, temporary protection can be a springboard for achieving progressively higher levels of efficiency and for eventual export expansion. Regional market integration in the developing world can also foster greater competitiveness in the operations of small local firms of individual member economies which produce, distribute and service consumer

---

13 At the production level, four types of gains are emphasised. First, by establishing larger markets, integration promotes competition and contributes to an improvement of production methods and to a decrease in monopolistic mark-ups. Second, larger markets encourage longer production runs with cost-reducing effects. Third, market integration may enable regional consumers to benefit from greater product diversity. Fourth, larger markets encourage firms to specialise and to concentrate on a narrower range of products achieving economies of scale and encouraging further cost reduction.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

durables as well as capital goods. Such an effect, usually transmitted through sub-contracting relationships, fosters the growth of entrepreneurship by opening up means of entry and of mobility, especially to segments of the population which have been deprived from equal access to such opportunities. The two specific dangers with the training ground argument however are that: (i) many developing regional groupings may not offer sufficient market size for exploiting economies of scale; (ii) even when regional economies of scale are achieved – with the rents accruing from protection contributing to regional welfare because the same income would not be realised without such protection – prolonged maintenance of temporary trade barriers might lead to excessive entry, with ensuing surplus capacity increasing average costs and absorbing profits assured through protection by causing inefficiencies owing to too many firms operating below optimal scale.

RIAs can, by stimulating supply-response, accelerate successful structural adjustment in some developing regions (e.g. Africa) where it remains elusive despite a decade of intensive adjustment effort. RIAs can facilitate adjustment by buying sufficient time for enterprises to become regionally competitive before becoming internationally competitive. However, unless RIAs are designed to ensure that regional competitiveness is an intermediate step towards achieving global competitiveness, market enlargement behind high common external tariffs can result in welfare losses rather than gains if the dynamic advantage of converting short-term trade-diverting effects into long-term trade-creating opportunities is foregone.[14]

Some dynamic gains can be secured in the short run on the basis of existing production structures. Others, however, materialise in the longer term, after industrial restructuring has taken place. Longer-term changes hinge on investors' perceptions of the credibility and permanence of any market-enlarging arrangements. They also depend on the strategic responses of transnational corporations to market integration in any particular region.

Dynamic gains from *externalities* also include the effects of technology transfer and *catch-up* effects, human capital development, improved education, research and development, better public health care, social safety nets and quality standards, improved bargaining power on the part of a consolidated

14 As de la Torre and Kelly (*op. cit.*) observe, this argument hinges on regional markets being fairly large and on ensuring that a policy of temporary protection for future export promotion can in fact be implemented successfully without protection becoming an entrenched feature due to successful lobbying by regional industries. Entrenched protection has for example become a characteristic feature of industries in South Asia. Along with other political factors, it has prevented successful regionalisation from taking hold in that region. Such entrenchment postpones the gains derivable from structural adjustment. By contrast in East and Southeast Asia initial protection has been progressively reduced enabling firms in that region to become internationally more and more competitive.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

trade bloc dealing with other blocs, reduced transport costs and improved market access, better management of natural resources, and coordinated approaches to environmental management especially in regions with fragile, unique ecosystems. Under RIAs, enhanced intra-regional competition can lead to better resource allocation by strengthening the reliability of relative prices as indicators of relative scarcity. In turn this leads to more efficiency, higher transparency, and reductions in the social costs of collusion and of other abuses of market power.

Dynamic gains can also be achieved from increased foreign investment, reduced fiscal inefficiency, and improved policy coordination. Appropriately designed RIAs can attract more foreign investment for the production of consumer durables in developing regions as a whole than in their fragmented national markets. Foreign firms which straddle the global production-marketing structure are interested in investments which cater to large markets and not to markets of countries which are not of continental or sub-continental dimensions. The attractiveness of regional investment increases for foreign investors for defensive reasons as well, i.e. to avoid the losses due to possible trade diversion. Larger regional markets also make investment attractive by enabling certain fixed costs (innovation, research, development, advertising, market-channel establishment etc.) to be spread out over a larger market base.

High costs from *fiscal impediments* to market unity are often incurred by developing countries. Even when the actual yield from tariff collection is low, the costs of non-collection can be high when smuggling, combined with the costs of rent-seeking activities of officials – encouraged by fiscally-induced price differences – is reflected in the size and growth of informal trade in parallel markets. In such conditions – endemic throughout Africa and South Asia – the institution of a customs or tax union could yield substantial benefits for countries that constitute an appropriate customs or tax area (e.g. the Southern African Customs Union). These gains are worth pursuing through RIAs, even if other benefits are not immediately significant. In some cases RIAs could enhance efficiency and probity in overall public revenue administration and collection for both direct and indirect taxes, especially if tax regimes were simplified, regionally harmonised and made more investment-friendly.

A lowering of regional trade barriers – both tariffs and non-tariffs barriers – under RIAs, coupled with greater intra-regional currency convertibility, could induce the absorption of parallel market activity in many developing regions into the official economy. Once a parallel market is created, which is accustomed to operating without any payment of taxes – except in the form of corruption – it is, of course almost impossible to absorb all such activity into the official economy until revenue administrations become much more

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

proficient and incentives change dramatically. Nevertheless, the removal of major price distortions has been seen to officialise a large amount of parallel market activity, especially illegal exports, and to ease the artificial hard currency constraints to development and growth which presently apply in many regions, most especially in South Asia and Africa.

Dynamic gains can also accrue from improved intra-regional policy and investment coordination. In regions where trade has previously been based on artificial tariff rates, correcting those distortions may have an initially adverse adjustment impact which regional cooperation might be able to ameliorate. At another level, improvements in transport networks or changes in transport regulations in one country inevitably have repercussions on another. When these are taken into account in policy formulation and public-sector planning under properly designed RIAs, significant gains can accrue.

RIAs can achieve more than unilateral actions when regional linkages and consultation yield larger pay-offs from policy improvements than those at national level. It was to capture precisely such benefits that European Union members agreed to coordinate monetary policies, transport regimes, and consumption and excise taxes. Similarly, because improved policy coordination and harmonisation can yield welfare gains (or minimise welfare losses) as a result of national policies being modified with regional effects in mind (e.g. exchange rates or labour market policies), there have been several proposals calling for structural adjustment programmes (SAPs) in Africa to be regionally sensitive. It is clear that such SAPs have not taken into enough account the impact that devaluations, trade liberalisation or financial sector liberalisation in one country can have on the trade and capital flows of neighbouring countries, as the experience of competitive devaluations in Scandinavia, the European Union, Africa and Latin America have clearly shown.

In a similar vein, the policies of individual governments bent on achieving self-sufficiency and security in electricity supply (in Asia, Africa and Latin America particularly) have led to a series of sub-optimal investments in surplus generating capacity with much higher environmental risks than would have been necessary if a regional perspective had been taken. RIAs designed to coordinate such investments could yield substantial tangible gains in a very short period of time, as recent studies for the Southern African region clearly indicate.[15]

In attempting to assess the significance of *unorthodox* gains from market integration, – often characterised as the costs of non-integration – the only recent quantitative indicators are to be found in studies of market completion

15 *Economic Integration in Southern Africa*, (Vol. 1-3), African Development Bank, Abidjan, 1993.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

in the European Union context. These studies point to short-term output gains from eliminating non-tariff trade barriers of 2.7%, and longer-term gains of up to an additional 4%, of regional GDP. These percentages are several times larger than the commonly estimated integration gains of less than 1% from *orthodox* trade creation. Even so, these estimates have been characterised as too low because of their failure to account for other dynamic gains that can be expected to result from associated increases in savings and investment and in increased financial market efficiencies in particular.

The European Union's estimates take no account of another important aspect, namely, the transaction costs entailed by the existence of multiple currencies, to say nothing of other costs that they impose. Separate calculations made in connection with the economic benefits of parallel European monetary unification and common currency initiatives have shown the latter to be considerable. However, the political costs of such initiatives are presently perceived to be quite high in terms of popular resistance to the loss of national currencies despite business sentiment in favour.

The absolute and relative magnitudes of these estimates for the European Union of course have no direct application to the other regions. In particular the relative importance of gains from trade creation might be larger in some regions and smaller in others. What is significant in any particular regional context, however, is: (i) the distribution of unorthodox gains between the short run and long run – gains in the long run being dependent on improved cross-border investment flows; and (ii) the linking of unorthodox gains to the elimination of non-tariff barriers rather than to tariff reductions.

Future research requires unorthodox benefits through dynamic effects to be specified more carefully, analysed further and, where possible, quantified. Their realisation will depend on the exertion of political will by regional governments to cooperate in meaningful ways and to subordinate narrow, short-term national interests to the wider regional good and to the longer-term benefit of all members. The extent to which such benefits are realised will also depend on acknowledgement by members that the emergence of a regional community may transform completely the vista and scope for RIAs. It may increase by a multiple, the potential for economic gains to be accrued both from market expansion and from cooperating on infrastructural investment in regions which adopt inclusive rather than exclusive approaches.

Political Commitment to RIAs and the Issue of Credibility

Whatever the *economic* potential for deriving gains from RIAs might be, it is the *political* importance attached to capturing such gains which will eventually determine the course and content of RIAs in the developing world. Mere acknowledgement of the case that the potential for such gains exists is

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

not, by itself, enough. The fact that different types of gains *can* be derived from RIAs does not mean that, in any particular region, they *will* be derived. An absence of coherence and consensus on the part of members as to the political and economic significance of RIAs usually impedes their progress, whether in mature arrangements like the European Union or in less integrated developing regions.

Commitment to cooperation is widely expressed by member governments in developing regions where regional institutional frameworks exist, but intent is rarely translated into determined action. Judged by their actions, the agenda of governments often contradict commitments. For instance, there are often divergent views about regional cooperation strategy within political camps in a country (e.g. the divergent views that exist within and between the British Conservative and Labour parties on the UK's role in the European Union). Even if they agree on the objectives of integration, governments may often differ on modalities and sequencing, i.e. on how further regional integration should take place, and what the institutional arrangements for increased regional interaction should be.

Publicly expressed apprehensions about the dominance of any one country in the region appear to be contradicted by the unseemly haste with which other like-minded governments informally agree to arrangements among themselves as an inner core, instead of making progress on a generally accepted regional framework within which all countries can participate constructively and non-threateningly. Carried too far, such inner-group agreements in the name of *variable geometry* and *multi-speed* approaches may impair the development of an appropriate multilateral agenda for regional cooperation and achieve a result opposite to that intended.

Movement towards deeper integration therefore depends on national perceptions about gains or losses from RIAs and the political will that national governments are able to muster in favour of movement toward widening or deepening. The pace of regional integration is a function of the pace of domestic political evolution in the member countries concerned. Surveying the political flux in member countries of a number of regions, there is little room for optimism about how smooth the process of evolution in these regions is likely to be.

Even in the European Union, only a few countries appear to have politically secure governments at the present time. In most developing regions, a large number of countries are either at, or are rapidly coming to, the threshold of major political and economic policy change. Inevitably, this is resulting in overstretched systems with machineries for governance having to manage several simultaneous transitions – political and economic. In some instances these pressures may well result in overloading the circuits and setting back, albeit temporarily, the regional agenda. On the whole, the thrust

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

of political and economic evolution throughout the developing world is presently aimed at more democratisation and liberalisation. These two forces may lead to a renewed thrust toward RIAs once governments accept the inevitability of a regional dynamic and take pro-active measures to capture the benefits that accelerated regionalisation has to offer.

Equity and Regional Policy

Although it is now widely acknowledged that appropriately constructed RIAs can result in substantial benefits – economic, political and security-related – to members, there is legitimate concern in many developing regions that gains from market integration will accrue mainly to the larger or more industrially developed member countries. These countries are in the most advantageous position to capture immediately the additional income benefits from an openly accessible regional market.

Asymmetries in the relative economic weight and capability of regional partners has contributed in the past to the disintegration of many RIAs in the developing world despite specific measures to redistribute some of the gains captured. Such problems have been encountered in East Africa and in the Andean Pact countries, and have slowed down the process of closer integration in ASEAN.

RIAs in the developing world (and even more so those which embrace both developed and developing countries) will therefore need to include more effective arrangements for *equalising* the gains from regionalisation to secure the continued commitment of the smaller, less developed economies to a regional market for sufficiently long for the gains from credible integration to emerge and be felt. To be effective, second-generation RIAs will need to incorporate mechanisms for redistributing regional benefits more equitably to other partners in ways that accelerate their levels of overall development. The design of future arrangements to achieve successful redistribution of regional welfare gains through compensatory policies will need to learn from more successful experiences and overcome their deficiencies if the present round of regional cooperation in the developing world is to succeed and endure.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

3 Reducing Non-Tariff Barriers

The potential orthodox and unorthodox gains to be derived from RIAs are unlikely to be realised if tariff barriers are reduced, but non-tariff barriers to integration remain. Non-tariff barriers that segment regional markets in the developing world can be distinguished as those that affect (i) trade; (ii) production; and (iii) investment. These are taken up below in turn.

Barriers to Trade Gains

Non-tariff barriers affecting trade include quantitative restrictions or voluntary restraints that reinforce tariff protection, and payments barriers that may not be protective in intent but may nevertheless end up having that effect. One feature of these restrictions, particularly of payments restrictions, is that they are apt to work in practice to discriminate against intra-regional trade which is often perceived to involve less essential products.

In the past, non-tariff barriers have been used to protect a particular country's market from competition not only from the rest of the world, but also from other members of an RIA. Such measures are rarely transparent. Their significance cannot easily be determined without laborious research into their quantitative effects. In most of the developing world where the currencies are usually non-convertible, monetary and payments barriers are two of the most significant barriers to trade.

Currency Convertibility and Monetary Harmonisation

The acute shortage of foreign exchange throughout some regions – especially in Africa and, to a decreasing extent, in South Asia and the former CMEA countries – limits the ability of countries to trade with one another. This shortage is, of course, exacerbated by inconvertibility not only into hard currencies but also into regional currencies. Clearing house arrangements have attempted to overcome this barrier but the settlement of net outstanding balances between countries in hard currencies remains a limiting factor.

The extent to which inconvertibility of currencies and state-controlled exchange rates limit intra-regional trade is partly measurable through the amount of unrecorded trade that occurs at unofficial, parallel market rates. Such trade has been estimated by various studies to be in the range of 15-70% of officially recorded cross-border trade in different regions of the world.

Even when currencies are convertible, as in the European Union, they impose significant barriers through the high transactions costs involved in

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

exchange. Such costs include those of buying and selling foreign currencies, and uncertainties about future movements in intra-bloc parities which may require forward cover to be bought by firms (at extra expense) in order to protect the value of their revenues. Short of monetary union with a common currency, these costs cannot be entirely eliminated, although clearing and payments unions can help to reduce them. With inconvertible currencies, exchange controls typically constitute a decisive, binding barrier to market unity, outweighing fiscal and tariff barriers in their significance.

Within some common monetary areas in the developing world, and in regions where currency convertibility has been largely achieved, there is both current account convertibility and a fairly liberal capital transfer regime. But in several developing regions there are still severe monetary obstacles to intra-regional trade and investment which arise from overvalued exchange rates and other policy responses to macro-disequilibrium. Their elimination is a prerequisite for effective measures toward further markets integration requiring harmonisation of both current and capital account regimes. Some progress has been made throughout the developing world in the 1980s and 1990s towards bringing official exchange rates closer to market-clearing levels. One approach has been via the operation of dual systems (second windows) under which the exchange rate is fully or partially determined by the market for certain types of transactions.

Studies have been done in developing regions of monetary harmonisation programmes that would be needed if exchange restrictions were to be removed, exchange rates stabilised and inflation rates brought into line. These outline the scale and sequence of required further economic adjustments, and usually lead to proposing monetary unions with a common currency. Such strategy seems to be supported by the experience of the European Union. In the case of NAFTA, however, the problem is partially resolved with all members' currencies being linked to the US dollar in way or another.

The harmonisation element of the programmes proposed is usually seen as a prerequisite to further integration, even though monetary union is something which most members of RIAs are not yet ready to accept. Even the European Union, which is the farthest advanced along these lines, faces serious problems in moving towards it. More precisely targeted proposals for attaining full convertibility therefore need to be worked out in most developing regions, focusing first on countries which are most advanced along the adjustment path.

The removal of monetary obstacles to trade is of course a necessary but insufficient condition for integration. Once major policy disequilibria in the countries concerned have been corrected, mechanisms have to be put in place to encourage the continued pursuit of policies which assure currency stability

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

and the maintenance of convertibility and, in so doing, to facilitate the progressive strengthening and deepening of RIAs.

Exchange Rate Regime

This poses the important issue of the appropriate exchange rate regime to be resolved between fixed or more flexible arrangements. Under the *real targets* approach, the exchange rate is an indispensable policy instrument for facilitating adjustment and growth, particularly with inherent volatility in the terms of trade that confront many developing countries. The *nominal anchor* approach rejects the efficacy of nominal exchange rate adjustments, in part because the monetary regime shapes private sector wage and price policies.

Exchange rate flexibility and floating rate arrangements are favoured by the donor community and the international financial institutions (IFIs) for *developing* countries. In contrast the opposite view is taken by the IFIs and governments for *developed* countries where semi-fixity is preferred to reduce undue volatility in currency markets.[16] Such volatility is seen as vitiating the attempts of governments to pursue sensible fiscal and monetary policies which the financial market may (for unrelated reasons) disagree with for longer than is desirable. The arguments against stable exchange rates in developing countries, however, are not convincing in the face of weak systems of domestic restraint and the inability of developing country governments to engineer significant changes in real wages. The adoption of a regime of stable rates, underpinned by credible and robust regional exchange rate stabilisation mechanisms, would certainly also encourage cross-border investment. Evidence now suggests that the tendency to push floating rates in developing countries may have been overdone, perhaps to the detriment of attracting much needed flows of foreign and domestic investment which would enable the desired adjustments in supply-side response to take place.

After major exchange rate misalignments in the member countries of a region have been rectified, one option is for members to harmonise monetary policies by fixing common inflation ceilings and bands. In developing countries, however, such policies are difficult to implement because of tenuous links between targets and instruments. The use of anchor currencies, or of baskets of currencies, to which countries can peg their own currencies

16 Excess volatility is sometimes generated simply because foreign exchange traders want to trade currencies and banks want to derive profits from such trading. Somewhat disconcertingly, a vested interest now seems to have developed within the international financial community to keep exchange rates far more volatile and unpredictable than they need to be or than economic fundamentals suggest they should be.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

would be a better strategy. Pegging to the same external anchor under RIAs can be a useful first step towards monetary harmonisation and stabilisation.

The optimal peg for any particular region would, of course, have to be determined by the patterns of trade and capital flows. The options essentially are the US dollar, the ECU, the SDR, a trade-weighted basket or, for the Asian region, perhaps even the Japanese Yen, just as for West and Central Africa, on a limited basis, it might still be the French franc. Adoption of a common anchor currency would be akin to an informal exchange-rate union, in which the right to change parities would initially be retained.

Monetary initiatives in developing countries usually argue for actions leading to the introduction of a common currency and monetary unions of the type that already exist (e.g. the CFA and rand unions). These are not full monetary unions, since the currency issues in each country are separately identified and national balances of payments are calculated, which ultimately govern national credit and fiscal policies. Contrary to IFI belief, these types of monetary union do not lead to the effective integration of national money markets and do not necessarily constitute a barrier to the operation of country-specific adjustment programmes.

It should be emphasised that monetary arrangements appropriate for developing regions do not depend on prior achievement of a high degree of integration among participating countries. They could just as well precede it. Nor do such unions require prior fiscal integration, though participants should accept firm constraints on resort to public deficit financing. Such arrangements can operate primarily as mechanisms for strengthening adherence to the conditions necessary for maintaining convertibility and fixed exchange rates, while still permitting the retention of national monetary identities and, to a limited extent, the operation of independent national credit policies.[17]

---

17 For example, in West and Central Africa, the retention of monetary unions for more than 35 years following independence has depended on the availability of an external guarantor (France), the immediate *quid pro quo* being the acceptance by the countries concerned of constraints on their fiscal and credit policies directly imposed by the guarantor. If some such arrangement for an informal exchange-rate union were to be adopted as a long-term objective in other developing regions, a precondition of its credibility, at least for an initial period, would be support from an equally credible external guarantor (which could be a regional bank or another multilateral agency). The benefits of such an arrangement, and its effect on inward investment, would then be greatly enhanced. Guarantees are evidently unlikely to be forthcoming without the acceptance of significant constraints on the fiscal and monetary policy sovereignty of member states, which they may be reluctant to envisage. But past experience shows that exercising such sovereignty has been a recipe for inflation as many developing governments now acknowledge. Under structural adjustment programmes effective monetary sovereignty has, in any event, been circumscribed by the acceptance of externally imposed monetary targets as a precondition for access to financing.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Clearing House and Payments Union

A related matter to consider in connection with RIAs in developing countries concerns the role of *clearing houses* in overcoming payment obstacles, especially in regions where normal trade finance linkages and instruments are absent. It may well be that before convertibility is fully attained, there is a good case for adapting this halfway-house in developing regions. An alternative approach would be the establishment of a payments union, resembling the European Payments Union of 1950-58, involving the provision of credit for which external funding has already been sought.

To some extent, a clearing house reduces the need for foreign exchange dealing in convertible currencies for intra-union transactions. However, the extent to which real gains are actually generated will depend on the extent to which savings in the use of foreign currencies are offset by the administrative costs of operating the clearing house itself. In many cases clearing houses under RIAs have not brought any increases in intra-regional trade flows (e.g. in the Preferential Trade Area for Eastern and Southern Africa).

Supporting credit facilities might encourage greater intra-regional trade, but in most developing regions the absence of donor interest in providing financial support makes such facilities difficult to finance. Sadly, such support might be developmentally much more effective than the balance of payments support or the debt service support which donors have traditionally been more willing to provide.

Parallel market rates might also be used in some cases for settling payments for intra-group trade; but although this might expand clearing house activity by restoring some unofficial trade to official channels, it would not necessarily expand intra-regional trade.

If a payments union is to be established under RIAs in developing regions, the case for it must be based on the contribution it makes to liberalising trade and payments – or to preventing trade from contracting in the face of balance of payments pressures – during the transitional period before full convertibility is achieved. In this context, credit facilities would have an important role to play. Still, where intra-regional trade is relatively low, the role of a payments union is likely to remain modest. To the extent that some countries might be persistent creditors in such unions, particular difficulties would arise unless special arrangements were made to reflect their circumstances.

Clearing house and payments union arrangements may *not* be crucial elements in RIAs for particular developing regions. If prematurely considered they may even deflect attention from the real issues. The fundamental question is whether the encouragement of regional trade by the use of parallel rates, and discriminatory relaxation of exchange-related non-tariff barriers, are desirable.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Whether there is a role for a clearing house should be determined by the relative efficiency of the commercial banking alternatives available in the region. If direct access were allowed to commercial banks, and letters of credit were more widely used in trade finance transactions, the market itself might resolve the issue. A clearing house might be partly justified in terms of its convenience for performing other useful monetary cooperation functions, including monitoring, not already undertaken by other institutions, that might contribute towards more rapid convertibility.

Barriers to Production

Non-tariff barriers affecting production consist of those that affect output by limiting entry to a market or by restricting competition. Such barriers also affect trade, but only indirectly. A lack of uniformity in national technical standards and regulations may have such effects. In service industries such as transport, regulatory policies often operate in a protective way, raising operating costs and prices. Public sector monopolies in production and distribution also restrict entry, as does the protection of domestic labour markets leading to the maintenance of artificially high real wage rates.

Limited and undiversified indigenous production structures with only a few products, and services which can be easily traded across borders, usually underline the limited potential for trade among members of less industrially advanced developing regions. In these instances, supply-side limitations are a more binding constraint on industrial development than the limitations of small market demand. The scope for eliminating high-cost producers and achieving efficiencies is limited when industrialisation among regional members is not sufficiently advanced or technologically competent.

The benefits from increased competition do not result immediately when the region does not have similar ranges of rival products, produced under different cost conditions in different member countries. Resources will not be better utilised through the realisation of scale efficiencies unless industries already exist which need larger markets than those limited to national economies. Nor will efficiencies result unless member countries have been protecting the same industries but with markedly different ratios of factor efficiency in protected industries relative to the same ratios in unprotected ones.

Product Standards and Privatisation

Of the non-tariff barriers to production for regional markets in the developing world, among the most important – especially in the case of land-locked countries where infrastructural links are weak – are additional costs

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

created by different national product or service regulations and standards in such fields as transport, health and safety. These add to the costs of production and inventories and distort production patterns. Inevitably, they discourage business cooperation and impede the creation of a unified market.

Product standards are becoming increasingly important considerations in terms of outward-looking policies. For example, European Union standardisation regulations after 1992 now have to be respected by producers wishing to export to that market for a much wider range of products than has previously been the case. The same is the case for NAFTA.

Though the significance of this factor is not easy to establish clearly there can be little doubt that the prevalence of multiple national standards adds to production costs, requires larger inventory holdings, distorts production patterns, discourages cross-border business cooperation by inhibiting subcontracting, and undermines efforts to unify the regional market. This problem has been recognised by several regional organisations in the developed and developing worlds which have undertaken surveys in the specific areas of product and service standardisation.

Another critical barrier arises from the pervasiveness of parastatals, i.e. public sector industries and state trading monopolies which dominate markets in developing countries. The dominance of state-owned enterprises throughout the developing world has been a powerful disincentive to regional cooperation and the design of effective RIAs. Run with national objectives in mind, usually flavoured by political and social rather than commercial considerations, parastatals are not as amenable to cross-border cooperation, or to cross-investment in one another, as are companies under private ownership and management. For example, cross-border cooperation among transport, power, water and telecommunications companies in many developing regions might have occurred sooner had commercial rather than political or security concerns dominated decision-making.

The privatisation trend in developing countries may well lead to more rapid integration of regional enterprises within the same industry, or at least of trade between these enterprises, than if parastatal ownership continued to prevail.[18]

There is a range of other barriers to production where differences are attributable to historical and accidental factors rather than to deep-seated policy

---

18 Railway and airline operations are two areas where cooperation exists in many regions but is not complete. Road haulage is another service industry in which most developing regions are hindered from operating as integrated areas, usually because of public ownership of haulage companies, as well as a lack of harmonisation of road transit charges and of truck licensing procedures. To the extent that these barriers are motivated by protection, their elimination will confront obstacles similar to those encountered by attempts to reduce other forms of protection.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

or ownership distortions. In such cases, although adjustment costs would be involved in eliminating barriers, it may still be possible to remove the impediments fairly painlessly.

Where export markets are sought outside a given region, harmonisation with the standards of the European Union and/or NAFTA would seem practical. For purposes of regional integration, the *principle of mutual recognition* employed in the European Union might afford an appropriate strategy for many cases, and would not demand harmonisation, though some derogations would doubtless be necessary if this path were to be followed.

Free Labour Markets

The protection of labour markets resulting from domestic political pressures to reduce chronic unemployment in any particular country can be a significant barrier to achieving cross-regional production efficiencies and can lead to regional *dis-integration*, quite apart from worsening a particular developing region's international competitiveness. If existing access to labour markets is denied to workers from neighbouring countries in some developing regions, remittances will fall, as will their purchasing power for consuming the goods and services of the country that imposed barriers.

If under RIAs labour market protection is accompanied by continued restrictions on intra-regional investment flows, the damage to prospects for regional cooperation can be further exacerbated. Apart from the direct effect of reduced purchasing power in neighbouring countries, some form of retaliatory action on their part against protection in adjacent markets might also result in compounding the damage to regional cooperation.

Regional interests can be threatened by political pressures within a particular country or sub-group of countries to maintain artificially high real wage rates. The social dumping argument in the European Union is a case in point. Such pressures pose a serious barrier to any region's achieving international levels of competitiveness in manufacturing or services. Lower real wage rates in different pockets of the same region can often prove a useful equilibrating mechanism to keep overall regional wage rates sufficiently under control, especially in political environments which are subject to strong pressures in the opposite direction.

For this to happen, of course, investment and labour flows across the region (and particularly from high-wage to low-wage countries) must be relatively free and unfettered. Unrealistically high domestic wage rates in some countries set against much lower wage rates in neighbouring countries pose a major policy issue which needs to be dealt with in the regional context. This is becoming a major issue in the European Union and will be even more of an issue in NAFTA as well as in ASEAN.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Barriers to Cross-Border Investment

A major benefit of RIAs in the developing world should be an expanded inflow of foreign direct investment from outside and within the region. To the extent that these two categories of investment depend on the creation of a regional market, cross-border investment will be influenced both by the trade and production barriers already discussed, and by the hindrances represented by investment licensing. The removal of these barriers is a precondition for exploiting the gains from investment under RIAs.

The main obstacles confronting the expansion of cross-border investment in developing regions are exchange control regulations. These regulations can be avoided by using externally held funds or by raising capital overseas. A further obstacle is represented by the underdeveloped nature of financial and banking markets. Domestic capital is perceived to be short (when it is usually misused) and capital markets are generally underdeveloped.

A crucial issue that must be addressed in framing RIAs among developing countries is that of trade-related investment incentives. Some investment incentives take the form of duty drawbacks or rebates, while others take the form of tax holidays. Direct subsidies may also be used. All parties to an RIA have a legitimate interest in the incentives offered by the others, since these may affect the level and location of regionally justified investment in the bloc and thus also affect the direction of trade and the distribution of the benefits of integration. If investment incentives are provided in the context of RIAs, this should be done directly and openly, in a way that does not raise the price of products to consumers. If existing incentives could be shifted to such a basis, one of the major distributional obstacles to operating a customs union would be immediately overcome.

Under RIAs, there must, at the very least, be a willingness on the part of partners to agree on a minimum harmonisation of incentives if the benefits of integration are not to be dissipated in higher costs due to smaller scale production than a regional market warrants. This need not mean complete uniformity of incentives, especially if there are large disparities in the levels of development of members of an RIA. In the interests of ensuring that the benefits of integration are appropriately distributed, it might be appropriate to allow certain countries to offer more favourable incentives, as is permissible in the case of the European Union's own regional policy. Differentiation on such grounds would imply a trade-off between efficiency and equity, but this may have to be accepted as the price of regional accord and to achieve the objective of levelling out.

Because of the intra-regional impact of investment incentives on integration, it may be appropriate for partners in an RIA to harmonise investment incentives as a precondition for access to any trade or tariff

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

concessions. Trade agreements being negotiated between various developing countries (e.g. in Africa and Latin America) already contain provisions of a traditional kind, intended to take account of the interests of the participating country in subsidies and incentives offered by partners, but these do not adequately address the issues involved.

Other Barriers

In addition to barriers which affect trade, production and investment distinctly, there are a number of barriers that relate to all three.

- The slowness of convergence among developing economies in different regions in their fiscal regimes, investment incentives, monetary regimes, exchange and inflation rates, acts as a powerful barrier to increasing intra-regional trade and investment. Structural adjustment programmes (SAPs) underway in several developing countries are attempting to correct these macro-imbalances.
- To the extent that such efforts are successful, they may, indirectly, (if inadvertently) achieve a measure of regional convergence. On the other hand, conflicts between national and regional objectives under SAPs may militate against regionalisation because nationally-focused objectives of SAPs may not be compatible with maximising intra-regional trade or welfare.[19]
- Misperceptions of regional opportunity by business communities – especially ethnically concentrated ones in particular regions – could impede rather than accelerate regional trade and investment if predatory rather than cooperative positions are adopted at an early stage.
- Many private businesses appear to perceive enlargement of the regional market in some regions (e.g. South African businesses in Southern Africa or East Asian businesses in Vietnam) as advantageous only because it enables them to compete for aid-funded project contracts and expand aid-funded exports. Establishing more effective long-term business partnerships through investment and joint ventures across borders is not at the forefront of their minds; nor is the prospect of undertaking long-term cross-border investments to capture low labour-cost advantages in contiguous countries. If the early years of business entry into regional markets are characterised

19 This is particularly true of the way in which structural adjustment programmes in Africa have caused an implosion in both public and private investment at the national level (because debt service outflows have been maximised at the expense of domestic investment), and triggered a competitive regional race for commodity exports in each national economy. This has often had a deleterious impact on net export earnings at the regional level, e.g. encouraging farmers in neighbouring countries to increase cocoa, tea, coffee, tobacco, or to increase production of the same mineral commodities simultaneously.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

by predatory behaviour on the part of any single country's or any ethnically identifiable business community (e.g. in Africa and Asia) the immediate reactions of countries will be to raise regional barriers rather than to lower them.

- Domestic policy instability in anchor countries, caused by fiscal laxity to accommodate domestic political pressures, can impede the process of regionalisation. If such instability weakens a particular region's anchor economy the setbacks to regional integration can be significant.[20] When fiscal looseness is accommodated by monetary expansion the negative impact on the regional economy is generally aggravated even further.

Regional integration in the developing world may also be hindered (or promoted) by the present roles and functions of different regional institutional structures. Several such structures exist in the form of: (a) large and well-endowed regional and sub-regional development banks in Asia, Africa, Latin America, the Caribbean and Eastern Europe; (b) various regional economic commissions linked to the UN system which are playing a significant role in promoting RIAs; (c) regional institutions and secretariats set up on a plurilateral basis under specific regional or sub-regional agreements. The latter aim at lowering intra-regional tariff and non-tariff barriers as well as at wider objectives such as administering monetary unions, or achieving infrastructural investment (and operational) coordination in key sectors, as well as broader policy coordination on trade and exchange policies and on monetary policies.

20 There are two vivid examples of this phenomenon which have occurred recently. The first was the way in which incompatibility between fiscal and monetary policy in Germany, immediately following reunification, and before the all-German national elections, disrupted the region's monetary and exchange regimes and broke the EMS. This happened because the severe monetary squeeze imposed by the Bundesbank to offset the government's fiscal expansion to accommodate unification, resulted in a sharp rise in Deutsche Mark interest rates when most the rest of Europe needed interest rates to decline in the midst of a deepening recession. The strains which emerged in the EMS in attempting to maintain parities under this unprecedented interest rate twist were too great for the system to cope with without very large disorderly changes in parities which were eventually forced by markets. The second example is the case of South Africa in SACU. That economy has been stagnant for over a decade. It complains about the overt costs of compensation and stabilisation arrangements for the smaller members of SACU even though such costs effectively constitute a covert export subsidy for South Africa's manufacturing industry. The cause of economic integration may be severely affected, and extant regional arrangements seriously endangered, if the South African economy goes off-track. This could happen if the new South African government indulges in the same kind of fiscal looseness and accompanying monetary expansion that has occurred in most of the rest of sub-Saharan Africa immediately after independence, to fulfil the unrealistic populist expectations which have been created. Initial signs, however, indicate that it will resist the temptation to indulge in the same type of profligacy.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

This looks all quite well. The problem, however, is that in many cases there are competing institutional arrangements within the same region which all aim at achieving much the same thing. In addition, there are a number of multilateral institutions with global functions (the IMF, World Bank, World Trade Organisation, and the various UN specialised agencies) which have taken an interest in the recent burgeoning of RIAs although with ambivalent perspectives. Duplicative institutional frameworks with overlapping memberships whose bureaucracies (however small) compete for regional attention and pursue different regional agendas cannot facilitate the integration process; they can only confound and confuse it. Hence the overlapping roles and responsibilities of these different institutional players need to be satisfactorily resolved, as does the future evolution of institutional arrangements in different regions aimed specifically at deepening progressively the content of RIAs.

The non-tariff barriers to regional cooperation outlined above identify the most pressing constraints which RIAs presently confront.

The path toward knitting together regional economic communities in the developing world will not be easy, especially under evolving, uncertain economic and political circumstances. Nevertheless, the inevitable emergence of different global economic arrangements makes it incumbent on national governments to ensure that RIAs are negotiated on a basis which benefits both the region and the global economy as a whole. Crucial research issues in examining the future prospects of RIAs in the developing world concern: (a) identifying and understanding fully the effect of non-trade barriers, a subject which has been neglected in the normal literature on integration; (b) devising means for overcoming the defects of past initiatives aimed at removing non-trade barriers and ensuring the implementation of new, more effective initiatives; and (c) stabilising and binding liberalisation measures that are in effect.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

4 The Experience of Developed vs. Developing Economies

As the vignettes of RIAs presented earlier suggest, the record of first-generation RIAs has been a mixed one. There has been gradual success – albeit with a number of hiccups and setbacks – in developed country RIAs governing the European Union, NAFTA and ANZCERTA whereas earlier RIAs in many developing country blocs failed, especially in Africa and Latin America. It is tempting to believe that the difference was because, in typical World Bank terminology, the former were outward-looking, open and efficient, while the latter were inward-looking, closed and inefficient. But those are partial answers at best and misleading at worst.[21] Things are more complex than that.

Why First-Generation RIAs Failed in Developing Countries

A more satisfactory explanation for the difference in experiences of RIAs is that for RIAs to succeed, the process and sequence of successive steps towards closer regional cooperation leading eventually to regional integration, are at least as important as the direction and ultimate goal of the integration enterprise. Political will (or the lack of it) for example, is a more powerful determinant of whether an RIA is successful than the validity of rational economic argument.

But the question remains: why did first-generation RIAs succeed among developed countries but fail among developing countries? Is it because integration would yield benefits only if applied by relatively advanced trading economies of roughly equal weight, producing a wide range of tradeables, and with similar production structures? Or is it that RIAs in developing nations have failed because of the very characteristics that define *developing* economies: lack of administrative capacity, political immaturity and instability, vulnerability

21 With its wasteful, distortion-ridden and trade-diverting Common Agricultural Policy and the protection it applies to sensitive industries (i.e. those in which Japan and East Asian countries are the most competitive), the European Union (EU) is hardly an open, outward-looking, trade bloc inclined towards inclusivity. It is prone to erecting protective barriers whenever the interests of its powerful vested industrial or parastatal lobbies appear to be threatened. Even so, the EU remains more open than the developing country regional blocs of the 1960s and 1970s were – although some second generation RIAs among developing countries are arguably more open now than the EU. Nor is American trade policy, which governs the ethos of NAFTA, immune to its own forms of retaliatory bilateralism or protectionism.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

to external trade and financial shocks, etc.? If so, would this mean that developing countries should not attempt to integrate till they become more developed? The answer is that both theoretical reasons and implementation failures interacted in determining outcomes of first-round RIAs in the developing world.

The studies that have been done in exploring these issues[22] generally conclude that:

- The Vinerean[23] hypotheses which underpin the modern theory of regional integration and those of Belassa *(op. cit.)* are basically correct. Both assert that there are, at best, likely to be few benefits and potentially high costs unless RIAs are accompanied by unilateral trade liberalisation.
- The greatest benefits are likely to be obtained with RIAs among countries that have: relatively high initial (intra-regionally oriented) trade ratios; low intra-regional transport costs relative to the transport costs involved in trading with the rest of the world; higher, less dispersed levels of incomes with high elasticities of demand for imports; high propensity for investment; and greater supply-side flexibility in their production structures for responding to competition.
- First-generation RIAs among developing countries failed to raise efficiency because of: (a) relatively low import demand elasticities; (b) relatively large differences in production cost structures vis-à-vis extra-regional sources; (c) widely disparate income levels; (d) divergent rates of industrial development which made gains from intra-bloc trade uneven; (e) low levels of initial integration by way of infrastructural links or intra-regional trade; (f) similar not complementary structures of production and resource endowments; (g) inward-oriented, protectionist industrial development policies under which protection was maintained for too long; and (h) divergence and instability in macroeconomic parameters that made domestic adjustment, as well as regional adjustment, uncertain, fragile and burdensome.
- In RIAs among developing economies, the implementation of measures to lower barriers (both tariff and non-tariff) was poor whereas developed economies were more diligent. The lowering of trade barriers in almost all RIAs among developing countries was delayed or postponed largely because of the heavy dependence of the fiscus on trade taxes.
- Processes for lowering tariff and non-tariff barriers under RIAs in developing countries lacked the automatism they had in developed countries. The tendency instead was to have protracted negotiations to achieve

22 In particular those of (1) de Melo et al., (2) Robson, (3) York, (4) Oman and (5) Cable and Henderson, *op. cit.*

23 Viner, Jacob, *The Customs Union Issue*, New York: Carnegie; London: Steven and Sons, 1950.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

multilateral consensus on a product by product basis. At the level of implementation, there was no strict timetable for executing trade barrier reductions.

- Such reductions were based on *positive lists* rather than across-the-board liberalisation of tariffs and non-tariff barriers with very restrictive rules of origin. Positive lists included products which were traded intra-regionally prior to the arrangements in question or were not produced in the region. They generally excluded protected products, the free trading of which might have engendered greater efficiencies despite inevitable dislocations.
- Vulnerability to bouts of exogenously induced macroeconomic instability in developing economies, or to import surges caused by economic liberalisation programmes led to immediate unilateral reimposition of trade barriers (mainly in the form of quantitative restrictions) even in those arrangements which were initially successful like the Central American Common Market.
- Where customs unions were intended, the implementation of a common external tariff was not achieved because members invariably sought exemptions from certain external tariffs (e.g. for essential imports from extra-regional sources).
- Developing country RIAs were unsuccessful, or only partially successful, in freeing intra-regional mobility of all factors – especially labour and capital.
- Satisfactory compensation schemes for losers under developing country RIAs proved difficult to design and negotiate multilaterally in a manner acceptable to all members. Problems with implementing structural adjustment programmes also led to conflicts among partners over the equitable regional distribution of costs and benefits.
- Too many developing country RIAs set up machinery to allocate resources through administrative decision-making and fiat rather than market determination for locating new import-substituting industries among different countries in an effort to ensure equity rather than efficiency.
- These mechanisms encountered administrative problems and frequent breakdowns of negotiations as a result of inter-country conflicts of interest and the impossibility of determining proper locations for particular industries in the absence of market-based criteria and incontrovertible evidence of comparative advantage – always difficult to provide in a dynamic sense.
- Intra-regional trade expansion in integration arrangements among developed countries occurred through rapid *intra*-industry trade expansion among members. Among developing countries trade expansion occurred more on *inter*-industry lines.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

- *Intra*-industry trade specialisation (i.e. trade in differentiated manufactures) and expansion was achieved without major shifts in factor proportions or entirely new technologies. Therefore it entailed relatively low transitional costs of adjustment, particularly in terms of labour dislocations.
- *Inter*-industry trade expansion was generally slower, requiring major restructuring of firms and industries. It was less susceptible to realising cost efficiencies and scale economies across a wide range of regional industries quickly, and required more adjustment assistance for compensatory purposes.
- Such costs were substantial in the short run with transitional losses reflecting long periods of labour retrenchment and re-training when firms which faced regional competition either failed or took too long to adjust and compete.
- Transitional losses were reduced to the extent that labour and capital were mobile within the region but that was not the case under most developing country RIAs.
- The political will to sustain RIAs through difficult economic circumstances was lacking in developing economies with members being prone to take soft options to ease the immediate pain at the expense of longer-term interests.
- Developing country members of RIAs were rarely able to subordinate short-term national interests to regional goals or to cede essential sovereignty to regional institutions.
- Under developing country RIAs there was a structural incompatibility between: (i) the pursuit of inward-oriented and inherently protectionist development policies at the *national* level and (ii) the ostensible objectives of *intra-regional* trade liberalisation. Powerful industrial lobbies prevented a reduction of domestic protection in key import-substituting industries.
- An unpropitious external environment facing most developing regions in the 1970s and 1980s did little to help matters. Under pressure to liberalise and adjust, many developing members of RIAs found their commitment to import-substitution strategies was inconsistent with regional liberalisation and introduced structural rigidities which were difficult to deal with through normal macroeconomic management.
- Although many RIAs among developing countries were modelled on European Union lines, most of them lacked adequate or technically competent institutional support.
- National legislation was invariably inconsistent with regional treaty commitments, but most developing countries delayed the necessary changes in their laws. Effective enforcement mechanisms and dispute settlement procedures were conspicuous by their absence.
- Developing country RIAs were aimed at the wrong objectives (inward-looking and based on high common external tariff) which did not yield

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

significant efficiency gains nor did they result in initial trade-diverting effects eventually being converted into trade-creating effects by capturing the potential for dynamic efficiency.

- There was more rapid intra-regional trade growth in developing regions (e.g. Asia) which had no formal regional arrangements for intra-country trade but which focused on unilateral trade liberalisation first, than there was when formal PTA/FTA/CU arrangements were entered into *before* members had undertaken unilateral trade liberalisation.

There is now a rich body of experience with RIAs in many developing regions from which various lessons might be learned in designing future arrangements. As emphasised above, most formal groupings have so far generally not fared very well, and for essentially the same reasons. Thus, their experience serves to underline the need to address the problems identified for future RIAs in developing countries, rather than to suggest possible transferable solutions from the experience of developed countries (see Annex II on Africa).

Lessons for the Future

In the case of the Andean Group, experience underlines one important point: the dangers of addressing the problem of *distributional equity* by controlling foreign direct investment (FDI) inflows. The Andean Group's attempt to legislate on FDI inflows and the transfer of technology in order to promote production integration and regional balance found expression in Decision 24 in 1970. Owing to the virtual drying up of FDI inflows, the decision was relaxed in 1987, and in 1991 it was replaced by Decision 291. This assures national treatment to foreign investors and effectively signals the abandonment of the original initiative. The Andean Group went even further in establishing a common market by the end of 1993 which assured capital mobility to an unprecedented degree.

The ASEAN bloc is one of the few not to have experienced the difficulties seen in some African regional blocs. Its members have enjoyed high rates of economic growth, and its share of intra-bloc trade, at nearly 30% of total trade, is substantially higher than that of any African group. However, although this might suggest a positive example, ASEAN is not a particularly good example of an RIA *per se*. As observed earlier, until 1993 ASEAN's objectives were more political than economic. Its most notable achievements were peaceful conflict resolution and regional security among members.

An ASEAN Preferential Trading Agreement has now been established, but its practical scope has been deliberately limited. It has not resulted in any significant trade expansion among the members of the bloc that is not occurring naturally anyway. Thailand's proposal that ASEAN should establish

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

an FTA has been accepted, with members agreeing to create the ASEAN Free Trade Area (AFTA) within the next 15 years.

The main lesson of ASEAN is that it is possible for fruitful transnational production links amongst the countries of a sub-region to develop, even without formal institutional support for RIAs, providing the following conditions exist: (i) a favourable economic policy climate for business enterprise – private and public, involving foreign and domestic capital – to flourish; (ii) a regional reservoir of entrepreneurial talent which is ethnically linked throughout the region; (iii) administratively capable – if not necessarily always incorrupt – domestic government; (iv) a will to encourage pragmatic regional cooperation on a step by step basis, building on small successes and eschewing grand designs; and, (v) above all, the existence of healthy and sizeable economies in which private enterprise is permitted to play the dominant economic role but with governments intervening intelligently in "governing the market".

For future RIAs among developing countries to succeed, most of the studies done have found that the following conditions would be essential:

- Strong and sustained political commitment to RIAs;
- Effective mechanisms to distribute equitably the costs/benefits of RIAs;
- Regional trade liberalisation as a complement to unilateral trade liberalisation;
- Macroeconomic stability among members with a trend toward convergence;
- Structural flexibility in converting import-substituting production structures;
- Better design of RIAs to be more comprehensive and inclusive.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

5 Second-Generation RIAs in the Developing World

In considering the prospects for second-generation RIAs in the developing world and the choice of partners in any RIA, the following determinants merit particular attention: (a) proximity and other geographical characteristics; (b) differences in levels of macroeconomic adjustment; (c) extent of convergence in levels of development and in fiscal and monetary policies; and (d) political attitudes towards accepting binding mechanisms that involve a transfer or pooling of sovereignty. These determinants are taken up below in turn.

Determinants of Success

To achieve significant intra-regional trade expansion, there is substantial evidence that geographical proximity and consequent low transport costs are particularly important factors for RIAs to succeed. Other geographical features, such as natural frontiers, landlocked boundaries, and readily controlled ports of entry, are relevant as well and quite material to the appropriate scope of fiscal jurisdictions and thus to the adoption of customs and fiscal unions, as opposed to other, looser forms of RIAs. These characteristics also illuminate the choice of *natural partners*[24] for each approach in terms of geographical scope, as well as the appropriate time scale and phasing of any process of closer sub-regional integration.

A second prerequisite for effective, beneficial trade-focused RIAs is that participant economies should be sufficiently well adjusted in terms of having achieved micro- and macro-equilibrium so that trade liberalisation is not impeded by exchange restrictions and is undertaken at market-clearing prices. Countries in severe economic difficulties whose structural adjustment programmes are in their early phases of implementation will not be attractive partners in RIAs with more developed and stable countries. Differing time

24 Natural trading partners are only really determined in retrospect and not before the fact when the benefits to members have become apparent as a result of their having highly integrated transport networks, and roughly similar production structures thereby providing scope for efficiency gains to be realised. Some studies suggest that African countries tied together in various regional cooperation arrangements may not be "natural partners" because while countries and borders are organised on a North-South orientation, the natural routes which minimise transport costs are East-West.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

schedules for implementing each country's structural adjustment programme may constrain the speed of trade-focused integration if such differences result in different rates and sequencing of trade liberalisation measures. Significant gains from RIAs can, however, be exploited even by countries that are at different stages of adjustment if such arrangements are focused on capturing gains from sectoral investment and policy coordination. Moreover, it may be possible, by the development of suitable mechanisms, to envisage constructive regional projects being undertaken outside the public sector in anticipation of further regional adjustment.

A third important determinant is the degree of convergence amongst prospective partners across a range of development (and not just monetary, fiscal and inflation) indicators. Conventional wisdom suggests that tight RIAs (which lean toward full integration) will be difficult to implement unless members are at comparable levels of development, since only then would there be a reasonable assurance that all would benefit equally. If, instead, integration takes place between unequal partners, then it will be viable only if effective compensatory mechanisms can be put in place.

Such a view must, however, be qualified. Except in the case of a simple free trade area, successful RIAs anywhere in the developing world will usually demand some form of regional policy to engender equity and accelerate development in underdeveloped parts of the region. Indeed regional policy is a cornerstone of European integration. But focusing on regional equity considerations prematurely may have its own drawbacks, as the case of Africa illustrates.

African RIAs have been concerned with enforcing equity mainly through administrative allocation of preferred locations within the region for new investments and especially for private foreign direct investment. Such an approach – aimed at directing investment flows by fiat – did not induce investors to locate production where governments would like. Instead it had exactly the opposite effect of deterring investment altogether. Even though, on the face of it, the costs of doing investment might initially be higher, foreign investors prefer to locate production in more advanced countries rather than invest in a country with a smaller market and offering poorer infrastructural and business support services.

A fourth determinant of realising the potential benefits of closer integration therefore centres on the crucial issue of *credibility* and *perceived durability* of RIAs, particularly in the eyes of intra-regional investors who have to take a long-term view. Ultimately, such credibility can only be underpinned when member countries are willing to cede powers to regional agencies and are prepared to assure the binding nature of any trade liberalisation, monetary cooperation or other regional commitments that are agreed.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Linking Up with Large Trade Blocs

Another issue that needs to be specifically addressed is whether new types of RIAs should be sought by developing country regional blocs with OECD countries, and especially with the European Union (for developing ACP countries, Eastern European countries and Mahgreb countries) and NAFTA (for developing countries in the Western hemisphere), in order to increase the gains from RIAs within their own regions.

Trade, investment, exchange and payments support are prominent areas where new arrangements for North-South cooperation could usefully be explored, certain aspects of which, unlike the present Lomé arrangements, might call for a measure of reciprocity if they are to attract outside support. The increase in credibility that such cooperation arrangements might engender could be crucial for attracting inflows of foreign direct investment to serve sub-regional markets and, ultimately, even markets beyond the developing region concerned. Additional benefits from greater macro-economic stability could also be anticipated. In this connection, developing countries should not ignore the significance of initiatives currently under way in the western hemisphere involving free trade areas between North and Latin American countries as well as those in the Caribbean.

These issues need to be urgently addressed by developing countries. Even with multilateral trading arrangements being liberalised and strengthened under the Uruguay Round, the world trading system will be strongly influenced by the practices of three competing large trading blocs. The impact of their evolution on different developing regions will be the result of two opposing forces. On the one hand, to the extent that market unification results in faster growth within those blocs, third countries may potentially benefit through increased markets for their exports, primarily of manufactures. On the other, the creation of more efficient production units within the European Union (EU) and NAFTA, resulting from closer integration, may well reduce the competitiveness of imports from other countries in these markets.

Whether overall demand in the EU and NAFTA for imports from non-member developing countries rises or falls will depend on whether the trade-diverting competitiveness effect is larger or smaller than the trade-expansion effect of faster growth in these two large blocs. Any particular developing region's position in these blocs will depend on the evolution of its relative competitiveness vis-à-vis the position of other developing countries and regions, especially that of the Asian NICs which have already developed significant market share in the EU and NAFTA.

Similar effects may be expected to operate in relation to foreign direct investment, via the investment-creation and diversion effects that will accom-

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

pany the completion of the single market in Europe, and the formation of trading blocs in North America, East Asia, Latin America and the Antipodes. Overshadowing all of these are the implications of the further widening of the EU and the development, already under way, of closer links between it and countries of the former East Bloc. Many studies point to the conclusion that these developments will not have any significant immediate impact on most developing regions in terms of their present structures of production and trade. Nevertheless, it can be anticipated that if a particular developing region does not already have entrenched access in EU or NAFTA markets for such products as textiles and clothing, these segments of developed markets will become even more competitive and more difficult to penetrate. For certain other products which might be of importance in the future, the harmonisation and improvement of EU standards will themselves constitute trade-diverting non-tariff barriers from the point of view of different developing regions if they do not take steps to respond. It must not be forgotten either that, in Asia, regional integration is progressing, primarily through trans-frontier corporate integration, aided in some cases by special enterprise zones. New initiatives are under way within ASEAN which can be expected to enhance further the relative competitiveness and rapidly growing significance of the East Asian economies in world trade.

In the face of determined moves towards more effective regionalism elsewhere, a failure to overcome, or reduce, the costs of market fragmentation in regions whose countries have not yet begun to cooperate will mean that those regions, as a whole, will be less well placed in the future to attract the foreign investment, technology and know-how on which they will have to depend for their future economic growth. A good deal of progress must therefore be made in some regions (especially in Africa) merely for them to maintain their present modest relative positions. If, additionally, the countries of these regions wish to prepare themselves to take full advantage of longer-term opportunities, when wage convergence in Europe promises to prompt a further shift of labour-intensive production from its periphery to proximate developing countries (particularly in Eastern Europe and North Africa), then development strategy in these regions will need to be positively shaped and vigorously pursued with those specific opportunities in mind.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

6 Options for Creating Regional Trade Preferences Among Developing Countries

How regional trade preferences are provided among developing countries involves a range of issues. There are four main options: (a) bilateral preferential trade agreements; (b) customs unions; (c) free or preferential trade areas; and (d) a *variable geometry* approach. To achieve the full benefits from any of these approaches, investment flows (and ideally, though this may be more difficult, labour flows) also need to be facilitated, which implies some form of a common market.

The Role of Bilateral Agreements

A number of long-standing bilateral agreements already exist between countries in many developing regions. Others are rapidly developing in response to changing circumstances. Typical safeguard clauses are embodied in most of these agreements relating to dumping, subsidies and, – in the context of RIAs – to imports that threaten domestic producers with serious injury. Not all the bilateral agreements which have been negotiated are equitable or even. The competitive capabilities of neighbours are often a factor in determining the favourability of reciprocal terms.

How should such developments be viewed in terms of a strategy for market unification and integration in different developing regions? If the preferences offered by the industrially more advanced members of a region are smaller than those they receive and, in the limiting case, are zero, this would seem to offer one way of promoting an equitable distribution of the benefits of market integration. The main impact of preferential trade agreements is, however, to improve the terms of trade of the preference receiver rather than to promote closer integration. Even then, in practice, the incidence of any such benefit is likely to depend on the degree of competition in import-export trade.

Beyond this, it is doubtful whether bilateral agreements would, by themselves, be perceived as constituting a sufficiently significant added incentive for foreign direct investment to serve the wider market created under such agreements. There are two main reasons to support such a conclusion. First, the lack of full reciprocity that typifies bilateral arrangements would render any concessions particularly vulnerable in the face of economic difficulties in the country granting them. Second, such agreements do not specifically address non-tariff barriers to trade, production and invest-

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

ment which are the most important constraints presently affecting RIAs among developing countries.

The experience of most developing countries with extended bilateral agreements – for example under the Generalised System of Preferences among such countries agreed under UNCTAD and the concessions offered to African Caribbean and Pacific (ACP) countries by the European Union under successive Lomé agreements – has been quite disappointing. These two instances underline the deficiencies of preferential trade agreements in themselves as instruments for expanding trade and investment, and for promoting internal market completion.

The Role of Customs Unions

A substantial degree of intra-regional trade and market integration can take place without the support of a customs union, free trade area or bilateral trade agreements. Nevertheless, a complete customs union (CU) can make a substantial contribution to market unification, particularly if it eliminates all internal fiscal frontiers. Moreover, by reducing private and public administration costs, minimising the need for special transit arrangements, and by avoiding revenue losses from smuggling, CUs have other important advantages as well.

For a CU to be an appropriate form of cooperation for a group of countries, there should be a willingness to regionalise (i.e. to integrate) customs administration.[25] Operational reasons require that tariff rates in a CU must be unified as well, although duty drawbacks and refunds of limited scope

---

25 Experience in Africa, for instance, supports that view. For example, consider the effectiveness of SACU, the EAC and the Francophone unions during their periods of greatest effectiveness. SACU is the only properly functioning customs union in Africa at present though it has its own stresses and strains. Its 1969 provisions embody a CET, and provision is made for sharing the revenue derived from this source (and from excise and sales duties) amongst the governments of the member states on whose consumers these taxes fall. Excise and sales duties were harmonised under the 1969 agreement and subject to the same sharing principles; the replacement of sales duties by the GST in 1978, and its subsequent replacement in 1991 by VAT, have eroded the consumption tax union. Provision is made in the agreement for compensation for disparities in the distribution of the costs and benefits of integration reflected by the division of revenue shares of RSA's partners. These shares are based on consumption of dutiable imports plus dutiable domestic production. The inclusion of the latter can be regarded as compensation for the costs of trade diversion. The so-called enhancement factor provides further compensation for the loss of fiscal discretion and the costs of polarisation. The agreement also contains provisions to enable the less-developed members to protect their infant industries against competition from their more-advanced neighbours, but the Secret Memorandum of Understanding largely ruled out recourse to those provisions. The same revenue-sharing principles have also been applied to the 'homelands' (TBVC) within South Africa, and to Namibia.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

might be workable. To the extent that consumption taxes now form a large part of total tax revenues in many developing countries, harmonisation of consumption taxes in a CU becomes essential if its full advantages are to be secured.

Could a customs union have a role in an integration strategy for developing countries? If so, there would be much to be said, in principle, for learning from the existing RIAs which invariably incorporate some form of compensatory arrangements, as well as mechanisms for the enhancement and stabilisation of revenues. Divergent views are held on the compensation, revenue enhancement and stabilisation arrangements for achieving equity under the present CU arrangements in different developing regions. The industrially more advanced countries in a grouping usually take a budgetary perspective rather than an overall economic cost-benefit approach and thus see current patterns of revenue distribution as overgenerous. Occasionally they attempt to link compensation specifically to the financing of investments in the less developed members of the grouping, rather than providing it for general budgetary purposes.[26] Such compensation, for a period, might conceivably be envisaged as one element of the *regional adjustment programmes* which have often been suggested for African countries.

The basic problem confronting the adoption of CU arrangements on a wider basis concerns the distribution of costs and benefits among members. In a CU, trade imbalances in regional products that compete with dutiable imports from the rest of the world are likely to be reflected in revenue losses for net deficit countries. In the absence of non-tariff barriers, these will usually correspond to real income losses. Revenue-sharing formulae incorporated in some CU agreements attempt to deal with this particular element of the problem. But internal lobbies in the more advanced members of an RIA often see such a formula as too generous to the smaller less developed members. Even when the more advanced members in a CU wish to bolster the prosperity of their neighbours, their financial ability to make direct transfers may be circumscribed by the worsening of their own economic conditions.

Fiscal reforms involving a substitution of consumption taxation for import duties in developing countries, and external liberalisation coupled with the tariff convergence that structural adjustment programmes imply, should reduce this problem, but such changes in tax structures cannot eliminate it altogether. Unless future CUs are based on a non-redistributive attribution of revenues, i.e. on a *clean* basis, they might become much less acceptable to the more advanced members.

---

26 In CEAO, part of attributable compensation which is based on revenue losses goes, not to the general budgets of the net benefiting partners, but to FOSIDEC, a solidarity fund which funds investment projects of regional development interest.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

For a CU *without* compensation to be a feasible option, a reduction in protection or, at least, a switch from price-raising forms of protection to direct assistance would probably be necessary. An accord on regional *trade-related investment measures* (TRIMS) and harmonised investment codes might then become key components of CU agreements. If such a switch were not negotiable, fiscal frontiers would have to be retained in any wider or closer grouping, and tariff-free trade would have to be excluded.

In the longer-term context of reform and liberalisation, if regional groupings of developing countries were willing to regionalise customs administration and harmonise tariffs, as well as rates of consumption and excise taxes, the introduction of some form of CU would merit consideration. The regional adoption of a computerised system for processing customs declarations, controlling the clearance of goods, and producing trade and fiscal data – such as the ASYCUDA system devised by UNCTAD – would be an indispensable aid to such an initiative, involving the simulation of the effects on revenues, consumption, and prices for all prospective participants.

The Role of Preferential and Free Trade Areas

It is difficult to envisage a complete unification of tariffs under full CUs among developing countries in different regions except in the long term. The alternative would be to aim at preferential or free trading areas (PTAs or FTAs). In such areas, each country retains its own external tariff, but trade within the area is wholly or partly tariff-free. In principle, such PTA-FTA-based RIAs for a selected group of countries have many advantages. While they are capable of capturing many of the benefits of full regional market integration, PTAs-FTAs reduce demands for compensation, either for revenue losses, or for the loss of fiscal discretion and autonomy that may both be entailed in a CU. At the same time, the harmonisation of customs and consumption tax schedules, documentation and procedures that occur under such RIAs still yields substantial benefits by reducing administrative barriers and costs to cross-border trade and investment and, at the same time, reduces fiscal incentives to illicit trade.

Furthermore, the PTA/FTA approach enables a *variable geometry* and/or *multi-speed* approach to be taken towards closer (and eventually full) integration. The adoption of such approaches may be vital if integration is to proceed at a pace faster than that of the slowest country. If market integration through trade preferences or other means is to proceed on a uniform basis in the sub-region, it is likely to be at the pace of the slowest. A more flexible approach would be, for instance, that a core group implements or maintains a customs union with a common external tariff, while a wider group at the periphery constitutes itself as a free trade area and links itself with the core

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

group in a free trade agreement on the lines of the EU-EFTA (European Free Trade Association) arrangement. Other flexible forms of RIAs, for instance those involving public sector investment and operation – e.g. involving joint or coordinated operation of utilities or telecommunications and transport companies –, might be handled similarly, with cooperation for particular purposes involving overlapping groups.

The PTA/FTA approach has many advantages but, as the experience of several such arrangements show, its implementation is not easy. For it to succeed, the prior fiscal reforms outlined above for the customs union have to be adopted. If these have not been undertaken, the problem of compensation will arise in any event.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

7 Regionalisation vs. Globalisation: The Issues

Instinct, common-sense, theory and history all suggest that non-discriminatory free trade across all borders, and not just those divided arbitrarily by nation or region, is clearly the *first best* option from the viewpoint of maximising both global and national welfare. That view, however, rests on traditional concepts rooted in trade theory. In practice, the different and conflicting economic and social objectives of nation states, and the chronic dependency of the fiscus in developing countries on trade taxes, leads to a search for the *least worst* policy options for multilateral economic cooperation, especially when the global economy is still very imperfectly organised and political relationships among nation states are fragmented and in danger of becoming more so.

For these reasons, the resurgence of interest in newer RIAs keeps raising the question of whether an increased tendency towards regionalisation is an optimal or an inferior way of moving towards free trade and investment on a global basis. As one study puts it:

> '... it is questionable whether the prospective proliferation of (regional) arrangements – which involves overlapping country membership, potentially inconsistent rules, and increased scope for conflict – is the most efficient way to move toward free trade on a global basis. Indeed, beyond a certain threshold an undue emphasis on regionalism would undercut the multilateral trade system and render it inoperative. The limits on the liberalisation that regional arrangements can deliver in trade-sensitive sectors where protection is most ingrained raises further doubts about this approach. ... a "fortress mentality" (on the part of regional blocs) that leads to an increase in protection would undermine world welfare. The key element that could reduce this danger is the extent to which the world economy has (already) become integrated through trade and through the globalisation of investment and production. ... The recent trend toward regionalism, however, may be qualitatively different from past efforts and may carry greater risks of becoming a substitute for, rather than a complement to, multilateralism.' (de la Torre and Kelly, *op. cit.*)

Regionalism as a Mezzanine Step

If one accepts the argument that free trade *within* a region will lead to greater benefits, efficiency and welfare, then the same logic leads to the

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

conclusion that free trade *across* regions would be even better. The real question is whether it is necessary to go through the RIA route as an unavoidable mezzanine step in order to arrive at global free trade, or whether that intermediate step can be dispensed with since it might delay rather than hasten the world's journey towards its inevitable destination?

In this context, the experience of the Uruguay Round is illustrative. As it turned out, global trade liberalisation was easier to negotiate through regional bloc formations than through negotiations involving individual countries. The answer to the question, of course, lies not in economics but in politics and social organisation – those of nations as well as of global multilateral organisations.

As noted earlier, most existing global institutions seem to be approaching their limits of usefulness. Increasingly, global multilateral organisations appear to have become vested interests in their own right, more concerned about protecting their long-established rights and privileges than about delivering on their obligations to the international community. Moreover, the type of international discourse that occurs through them suggests that nation states themselves have reached an impasse. Present national political and administrative systems are not geared to providing effective and coherent direction to multilateral organisations. They are too internally divided – both within and among nations – and have become disconcertingly captive to the exercise of undue influence by special, single-issue lobbies. As a result, most national systems are more oriented toward short-term insularity than long-term internationalism. That is not surprising for two reasons.

First, few democratic governments have any incentive to employ a perspective of longer than four years. Second, except in very small countries, national governments do not attract votes on the basis of how well they handle international economic issues. They are therefore more attuned to appeasing and pandering than to leading; more adept at resisting change than adapting to it; and more prone to prescribing adjustment for others while resisting domestic adjustment for themselves when, in fact, embracing adjustment would, in the long run, be the least cost option both economically and politically.

In such a world the question becomes one of whether a *regional* approach may, at least for the foreseeable future, be more manageable than a *global* approach for myopic nation states and global organisations to cope with. The example of the European Union, despite its many shortcomings, controversies and distractions, has made a fundamental difference to thinking about whether the relative success of that regional arrangement – in contrast to the perceived daily failures of global endeavours – might not be replicable elsewhere.

When the ideal of globalism fades as a consequence of international

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

institutional failure and an erosion of national political will – two forces which feed on and reinforce each other negatively – the less ambitious *regional* undertaking begins to look distinctly more attractive if only on the grounds of greater tractability. It may just be that increasingly obsolescent smaller nation states, fighting for their own survival as sovereign entities against a powerful array of global market forces over which they have diminishing control, have subliminally come to the conclusion that they are more able to live with processes and institutions over which they *think* they still have some control (*regional*) than those over which they obviously have none (i.e. *global*).

It may also be that for a variety of reasons which have bred more familiarity, regionalism may be more manageable politically from a domestic point of view. Voters of all social and economic strata are perhaps able to comprehend and react to regional issues more than they can to global issues. Whatever the reasons, regionalism may be here to stay, for economic but mainly non-economic reasons, and therefore may be an unavoidable way-station to globalism. The risk always exists that such a detour might derail globalism. But it cannot do so altogether and for all time if history is a reliable guide. It can only delay the process through temporary setbacks of varying severity.

The questions then are: For how long will regionalism delay globalisation? And at what cost to global welfare? If one accepts that regionalism is here to stay, then the most useful question to answer is: What needs to be done to make it as friendly to the process of global market development as possible? And what should be done to make RIAs contribute to, rather than detract from, global welfare?

Trade Blocs

Clearly the propensity of regional trade blocs to become protectionist in the face of competitive pressures which create domestic political ructions is damaging to global welfare. The various studies which have been done on this subject suggest that the increasing of trade barriers by either the European Union or NAFTA would have large negative effects on global GDP, on most individual countries, and on all regions, including the region which increased protection. Such losses would increase if either bloc retaliated.

For example, in one study, assuming a world comprising the three major trade blocs, it was estimated that if EC-92 was accompanied by an increase in external trade barriers, world GDP (measured in 1988 dollars) would decline by US$108 billion (US$52 billion in the European Union, US$40 billion in

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

NAFTA, and US$16 billion in Asia).[27] By the same token, more recent estimates suggest that the creation of a North Atlantic free trade area would increase global GDP by about $250 billion (1994 dollars) and generate almost a million new jobs in the European Union and NAFTA.

One study (Krugman: 1990) explored the implications of trade bloc protectionism in somewhat simplistic terms employing a model of one-product monopolistic competition among a large number of identical countries with each country producing one variety of the product and imposing the optimum tariff on imports from all other countries. Using this model to project different scenarios, the results showed that, as trade blocs emerged, starting from a large number of identical blocs, tariffs become positive and welfare declined. With increasing size of blocs the optimum tariff on extra-bloc trade kept rising, producing both trade-creating and diverting effects. The trade-creation effect dominated trade-diversion only after the number of trade blocs declined to three and was maximised when the world became a single bloc with the optimum tariff diminishing to zero.

Others, arguing that these assumptions precluded inter-industry trade and assumed unrealistic symmetry, have postulated alternative models – with countries differentiated by factor endowments, in which small numbers of trade blocs can maximise welfare.[28] The theoretical debate on this issue is not particularly illuminating (de Melo: 1993). The more critical issue is how trade blocs behave vis-à-vis one another once they have been formed. If a dynamic view is taken, it may still be worthwhile for new trade blocs to emerge which generate significant intra-bloc efficiencies, even if their trade-diverting effects diminish global welfare in the short run, provided that such blocs eventually lead to free global trade. That approach could be seen as taking one step backwards or sideways in order to go two steps forward.

RIAs, by their very nature, involve preferential treatment among members and therefore discrimination against countries outside the region. But for RIAs to avoid excessive damage to the long-term interests of global free trade such discrimination must be contained within acceptable bounds.

RIAs among developed countries have limited the damage done by welfare-diminishing discrimination mainly because the focus has been on reducing barriers to trade in manufactures on which most developed countries (in sharp contrast to developing ones) have always maintained generally low levels of intra- and extra-regional protection.

---

27 Stoeckel, A., Pearce and Banks, *Western Trade Blocs: Game, Set or Match for Asia-Pacific and the World Economy*, Centre for International Economics, Canberra, Australia, 1990.

28 (1) Deardorff, and R. Stern, *Multilateral Trade Negotiations and Preferential Trading Arrangements*, (mimeo), 1991; (2) Srinivasan, T.N., 'Discussion on Regionalism vs. Multilateralism by Krugman', In: de Melo, J. and A. Panagariya, *New Dimensions in Regional Integration*, (op. cit.), 1993.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

In some cases extra-regional barriers were reduced as RIAs were implemented. In others trade barriers were already low when these arrangements were agreed. Such outcomes have done little to damage global welfare. But even in such cases, large negative effects may still be felt by *non-regional* countries whose production and exports are concentrated in products and industries where discrimination applied by large global trading blocs such as the European Union and NAFTA – because of the proportion of world trade which they account for – have been increased or remain high. For example, in the European Union products discriminated against are in agriculture, coal, steel, shipbuilding, textiles and apparel. These products have enjoyed excessively high protection for several decades. The European Union has raised average effective protection for these products above those which would have prevailed in several member countries in the absence of the common market.[29]

RIAs (like those of the European Union in the automobile and electronics industries) which force defensive foreign direct investment by firms from non-member countries also damage global welfare. Defensive foreign investment is FDI which is diverted to a particular region by foreign firms anxious to establish production capacity within that region and avert the risk of losing market share should that region increase its trade barriers later. It represents a diminution of global welfare if it reflects a pattern of foreign investment which is different from what would occur in the absence of regional trade barriers and guided by undistorted market signals.

GATT Rules

RIAs, by definition, go against the *raison d'être* of GATT, which is founded on the principle of non-discrimination in trade across all of its signatories (Article 1). Yet GATT permits RIAs under Article 24 as long as: (a) other GATT members are notified of their details; (b) they do not raise trade barriers against other GATT members; (c) such arrangements embrace substantially all trade between the regional members; and (d) RIA partners

29 The absurdity of the EU's Common Agricultural Policy (CAP) has been a glaring example of regional and global welfare reducing protectionism for a long time. The CAP has introduced substantial discrimination against non-regional producers (mainly Eastern European and developing countries) in virtually the entire range of agricultural tradeables. CAP sets intra-EU prices so far above world prices that it encourages over-production and structural oversupply with very heavy (and costly) stockpiling and even more heavily subsidised dumping in export markets which depresses world prices even further and drives efficient farmers in other parts of the world out of business. CAP involves an egregious expense for foreign producers as well as to EU consumers. It also results in major losses of production efficiency within the EU because of the amount of resources it compels to be misallocated.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

are committed to reducing barriers to intra-regional trade along a specified schedule within a reasonable time span.

Article 24 was included in GATT mainly because those who framed the Agreement felt that RIAs could provide a complementary, practical and possibly, in some areas, faster route to global trade liberalisation. But the clauses in Article 24 were inserted to minimise the adverse effects of RIA-induced trade diversion on members of such arrangements as well as on non-members. There was also concern that the number of RIAs within the GATT system should be limited to those where the intensity of the political commitment to RIAs was commensurate with the liberalisation and structural adjustment effort required for such arrangements to succeed (Bhagwati: 1993).[30]

GATT's main concern was that the world trading system should not again fragment into the myriad discriminatory or sectoral, bilateral, and plurilateral arrangements that characterised the 1930s. It also recognised that, if RIAs led to regional blocs assuming nation-state characteristics as far as their trading and other economic arrangements were concerned, they might actually facilitate rather than debilitate eventual global integration by reducing the complexity involved in global negotiations. It would not be unreasonable to argue that global integration might actually be easier to achieve through negotiations among a few large players (e.g. regional blocs which were fully internally integrated) than through negotiations involving 200 individual players of vastly differing weight, size and capacity. Moreover, trade liberalisation via RIAs could be a useful first step towards global liberalisation under future WTO negotiations.

RIA negotiations are less affected than GATT rounds by *free riders* (i.e. members who benefit from most-favoured nation (MFN) treatment while escaping the reciprocal obligations that MFN requires), *foot dragging* (when advantage is taken of rules requiring consensus to block movement) and the *convoy effect* (moving at the pace of the slowest).

In 1979, an enabling clause was inserted into GATT which weakened Article 24 by allowing RIAs involving only developing countries to ignore Article 24 altogether unless they involved the selective lowering of non-tariff barriers, in which event approval was required by all GATT members. Though the intent and spirit (if not the letter) of Article 24 have been violated extensively by several RIAs, not least by the European Union, it would be difficult to make the case that such side-stepping of its provisions has impeded movement towards gradual globalisation of freer trade – as the

30 Bhagwati, J., 'Regionalism and Multilateralism: An Overview', In: de Melo, J. and A. Panagariya, *New Dimensions in Regional Integration*, (op. cit.), 1993.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

completion of the Uruguay Round would suggest is happening. Despite the proliferation of RIAs, most of them (especially EU and NAFTA) maintain relatively low external trade barriers except in the egregious cases of certain protected industries and sectors mentioned earlier (especially agriculture).

Also, the unilateral trade liberalisation undertaken by countries which are members of RIAs has helped to mitigate the potentially negative effects of trade diversion. It is generally accepted that RIAs are not responsible for the various non-tariff barriers that have crept in since 1980 such as voluntary export restraints, countervailing duties, anti-dumping measures, orderly marketing arrangements and legislation like Super 301 in the United States. Such measures reflect the resistance of most developed economies to undertaking the necessary structural adjustments required by changes in dynamic comparative advantage.

Theoretical Objections and Practical Benefits

For RIAs to contribute to the globalisation of free trade, the multilateral system must be receptive to commensurate change in order to be able to subsume effectively and gradually the liberalisation occurring under regional integration arrangements. As de la Torre and Kelly argue:

> 'The multilateralisation of liberalisation gains under regional arrangements presupposes, of course, that a credible and well-functioning multilateral system is in place. Thus, steady progress with multilateral liberalisation is essential to: subsume preferential trading arrangements into a broader and more open trading system; to hold in check – and indeed to erode – the inherent discrimination of such arrangements; to convert their regionally circumscribed liberalisation into building blocks for freer trade on a global basis; and to prevent regionalism from fragmenting the world trade system.' (de la Torre and Kelly, *op. cit.*, p. 44)

Whether RIAs are consistent with, or antithetical to, the strengthening of the multilateral system is, in the final analysis, more a matter of judgement than of fact. Assessing whether RIAs (either particular ones or in general) will help or hinder the cause of globalisation is more a matter of *ex-post* empirical than of *ex-ante* theoretical analysis. Global trade authorities who are also confirmed multilateralists, like Bhagwati and Schott,[31] remain sceptical about the revival of regionalism while acknowledging its popular and political appeal. Others take the opposite view in being somewhat overenthusiastic

---

31 Schott, J., 'More Free Trade Areas?', In: Schott, J. (ed), *Free Trade Areas and U.S. Policy*, Institute for International Economics, Washington DC, 1989.

about the benefits of regionalism versus the intractability of achieving much at the global level.

Taking the view that RIAs would be less harmful if they were more open to new (and non-regional) members – because they might then realise the potential of being building rather than stumbling blocks towards globalisation – the sceptics see the following issues as limiting the extent to which RIAs can aid the cause of global trade liberalisation:

- When negotiations for RIAs and multilateral trade rounds occur simultaneously, as in the Uruguay Round, RIA negotiations divert more capable and scarce human resources and skills available in participant governments away from the GATT negotiations. Such diversion occurred even in cases where members were more committed to the cause of multilateralism but felt the need to take a defensive posture in the face of moves towards RIAs by major trading partners.
- The cumulative trade-diverting effects of RIAs across several different regions increase the risk of trade frictions and political pressures for retaliation, thus risking damaging chain reactions and setting back the cause of global free trade.
- Proliferation of RIAs would trigger a number of technical problems such as mismatching in the phasing of tariff reductions under different overlapping agreements, inconsistent rulings under different dispute settlement mechanisms, and confusion in interpreting and enforcing different rules of origin.
- Smaller countries would be hurt more by RIAs than by globalisation of trade liberalisation, particularly if they were undertaking structural adjustment programmes at the same time.

The interested observer might be forgiven for concluding that some of these reservations, manufactured in the heat of debate, when it appeared that the Uruguay Round was in mortal danger, seem to be more contrived than real. The Uruguay Round has now been satisfactorily concluded, despite a few loose ends. It has succeeded in striking a crude bargain between developed and developing countries, with the former conceding the need for further liberalisation in agriculture and textiles and the latter agreeing to consider opening their markets in areas not formerly covered by GATT, i.e. services, investment and intellectual property. Now that the distemper of negotiation has faded, some of the more imaginative arguments against RIAs have moderated with an acknowledgement that regionalism is here to stay and that it may, on balance, be a beneficial development.

It is now more widely accepted that RIAs may bring collateral benefits to trade liberalisation, especially by: (i) cementing economic cooperation in non-trade areas such as sectoral investment coordination, macroeconomic policy coordination, financial sector integration and in achieving efficiencies

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

in externalities; and (ii) bringing about closer political cooperation and perhaps even providing a framework (*à la* ASEAN) for the more effective settlement of disputes on a regional neighbourhood watch basis than the multilateral security system presently provides.

In the last aspect, of course, the UN security apparatus needs to develop much more effective linkages with regional political organisations (such as Organisation of African Unity and Organisation of American States) than it has done so far with the world community devolving more responsibility to these regional organisations for resolving conflict and maintaining stability in their regions.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

8 Synopsis and Conclusions

The Road Ahead for Developing Countries

The preceding sections made the case that developing countries may have much to gain from various forms of regional cooperation and from launching determined efforts to integrate their regional markets despite the difficulties that confront them. There are in fact few developing regions in which a case might be made that welfare gains would *not* emanate from greater integration.

But it has to be acknowledged that, without in-built compensatory mechanisms designed to distribute regional welfare gains equitably across all members, the pattern of their accrual, left to market forces alone, would benefit the more developed countries in each region, especially in the short and medium term. This pattern would be reinforced, at least until such time as major regional investments in infrastructure and production bore fruit, and the less developed countries within a region began to benefit from cross-border investments and enhanced intra-regional trade.

Economic development is likely to be enhanced through capturing the benefits of increased regional welfare in the next few decades in most developing regions. Such benefits are likely to accrue primarily from three sources:

1. *Infrastructural investment coordination*: Developing countries will gain from substantial cost savings by coordinating investments in physical infrastructure on a regional basis. Such investments have so far been unnecessarily expensive in most developing regions, due to the desire of each developing country to be self-sufficient and independent of its neighbours for strategic reasons. The absence of regional accord and harmony between neighbouring states in several poorer developing regions (South Asia and Africa) has particularly inhibited rational use of scarce regional energy and water resources, making them more vulnerable to weather for their agriculture, and to costly oil imports for their energy needs than is either desirable or necessary.
2. *Cooperation in regions afflicted previously by conflict*: Substantial benefits wait to be realised from trade creation, expansion and intensified cross-border investment between contiguous countries which have previously been in conflict, in a new era of normalised relations. This would be particularly true in the Middle East, South Asia, Indo-China, Central Asia and Southern Africa. RIAs in these areas will enable frictional losses from

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

substantial illicit trade, and the inhibitions to more open trade, to be dispensed with. Clearly the trade deficits that less developed countries in a region are likely to incur vis-à-vis more industrialised neighbours in any given region will need to be offset by capital inflows and remittances in the opposite direction over the medium term.

3. *The 'externalities' or unorthodox gains* from regionalisation which occur when the major non-tariff barriers to enhanced regional intercourse are removed are likely to be even more important than the orthodox net trade creation gains. These types of gains are numerous and varied, as previous sections have brought out.

It may be therefore that developing countries need to approach RIAs on two parallel but connected tracks without holding progress on either hostage to the other. These involve:

A. *Sectoral investment coordination* and cooperation on major investments and policy harmonisation in key sectors and industries on a regional scale, coupled with closer integration of financial sectors and markets. RIAs in these areas in most developing regions can proceed almost immediately. They are not contingent upon, nor should they be delayed by, progress on a more intensive agenda of trade liberalisation and integration. Coordination in each sector should be encouraged to proceed as fast as circumstances permit without being affected by the pace of progress in other sectors. This will necessarily mean accepting the concept of *multi-speed* coordination across different sectors. Given different levels of development among member countries, coordination should not be held hostage to universal consensus being reached by every country in the region on each action. Where coordination can be achieved among a sufficient number of countries in a particular sector, such coordination should be arranged to occur at the most rapid possible pace providing, of course, that such progress does not compromise the interests of other countries in the region.

B. *Trade liberalisation and market integration* constitute a related but separate track on which progress can be made with a clear agenda being established for the reduction of tariffs and non-tariff barriers. Such reductions can be programmed on schedules which are realistic in the context of evolving political and economic developments in particular developing regions. The market integration agenda, though related to the investment coordination agenda may, in substance, be a distinct one. Progress with the reduction of tariff barriers can and should be made as rapidly as possible, especially as their consequences are not as significant as is often portrayed. Apart from reducing tariffs, the market integration agenda involves an array of issues in eliminating non-tariff barriers and in achieving

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

greater convergence and stability among members in their fiscal and monetary policies and performance, their inflation targets and their exchange rate and currency convertibility regimes.

These issues are complex and go to the heart of national economic policy-making. They involve questions about subordinating sovereign national interests in the short term to achieve regional benefits in the long run which should make all national members better off. Given the macroeconomic divergence which still characterises developing economies in most regions at present, and their relative states of political flux, movement on a market integration agenda will necessarily be slower than the pace at which coordination can be achieved in particular regional investments and the harmonisation of operations in particular sectors.

The Political Dimension

Although a strong case could be made for further economic integration in most developing regions, it would be sanguine to suggest that the acceptance of such evaluations would rest solely on perceptions of the *economic* costs and benefits to be derived either by the region as a whole or by its individual members. In the final analysis it is *political will* and commitment that determine whether regional integration is embarked upon with serious intent and whether it succeeds or fails.

That fundamental factor has determined the fate of previous attempts at integration in various parts of the developing world. Matters are not likely to be different now, despite the new climate in favour of regionalism as a necessary intermediate step towards globalism. Mustering political will for integration in the individual countries of several regions will depend on how accurate perceptions are about the costs and benefits of integration in each country, not just in economic but in political terms. And the perceptions which count in democratic societies are those held by the public at large rather than those of a technocratic elite.

RIAs must bring prospects not only of prosperity but also of durable peace, security and stability. At a time of intense political flux in most developing (and indeed some developed) regions, the national political will to achieve closer integration is difficult to muster. Unless individual member governments and political leaderships can be convinced unambiguously that the process of closer regional integration will help them deal with their domestic economic, political and social problems better than they otherwise could, they are likely to be preoccupied more with managing, in a purely national setting, the simultaneous transitions which are now overstretching their limited capacities than with regional issues.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

For regional integration to succeed it must have a large political constituency among political leaders, technocrats, opinion-makers and the public at large. It must convince the populace at large that *regionalism* can be an effective route to the solution of *national* problems. But, unfortunately, in those developed and developing countries which are pivotal to the success of RIAs in their respective regions, the present political thrust is to turn inward and deal with the issues of national rather than regional integration.

In other countries leaderships have not yet fully appreciated that their prospects for mutually advantageous interaction with neighbouring countries may be improved through the negotiation of appropriate *regional* arrangements rather than through *bilateral* arrangements. That, for them, may prove to be the strongest political argument. United within the region, smaller countries can stand and deal with much larger neighbours on mutually acceptable terms; divided, they are more likely to fall and be compelled to deal with the dominant economies of the region on the latter's terms.

The danger that must be avoided in the search for closer integration is a situation where countries in a particular region express far-reaching commitments which do not reflect their national priorities.[32] Even though some of the requirements that have to be satisfied for RIAs to play a developmentally supportive role are well recognised, and are reflected in specific provisions of RIAs among developing countries, this has not had much effect on policies because of the lack of priority accorded to regional integration in national development strategies.

Given the obvious potential that exists for mutually beneficial cooperation among countries in many developing regions, where should they go from here? What are the implications for a strategy on the part of developing countries and for the role of donors and funders? What steps seem to be indicated, and in what sequence? What can be done in the short run? What mechanisms need to be put in place to provide the best assurances that once the preconditions for integration have been given and a favourable framework for cooperation has been created, these will subsequently be maintained?

The Role of Donors

The role of donors and other external funders in supporting regional integration for its own sake, or as a means of facilitating structural adjustment,

---

32 For example, commitments have been made by various African countries, as members of the OAU, with respect to RIAs in acceding to the 1991 Abuja Treaty establishing the African Economic Community which contains an article establishing a Solidarity Development and Compensation Fund. But even in the many sub-regional arrangements which exist in Africa, implementation lags woefully, not only in relation to tariff preferences but also in relation to the many potentially valuable administrative cooperation measures that have already been agreed.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

must be predicated upon a realistic appraisal of objectives and instruments in a given region. The European Union in particular could play a more broadly based part, as suggested by the Lomé IV Convention and the post-Maastricht initiative, especially in the light of the problems of information and negotiation which developing countries face in negotiating RIAs amongst themselves.

A separate but related issue is whether an RIA-based framework might provide a more appealing and workable set of organising principles for the development assistance paradigm, changing it from government-to-government capital aid to various forms of aid-supported, capital and investment flows between industries and firms within the private sector. At the same time greater responsibility might be allocated to private voluntary, non-governmental organisations for the delivery and management of humanitarian assistance, emergency relief, and people-to-people assistance aimed at poverty alleviation and meeting basic human needs.

Such a paradigm shift would provide one possible option for replacing the present official aid machinery (bilateral and multilateral) which has evolved over the years into becoming somewhat sterile and sclerotic. It might also encourage more genuinely democratic, participatory involvement in development at the recipient end, thereby diminishing developing-country government domination of that process in a manner which disenfranchises and disempowers the intended beneficiaries.

Whether such a paradigm shift should replace entirely the existing structure of the global aid industry, which has become a powerful vested interest in its own right, or whether it should emerge as a competitive complement to regalvanise that government-driven structure is an interesting but somewhat different matter that must be left open for further consideration.

Learning from Experience

RIAs among developing countries which bring them closer in regions across the world should clearly draw on their own previous experience as well as lessons learnt from elsewhere. This would mean adopting approaches which are:

(a) aimed at alleviating the binding constraints first;
(b) incremental rather than comprehensive in terms of the chosen instruments;
(c) open-ended rather than exclusive in terms of membership, focusing initially on a core group of contiguous countries among which significant transactions already occur, whether officially or in parallel markets;

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

(d) limited in initial operation to particular classes of enterprise or zones, though relying on automatism rather than administrative discretion for the operation of any incentives and preferences; and
(e) above all, flexible in accepting the need for variable geometry.

Such an approach would suggest that although a time frame and appropriate sequencing are important for the success of RIAs, specific proposals for both would be out of place until the scope for cooperation in various sectors and in all factor markets had been tested. There are obvious merits in proceeding on several fronts simultaneously through packages of measures from which all countries can expect to benefit. But if RIAs are confined to cooperating in particular sectors or coordinating certain policies, it will be less easy for developing countries to achieve wider, more comprehensive resource allocation efficiencies – and yet respect the imperatives of equity among members – without some type of regional policy being included in the arrangements agreed.

Distribution of Costs and Benefits

The main issue which has influenced national perspectives on the merits of RIAs is, of course, the distribution of the costs and benefits of regional cooperation. There are two ways of dealing with the trade-off between equity and efficiency. The first is through fiscal compensation. Sole reliance on compensation is unlikely to be attractive to less advanced countries unless it is so generous that it is also unattractive to the more advanced countries who will be the net contributors. The alternative is to adopt measures that are calculated to ensure that moves towards integration are irreversible. Such measures may also be expected to minimise the risk of polarisation without sacrificing the production gains from regional integration.

If approaches along these lines are insufficient, then some form of *regional investment policy* may be necessary. Such a policy would be designed to influence the allocation of investment through incentives. However, a strong interventionist thrust towards planning resource allocation and infrastructural investment on a regional basis (as was the case with many first-round RIA attempts in the developing world) would be anachronistic and inconsistent with the current ethos of structural adjustment.

Such an orientation would, in any event, be opposed by external funders and donors whose support is crucial. It would go against the grain of increasing private participation in investment, which individual governments could encourage on a *regional* basis by clearing the obstacles they have placed in the way of such investment, rather than attempting to undertake it themselves. Of course, significant public sector involvement will be necessary

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

in implementing RIAs in the developing world, but outside of a strictly limited public sector, the role and design of second-generation RIAs must be such as to create a regional policy environment which enables markets to be progressively integrated over time.

It must be recognised that RIAs by themselves are unlikely to make a significant contribution to the convergence of real incomes across economies in any of the world's developing regions in the foreseeable future. The economic dominance of some large countries, and therefore some degree of polarisation, is likely to continue whether or not there is greater movement towards regional integration. However, it would be self-defeating for developing countries to protect themselves by taking unilateral measures that discriminate against their more advanced neighbours. If they are to moderate the effects of existing dominance, it can only be through the development of RIAs that enhance their own economic attractiveness, and at the same time promote infrastructure investment coordination so as to level the playing field for private investment across the region.

Regional Adjustment Programmes

An indispensable impetus to the process of strengthening sub-regional cooperation might be given by funders through the initiation of a multi-faceted regional reform programme. Unlike the World Bank's Regional Adjustment Programme for UDEAC in Central Africa, however, any such programme for other developing regions should not be confined to measures which would only make country-specific structural adjustment programmes more effective. Regional adjustment programmes should instead be aimed specifically at encouraging integration initiatives by supporting harmonised reforms needing multilateral negotiation.

Priorities of properly designed regional adjustment programmes would need to include: (a) currency convertibility, (b) fiscal reform, (c) lowering of barriers to entry, (d) trade liberalisation, and (e) arrangements to promote credibility.

(a) *Convertibility*: The lack of current-account convertibility is a dominant obstacle to exploiting such feasible trade opportunities as there are, just as capital convertibility is the dominant obstacle for cross-border investment. The policy measures already taken by most developing countries in reforming their fiscal and monetary regimes will need to be continued, but their regional dimension and their possible regional repercussions will need to be addressed.

(b) *Fiscal Reform*: In most developing regions, the next stages of fiscal reform must focus on more buoyant and broadly based sources of revenue and indirect taxation. In particular, fiscal reform should be a precondition for:

fiscal and monetary stabilisation; the introduction of regional tariff preferences which might otherwise have adverse revenue implications; moving towards lower tariffs; more efficient and transparent methods of raising revenues in ways which do not raise prices to consumers. In unifying markets and reducing transactions costs, harmonisation of tax structures would have an important role to play so that, for a foreign investor, familiarity with the tax system of one country would imply a familiarity with those of the rest. A simplification of tax structures, particularly for any taxes that are involved in border tax adjustments, would be equally important. Tax obstacles to regional operation of enterprises posed by different national regimes for corporate taxation need to be reduced. Some of these reforms would be required under country-specific structural adjustment programmes anyway. If integration is to be encouraged, the regional implications of such reforms should be taken into account, either on an ad hoc basis, or preferably in conjunction with a supplementary regional adjustment programme.

(c) *Entry Barriers*: A third priority is to overcome entry barriers. In some areas, the costs of doing so would be largely administrative, though perhaps considerable. Action on these lines would help to create a framework for capturing many of the unorthodox benefits of RIAs which promise to be of greater significance than any immediate trade expansion gains. Once such a framework was in place, the stage would be set for a unified customs union within which trade could be freed, not only from non-tariff barriers, but also from tariffs. Such a union could be underpinned by expanded foreign direct investment, partly from within the particular region.

(d) *Trade Liberalisation*: For a variety of reasons, many developing countries (especially the least developed) have not been directly involved in the process of reciprocal negotiations through which world trade has gradually been liberalised over past decades. Instead, these countries through UNCTAD and the European Union have sought and obtained non-reciprocal trade concessions from developed countries *en bloc* (e.g. under the ACP arrangements of the European Union). Non-reciprocity has left some of the least developed country governments free to impose trade restrictions at will. The resulting climate of protectionism and uncertainty has been highly damaging to the development of enterprise, regional trade and foreign investment. Of course, in the 1980s trade liberalisation became a prominent objective of donors and multilateral funders, and was encouraged by adjustment conditionality, but liberalisation of trade policy encounters the same problem of credibility as monetary and payments reform. There is a perceived risk in the eyes of investors that it may not be sustained, regardless of rhetorical assurances.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

For trade liberalisation and market integration to be fully credible in developing regions, member states would have to be prepared to accept regional arrangements from which they would have much to lose if they should resort to a reimposition of national barriers to market integration.

(e) *Credibility*: In the early phases of implementing RIAs, it is imperative that confidence is established in the binding nature of the integration initiatives and the general policy reforms bearing on them. For example, once regional currency convertibility has been established, ensuring its durability becomes crucial. Since few, if any, individual developing country groupings constitute optimal currency areas, a fixed peg to an external anchor currency would seem to be the best option. An external anchor can provide the needed external support by donors for maintaining parity while at the same time imposing the necessary monetary discipline.[33] In some regions, the level of development of most member countries might rule out the need for external support. But in any case, the need to devise suitable mechanisms for preventing a dominant country from inadvertently pushing its own currency as the regional reserve currency or from pushing other countries' exchange rates in a direction they did not wish to follow would have to be addressed.

External Linkages

It is arguable whether new kinds of external links may need to be negotiated if intra-regional trade and investment in developing regions and, ultimately, outward-looking policies on the part of developing regions as a whole, and not just their individual members, are to be significantly promoted. The completion of the European Union's own internal market, its movement towards a monetary union, and the eventual renegotiation of the Lomé Convention, all provide an opportunity for fresh thinking about an appropriate external context for RIAs in the developing world.

A revised form of association with the European Union, with some reciprocal elements, could have several beneficial effects for countries in Eastern Europe, the Middle East, Africa, the Caribbean, the Indian Ocean,

33 In Africa, for instance, the recognition of these factors has led several countries outside the franc-zone monetary unions (Ghana, Equatorial Guinea, Guinea-Bissau and Gambia) to signify their willingness to abandon monetary sovereignty by accepting the monetary and fiscal constraints implied by the acceptance of franc-zone membership in return for its benefits. The acceptance of such obligations has had a significantly favourable effect on the member states of the franc-zone currency union's macro-stability. If the franc-zone monetary union arrangements survive their post-devaluation difficulties, their members will, in effect, become associate members of the European Monetary Union.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

and the Pacific and even South Asia (especially Bangladesh, Nepal and Sri Lanka). Such an association could contribute to binding trade liberalisation by increasing the disincentives to reimposing trade restrictions. It could thus encourage both intra-regional trade and intra-regional cross-border investment in these different parts of the world.

It could also contribute in the long run to improved performance in European markets by encouraging the creation of capacity. In the case of the Caribbean, which has ACP entry into the European Union, associated arrangements are also being sought with NAFTA, although it is questionable whether a Caribbean Economic Community could actually have preferential arrangements with both trade blocs. The idea is an intriguing one. It would, of course, be automatically resolved if the super-NAFTA now being mooted actually came into being.

Many strongly held views and prejudices would, however, have to be discarded before any such approach could enter the realm of practical politics in several developing countries. Fears of the loss of economic sovereignty (i.e. the spectre of recolonisation which would undoubtedly be raised by populist politicians) need to be allayed.

That this path need not be excluded, *a priori*, from consideration is suggested by events now taking place in several regions of the developing world. For instance, in marked contrast to their previous positions, most Latin American countries are now seeking to forge new and closer links with NAFTA, partly with some of the motives outlined here in mind, while the Caribbean islands are looking at the utility of external cooperation links in relation to monetary affairs.

A Pragmatic Approach to Strengthening RIAs in Developing Countries

In order to succeed, second-generation RIAs in the developing world will have to adopt a selective, pragmatic, step-by-step approach towards achieving progressively greater integration. Such an approach would need to focus initially on agreeing RIAs within those countries that constitute the most cohesive groupings and where successes can be quickly achieved.

It is clear that continuing adjustment problems in many developing regions, and large reconstruction needs in others, will make it difficult or impossible for all regions, or even all countries within a particular region, to integrate at a uniform pace, except the pace of the slowest. At best, integration at several speeds and with a variety of focuses may be the only practical path to follow for developing countries negotiating RIAs. Even so, the process of negotiation and agreement-making could be a long one.

Are there more immediate alternatives that might be pursued meanwhile? Several actions which might promptly be taken in advance of wider integration

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

initiatives in different regions are worth exploring in order to give some impetus to the process.

1. If current payments obstacles can be overcome by building on bilateral trade agreements already in place, these may help to encourage further trade expansion and rationalisation. However, unless this could be done within a harmonised framework of preferences, it might create in-built distortions. Without investment guarantees, this approach is unlikely to generate the cross-border and other investment needed to generate significant benefits from regional cooperation. Effective investment guarantees would require more than merely inter-governmental accord on regional objectives. New forms of independent guarantee institutions, properly funded by interested states, and perhaps underpinned by external aid, may be an indispensable precondition for significant progress. As a start, all developing countries should at least join the Multilateral Investment Guarantee Agency (MIGA), a World Bank affiliate, as an indication of their commitment to fostering and protecting foreign direct investment.
2. In order to anchor firmly efforts of full convertibility, intra-regional trade in developing countries might be encouraged by ensuring that existing exchange controls do not discriminate against such trade. Such a policy could go even further than this by encouraging discrimination *in favour* of it. The modus operandi for such an operation might be to extend existing systems of open, general import licenses to cover all intra-regional trade (but administrative and financial difficulties might rule this out). The abolition of licensing in respect of transactions passed through clearing houses created to facilitate intra-regional settlement should be agreed at a minimum.
3. Attention could be given to extending cooperation and improving the efficiency of public sector operations in the development and maintenance of infrastructure which are critical for regional economic integration and development. Such areas include interstate roads, railways, ports, airlines and airports, telecommunications, water supplies and energy. The establishment of regional operating authorities in these sectors, jointly owned by all regional members, has evident attractions in the longer term.
4. Consideration should be given to reorienting the roles of existing regional and sub-regional development banks specifically to promote RIAs in the regions they serve. The Inter-American Development Bank is playing a useful and effective role in this regard, while the African Development Bank is somewhat less effective in the many efforts it too is making to further the interests of integration in the various sub-regions of Africa. The Asian Development Bank has played a relatively small role in this

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

regard, while the newly established European Bank has focused on the issue with some enthusiasm. Sub-regional banks (e.g. in Africa and the Caribbean) have focused more heavily on aspects of regional integration than their larger regional counterparts. Given the characteristics of their memberships, regional banks now need to model themselves and their activities much more on the lines of the European Investment Bank and much less on those of the World Bank. If regional integration is to become one of their main concerns the regional banks need to become strong focal points for the promotion of RIAs with a large proportion of their funds being specifically earmarked for financing regional adjustment programmes, large joint regional projects in cooperation with the domestic and foreign private sector (regional banks operating in this way could be very effective magnets for attracting foreign investment flows), developing regional financial and capital markets, and alleviating the constraints on trade financing and cross-border private investment financing.

5. Other partial approaches to RIAs – e.g. through the establishment of joint special free trade and economic zones (such as the growth triangle venture among Indonesia, Malaysia, and Singapore)[34] – could be attempted although overall experience with such initiatives has been mixed. Regional wage rate differences play an influential role in determining the momentum behind, and success of, such initiatives. It will be important to take advantage of wage rate differences in developing regions, either by promoting arrangements for facilitating additional cross-border labour flows or by facilitating cross-border investment.

Strategies for achieving progressively closer regional economic integration in the developing world thus need to be based on three simultaneous prongs: (a) sectoral cooperation, (b) market integration, and (c) an appropriate institutional framework. In the short term, priority must be given to working on areas which promise immediate pay-offs in any particular region. Over the medium term, more progress can be made in other sectors of activity and on gradual macroeconomic convergence which progressively relieves constraints on the free regional movement of commodities, manufactured goods, services,

34 The success of the growth triangle in the Malacca Straits, which involves transnational corporations-based production integration, does not rely on trade preferences. Acute labour shortages in Singapore have been a major factor in stimulating these links; to that extent their significance in other developing regions may be limited. Interestingly enough, a similar situation has arisen in the Indian Ocean with the spectacular economic success of Mauritius resulting in overemployment and triangular relationships developing with other Indian Ocean islands as far afield as Sri Lanka. Another example which is similar, though not based in designated zones as such, is the success of the maquiladora enterprises located just south of the US border in Mexico.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

people, capital and technology. In these other areas a strategy for RIAs in any given developing region will still require certain foundation-building measures to be taken now, even though results can realistically be expected to materialise only over a much longer period of time.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Annex I Economic Coordination, Harmonisation and Integration - Definitions

A non-trivial issue concerns the definition of what is meant by the generally used terms regional cooperation, coordination, harmonisation and integration. This concern about semantics goes beyond simple pedantry. It is essential to be clear about these definitions as they involve different objectives, processes, decision-making arrangements, and institutional structures. In attempting – but not always succeeding – to adopt consistent terminology throughout, this study adopts the following definitions in ascending order:

- COORDINATION constitutes the lowest level of economic integration. It suggests a voluntary alignment of specific national (project) investments whether public or private in various sectors of activity. It may even involve an alignment of policies at the *meso* or *sectoral* level in such key areas as power, transport, communications, water resource management and so on. It is the level at which several regional integration arrangements (RIAs) in the developing world actually function.
- HARMONISATION is the next higher level of integration. It usually involves the adoption of common legislation, on a national basis, governing the way in which countries utilise particular policies or instruments – i.e. tariffs, non-tariff barriers, fiscal incentives and subsidies, investment and other capital allowances, direct and indirect taxes, standardisation of specifications for products or qualifications, monetary management, etc. Although these may be *regionally* agreed they are *nationally* controlled and applied. Preferential Trade Agreements and Free Trade Areas usually require some harmonisation of domestic legislation governing the trade and exchange regimes of member countries.
- INTEGRATION, strictly speaking, usually means the assignment of responsibility for formulating regional policies, developing rules and regulations, and for applying these policies to all markets at a regional level, superseding national control. It requires members of an RIA to cede sovereignty over particular economic functions and activities as well as policies and instruments to an authority or institution which exercises its power at the regional level. Integration thus means formulating and applying regional trade, exchange, labour market, fiscal and monetary policies at the regional level. Integration also implies the development of a common currency and a single central bank or monetary authority which regulates the monetary – and indirectly the fiscal – parameters within which national governments function. It implies the free movement of all

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

investment coordination in priority sectors through one institutional framework, while simultaneously trying to achieve trade liberalisation and eventual market integration through another.

In these instances the coordination option is not a prelude to the normal trade liberalisation route to integration but an adjunct. A variant of the coordination route involves greater political *cooperation* between members at an earlier stage. This is necessary in order to overcome impediments to integration on the assumption that a market-based, trade liberalisation approach may yield limited immediate results given the circumstances in which developing countries usually find themselves.

Such a variant stresses the need for achieving *equity* and *balance* in relations under regional trading and investment arrangements which otherwise are likely to result in the net welfare and efficiency gains accruing from RIAs being captured unequally by different members (this was a problem which exercised Indonesia in ASEAN).

Yet another variant of this approach might be called *enhanced* coordination. In addition to sectoral investment coordination and political cooperation on a wide range of matters, such an approach incorporates the need for compensatory policies, as well as targeted regional investment and development policies, to accompany coordination and/or trade liberalisation measures so as to accommodate the needs of the lesser developed members of the region. It envisions the need for market integration to be accompanied by coordinated regional industrial development, regionally-decided allocation of investment resources, and harmonisation of investment flows toward lesser developed members. This approach was attempted across Latin America, the Caribbean and in some sub-regional RIAs arrangements in Africa (e.g. in the East African Community).

Enhanced coordination is subject to the criticism that, rather than correcting the causes of market failure in exacerbating maldistribution, bureaucratic interventions fail to equalise welfare gains through *directed* regional investments. Such attempts have usually resulted in costly planning and implementation failures without achieving the distributional or development objectives intended. The alternative of *undirected* compensation, as occurs under some regional arrangements (e.g. SACU), has the advantage to recipients of being a general budgetary resource usable at the discretion of governments but with the disadvantage that, for precisely that reason, such revenue can be used to meet recurrent expenditures thus relaxing budget discipline and having little developmental impact.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Annex II The African Experience with Regional Integration Arrangements

The arrangements of African blocs that go beyond preferential trading are similar to those first practised in Europe for customs unions and free trade areas, but adapted to African conditions. Several such arrangements have been attempted in Africa during the colonial period and thereafter. Some have evolved, many have atrophied and others have been abandoned. The most notable examples include those in Southern Africa – i.e. PTA, SADC and SACU-MMA – which were preceded prior to independence by even closer arrangements such as the Federation of Rhodesia and Nyasaland.

Wide cooperation arrangements also existed during colonial days and post-independence in Central Africa (CAU and UCAS), West Africa (CEAO, UDEAC, WACU and OSRS), the Indian Ocean (IOC) and in North Africa (MPCC). Specific and limited cooperative arrangements have been attempted at the level of sectors and for specific commodities (coffee, cocoa, peanuts, tobacco, etc.).

It is obviously impossible to recount experience with all of these arrangements, but it is instructive to dwell briefly on two of the more interesting cases: those of the now defunct East African Community (EAC) and the Economic Community of francophone West African states (CEAO). The special interest of these experiences lies in the attempts to deal with the problem of regional equity.

The East African Community (EAC)

In East Africa, recourse was first made, in 1961/62, to fiscal compensation from a distributable pool of revenue, fed mainly by 40% of the revenue from income tax on companies' profits from manufacture and finance in the three East African countries. Its allocation resulted in a redistribution of revenue from Kenya to Uganda and Tanzania.

The pool was an attempt to compensate the latter two countries for the concentration of industry in Kenya and for their losses of revenue and real income sustained by purchases of Kenyan products within the customs union and common market. The device did not satisfy Tanzania and Uganda.

In 1964, a fresh attempt was made to deal with the problem of inequality in the operation of the common market by adopting administrative measures to eliminate trade imbalances between the three countries. The chosen means were the industrial allocation of new single-plant industries in favour of Tanzania and Uganda, adjustments in the output of existing multiplant firms, and quotas on exports from surplus countries. The provision of a system of

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

differential incentives to attract manufacturing industry to Tanzania and Uganda was also envisaged, but not simultaneously introduced. The industry-sharing agreements failed, and Tanzania resorted to large-scale import restrictions against Kenya.

The 1967 Treaty which established the East African Community represented a further attempt to devise a framework that would enable the benefits of economic integration to continue to be enjoyed by the three East African countries on an equitable basis.

First, there was to be a decentralisation of the headquarters of certain common services, including railways, harbours, posts and telegraphs, together with some operational decentralisation.

Second, an East African Development Bank was created to give priority to industrial development in the relatively less industrially developed partner states.

Third, so-called 'transfer taxes', which were in effect limited inter-common market tariffs, were permitted to be imposed by countries that were in deficit in their total inter-community trade in manufactures on imports from a country with which it had a trade deficit in manufactures. Fiscal compensation was simultaneously phased out.

The EAC was disbanded in 1977. Foreign policy differences played a significant part in its demise. Difficulties created by the co-existence of state planning in Tanzania and the market-oriented system of Kenya, coupled with problems created by the break-up of monetary union, were in any case proving to be extremely damaging, as was the failure to deal with the financial problems of the common services.

The Economic Community of West Africa (CEAO)

One of the few African integration blocs, apart from SACU, to have survived and to have substantially implemented its trade provisions is the CEAO, which was established in 1973. A significant amount of intra-bloc trade (around 10% of total trade) occurs under its auspices. Part of this is underpinned by preferential tariff arrangements on industrial products and complementary fiscal compensation. The preference operates through the substitution of the regional cooperation tax (TCR) for import duties. This is levied at a lower level than the corresponding import duties, at rates fixed on a product-by-product basis by the Council of Ministers.

Fiscal compensation is paid by the industrially more advanced members – principally Côte d'Ivoire and, to some extent, Senegal – to their less industrially advanced partners. The major part is paid automatically to national budgets through the Community Development Fund to offset two-thirds of the assessed net revenue losses of the partner countries arising from

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

the importation of industrial products subject to the TCR. The remainder is distributed on a discretionary basis among the member states to support national development projects of Community interest. A Solidarity Fund (FOSIDEC) also exists to contribute to the regional balance of the Community by loans, guarantees and participations. It is required to give priority to the least developed members.

CEAO has survived and has been modestly successful in operating a partial free trade area for industrial products, together with liberalised trade in unprocessed agricultural products. The absence of exchange problems because of the monetary union that embraces all but one of its members has been one important factor in its success.

Another major factor is that each state is given substantial discretion over the degree of industrial integration with its partners through the need for mutual prior agreement on TCR eligibility and rates. The corollary of this discretion is that the opportunities that the regional integration system affords for generating benefits is correspondingly modest.

Its weakness is reflected in the replication of identical industrial plants in several countries where fewer would often have sufficed. The need for lengthy and uncertain negotiations before TCR status can be accorded has discouraged investment inflows and cross-border investment.

RIAs and Outward Orientation in Africa

African RIAs have been portrayed by some international agencies as having a protectionist and inward-looking bias. This has undoubtedly been the case in some past arrangements, and partly explains their inability to generate net benefits, but such a bias is not inherent in RIAs. Even a tariff-averaging customs union may represent a move towards overall trade liberalisation. If the formation of a wider customs union or free trade area were to be accompanied by a general or selective reduction in external tariffs, this could guarantee a significant overall liberalisation within a framework of regional market widening.

The question often posed is whether, given the need for policy reforms within Africa in the context of structural adjustment, regional market integration should be a priority. This issue is raised on the grounds that any integration-induced intra-group trade expansion is likely to be insignificant anyway given present economic structures. Others, while supporting RIAs, have argued against a market-led strategy.

One influential view sees the role of regional market integration in Africa primarily as a support to structural adjustment. In that perspective, a transitional role is seen for reducing intra-African tariffs at a more rapid rate than external tariffs. This is expected to diminish the costs of adjustment by

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

forcing companies to compete first with firms that have comparable levels of efficiency or inefficiency, before they are exposed to the full force of world competition. Such regional competition could offer the prospect of a reduction in costs, through mergers and take-overs, significant enough to permit the survival of several African industries which increased global competition would otherwise eliminate.

On this, and other grounds, some multilateral donors have sought to identify justifications for supporting regional integration as a component of development strategy consistent with other general policy advice. The conclusion has nevertheless been that benefits are likely to be small, and that its costs in terms of diverting attention away from liberalisation and arriving at a regional consensus may be considerable. Regional market integration is perceived to be justified only as part of an overall liberalisation strategy.

As a general proposition, this emphasis on liberalisation is persuasive. But the often associated conclusion that the net benefits of regional integration, or the costs of non-integration among African countries, are likely to be small, is less convincing and does not necessarily follow. The reason is that such a conclusion would disregard many other benefits of RIAs that are of considerable potential, and perhaps greater significance, particularly in the African context.

Some of these benefits have only very recently been recognised in reappraisals of the gains from trade liberalisation and regionalism. These other benefits deserve to be given full weight by donors. Their importance needs to be appreciated above all by policymakers in southern Africa, on whose degree of commitment to integration its success will ultimately depend.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Annex III Membership of Selected Regional Integration Arrangements

Africa

CEAO (Communauté Economique de l'Afrique de l'Ouest)
Members: Benin, Burkina Faso, Côte d'Ivoire, Mali, Mauritania, Niger, Senegal

CEPGL (Communauté Economique des Pays des Grands Lacs)
Members: Burundi, Rwanda, Zaïre

ECOWAS (Economic Community of West African States)
Members: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo (integrates the members of the CEAO and MRU, and Cape Verde, Gambia, Ghana, Guinea-Bissau, Nigeria, Togo)

IOC (Indian Ocean Commission)
Members: Comoros, France, Madagascar, Mauritius, Seychelles

MRU (Mano River Union)
Members: Guinea, Liberia, Sierra Leone

PTA/COMESA (Preferential Trade Area for Eastern and Southern Africa/Common Market for Eastern and Southern Africa)
Members: Angola, Burundi, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe

SACU (Southern African Customs Union)
Members: Botswana, Lesotho, South Africa, Swaziland

SADC (Southern African Development Community)
Members: Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe

UDEAC (Union Douanière et Economique de l'Afrique Centrale)

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

Members: Cameroon, Central African Republic, Congo, Gabon, Chad, Equatorial Guinea

Asia

ANZCERTA (Australia-New Zealand Closer Economic Relations Trade Agreement)
Members: Australia, New Zealand

ASEAN (Association of South-East Asian Nations)
Members: Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand

SAARC (South Asian Association for Regional Cooperation)
Members: Bangladesh, Bhutan, India, Myanmar, Nepal, Pakistan, Sri Lanka

Europe

BENELUX (Belgium-Netherlands-Luxembourg Economic Union)
Members: Belgium, the Netherlands, Luxembourg

BFTA (Baltic Free Trade Area)
Members: Estonia, Latvia, Lithuania

CEFTA (Central European Free Trade Area)
Members: Czech Republic, Hungary, Poland, Slovakia

EFTA (European Free Trade Association)
Members: Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, Switzerland

EU (European Union)
Members: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, the United Kingdom

Middle East

ACM (Arab Common Market)
Members: Egypt, Iraq, Jordan, Libya, Mauritania, Syria, Yemen

ECO (Economic Cooperation Organisation)
Members: Islamic Republic of Iran, Pakistan, Turkey

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

GCC (Gulf Cooperation Council)
Members: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates

The Maghreb Union
Members: Algeria, Libya, Morocco, Tunisia

Western Hemisphere

Andean Group (Andean Pact)
Members: Bolivia, Colombia, Ecuador, Peru, Venezuela (Chile withdrew in 1976)

CACM (Central American Common Market)
Members: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua

CARICOM (Caribbean Community)
Members: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominicana, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago

LAFTA/LAIA (Latin American Free Trade Association/Latin American Integration Association)
Members: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela

MERCOSUR (Mercado Común del Sur)
Members: Argentina, Brazil, Chile, Paraguay, Uruguay

NAFTA (North American Free Trade Agreement)
Members: Canada, Mexico, the United States

Global

APEC (Asia Pacific Economic Cooperation)
Members: Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, the Philippines, Singapore, Thailand, Taiwan, the United States

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Bibliography

African Development Bank, *Economic Integration in Southern Africa* (Volumes I-III), AfDB, Abidjan, 1993.

Ariff, M., *The Role of Asean in the Uruguay Round: Opportunities and Constraints*, International Center for Economic Growth, (OP No 37), San Francisco, 1993.

Anderson, K. and R. Blackhurst (eds), *Regional Integration and the Global Trading System*, Harvester Wheatsheaf, New York, 1993.

Asia-Pacific Economic Cooperation, *Achieving the APEC Vision: Free and Open Trade in the Asia-Pacific*, 2nd Report of the Eminent Persons Group, APEC Secretariat, August 1994.

Bergsten, C.F. and M. Nolan (eds), *Pacific Dynamism and the International Economic System*, Institute for International Economics, Washington DC, 1993.

Bhagwati, J., 'Regionalism and Multilateralism: An Overview', In: de Melo, J. and A. Panagariya, *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge, UK, 1993.

Bakoup, F. et al., *Regional Integration in Eastern and Southern Africa: The Cross-Border Initiative and Its Fiscal Implications*, IMF African Department, Working Paper, Washington DC, February 1995.

Baldwin, R.E., *Towards an Integrated Europe*, Centre for Economic Policy Research, London 1994.

Belassa, B., *Regional Integration and Trade Liberalisation in Latin America*, World Bank, Economic Staff WP No. 120, Washington DC, October 1971.

Blumberg, L., *Trade Relations with Southern Africa*, Development Bank for Southern Africa, Johannesburg, July 1994.

Blumenfeld, J., *Economic Interdependence in Southern Africa*, St. Martin's Press, New York, 1991.

Bouzas, R., *MERCOSUR and Preferential Trade Liberalisation in South America: Record, Issues and Prospects*, (mimeo), FLACSO, Buenos Aires, December 1994.

Bouzas, R., *Trade Liberalisation and Regional Integration in the Western Hemisphere: Some Policy Issues*, (mimeo), FLACSO/CONICET, Buenos Aires, February 1995.

Bouzas, R., 'Preferential Trade Liberalisation in the Western Hemisphere: NAFTA and Beyond', In: Teunissen, J.J. (ed), *Regionalism and the Global Economy: The Case of Latin America and the Caribbean*, FONDAD, The Hague, 1995.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

Bradford Jr, C. (ed), *Strategic Options for Latin America in the 1990s*, OECD, Paris, 1992.
Braga, C.A.P., *The New Regionalism and Its Consequences*, World Bank (IED), Washington DC, August 1994.
Broinowski, A. (ed), *Asean into the 1990s*, Macmillan, UK, 1990.
Cable, V. and D. Henderson (eds), *Trade Blocs? The Future of Regional Integration*, RIIA, London, 1994.
Cecchini, P. et al., *The European Challenge: 1992. The Benefits of a Single Market: The Cecchini Report*, Wildewood House, UK, 1989.
Deardorff, and R. Stern, *Multilateral Trade Negotiations and Preferential Trading Arrangements*, (mimeo), 1991.
de Cecco, M. and A. Giovannini, *A European Central Bank? Perspectives on monetary unification after ten years of the EMS*, Cambridge University Press, Cambridge, UK, 1988.
de la Torre, A. and M.R. Kelly, *Regional Trade Arrangements*, IMF Occasional Paper No 93, Washington DC, March 1992.
de Melo, J. et al., *Regional Integration Old and New*, World Bank Policy Research Working Papers WPS 985, Washington DC, October 1992.
de Melo, J. and A. Panagariya (eds), *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge, UK, 1993.
Drobnick, R., *Economic Integration in the Pacific Region*, OECD Development Centre, Technical Paper No 65, OECD, Paris, May 1992.
Ffrench-Davis, R., 'Trends in Regional Cooperation in Latin America: The Crucial Role of Intra-Regional Trade', In: Teunissen, J.J. (ed), *Regionalism and the Global Economy: The Case of Latin America and the Caribbean*, FONDAD, The Hague, 1995.
Frimpong-Ansah, J. et al. (eds), *Trade and Development in Sub-Saharan Africa*, Manchester University Press, UK, 1991.
Fukasaku, K., *Economic Regionalisation and Intra-Industry Trade: Pacific Asian Perspectives*, OECD Development Centre, Technical Paper No 53, OECD, Paris, February 1992.
Fukasaku, K., M. Plummer, and J. Tan (eds), *OECD and ASEAN Economies*, OECD Development Centre, OECD, Paris, 1995.
Gill, S. and D. Law, *The Global Political Economy*, Harvester Wheatsheaf, 1988.
Giovannini, A. and C. Mayer (eds), *European Financial Integration*, Cambridge University Press, Cambridge, UK, 1990.
Goldin, I. et al., *Trade Liberalisation: Global Economic Implications*, OECD/ World Bank, Paris/Washington DC, 1993.
Helpman, E. and A. Razin (eds), *International Trade and Trade Policy*, MIT Press, Cambridge, USA, 1990.
Hettne, B. and A. Inotai, *The New Regionalism: Implications for Global*

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall? FONDAD, The Hague, 1996, www.fondad.org

Development and International Security, UNU/WIDER, Helsinki, 1994.
Kemp, M.C. and H. Wan, *An Elementary Proposition Concerning the Formation of Customs Unions*, Journal of International Economics, Vol. 6, February 1976.
Krugman, P., 'Is Bilateralism Bad?', In: Helpman, E. and A. Razin (eds), *International Trade and Trade Policy*, MIT Press, Cambridge, USA, 1990.
Krugman, P., *Geography and Trade*, Leuven and MIT, 1991.
Krugman, P., 'Regionalism versus Multilateralism: Analytical Notes', In: de Melo, J. and A. Panagariya (eds), *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge, UK, 1993.
Lachler, U., *Regional Integration and Economic Development*, World Bank, IED Industry Series Paper No. 14, Washington DC, November 1989.
Martin, M. et al., *Implications of the NAFTA for Central American Development*, (mimeo), University of Florida, Gainesville, 1995.
Massad, C., *A New Integration Strategy*, CEPAL Review No. 37, CEPAL, Santiago, April 1989.
McCormick, B.J., *The World Economy*, Philip Allan/Barnes and Noble Books, 1988.
Mutharika, B., *Toward Multinational Economic Cooperation in Africa*, Praeger, USA, 1972.
Mytelka, L. (ed), *South-South Cooperation in a Global Perspective*, OECD Development Centre, OECD, Paris, 1994.
Oden, B., *Regionalisation in Southern Africa*, (mimeo), Uppsala, February 1995.
Oman, C., *Globalisation and Regionalisation: The Challenge for Developing Countries*, OECD, Paris, 1994.
Palmer, N.D., *The New Regionalism in Asia and the Pacific*, Lexington Books, USA, 1991.
PECC, *Advancing Regional Integration: Pacific Economic Development Report (1995)*, Pacific Economic Cooperation Conference (PECC) Secretariat, Singapore, 1994.
Prebisch, R., *The Economic Development of Latin America and its Principal Problems*, UN-ECLA, New York, 1950.
Prebisch, R., *Towards a Dynamic Development Policy for Latin America*, UN, New York, 1964.
Robson, P., *The Economics of International Integration*, 3rd edition, Routledge, London and New York, 1993.
Saasa, O. (ed), *Joining the Future: Economic Integration and Cooperation in Africa*, ACTS Press, Nairobi, 1991.
Schott, J., 'More Free Trade Areas?', In: Schott, J. (ed), *Free Trade Areas and U.S. Policy*, Institute for International Economics, Washington DC, 1989.
Sorsa, P., *Regional Integration and the Baltics: Which Way?*, World Bank Policy

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org

Research Working Paper 1390, World Bank (IED-ITD), Washington DC, December 1994.

South Centre, *South-South Cooperation in Trade: An Action Programme for the Non-Aligned Movement*, South Centre, Geneva, May 1995.

Srinivasan, T.N., 'Discussion on Regionalism vs. Multilateralism by Krugman', In: de Melo, J. and A. Panagariya (eds), *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge, UK, 1993.

Stoeckel, A. et al., *Western Trade Blocs: Game, Set or Match for Asia-Pacific and the World Economy*, Centre for International Economics, Canberra, Australia 1990.

UN-ESCAP, *Review and Analysis of Intra-Regional Trade Flows in Asia and the Pacific: Background Paper*, UN-ESCAP, Bangkok, August 1994.

Viner, Jacob, *The Customs Union Issue*, New York: Carnegie; London: Steven and Sons, 1950.

World Bank, *A Continent in Transition: Sub-Sahara Africa in the mid-1990s*, (mimeo), World Bank, Africa Region, Washington DC, January 1995.

York, R.C., *Regional Integration and Developing Countries*, OECD, Paris, 1993.

From: Regional Integration Arrangements in Economic Development: Panacea or Pitfall?
FONDAD, The Hague, 1996, www.fondad.org