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Economic Commission for Africa
Symposium on Industrial Development in Africa
Cairo, 27 January - 10 February 1966

CID/SYMP.B/12

December 1965

04920

THE EXPERIENCES OF THE CENTRAL AMERICAN ECONOMIC INTEGRATION PROGRAMME AS APPLIED TO EAST AFRICA

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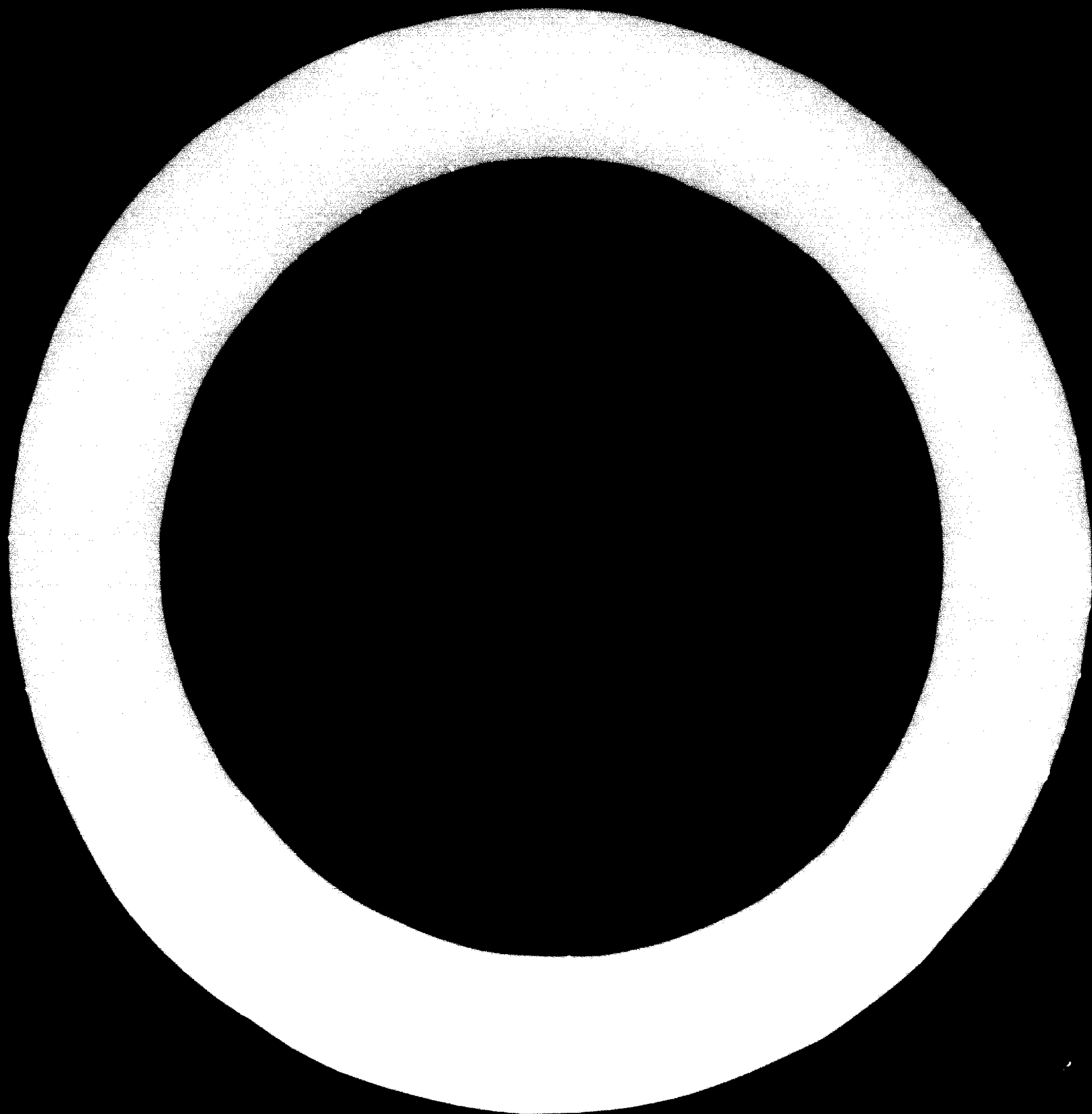

INTRODUCTION

1. In the present day, largely decolonised, Africa, there is a general agreement upon an urgent need for industrialization as one of the basic means to accelerate economic development of the continent. At the same time, there is a growing awareness that, because of the size of markets, the absence of managerial and entrepreneurial skills and the high cost of modern technology, the great majority of independent African states are not in the position to undertake industrialization efforts on a national scale. Consequently, numerous attempts are being made to bring about in various African sub-regions some measures of trade and cooperation and industrial integration. Among these schemes and experiments in addition to the East African Common Market, the setting up of Maghreb institutions for Economic Cooperation, the Central African Customs and Economic Union, the projected Free Trade Area in West Africa and the most recent proposals for a larger Eastern African Common Market should be mentioned.

2. The experiences of other developing regions, preceding the recent movement towards economic integration in Africa, strongly suggest that one of the most difficult problems is that of equitable multinational distribution of benefits and burdens of such integration, especially in the industrial sector. Consequently, this paper analyses in some detail two concrete sub-regional industrial policy mechanisms: the Central American Regime for Integration Industries and the East African Kampala Agreement on allocation of industries on a regional basis. In the light of the failure of these two schemes the final part of the paper offers some preliminary proposals, which it is expected, will help to elaborate mechanisms adaptable to the African conditions.

I

3. The first case worth studying is that of the Regime for Integration Industries, an important piece in the economic integration mechanism set up in 1958 through the Multilateral Treaty on Free Trade and Central American Economic Integration. The Regime has been subscribed by four Central American republics (El Salvador, Guatemala, Honduras and Nicaragua) at the time of the signature of the Multilateral Treaty and joined later by Costa Rica. The Multilateral Treaty itself, while creating a free trade area for a first list of commodities of domestic origin, considered trade liberalization and regional industrialization as two key aspects of the integration process and consequently contained a specific commitment of the member countries to the effect that –

> "with a view to promoting industrial development consistent with the purpose of this Treaty, the Contracting Parties shall adopt, by mutual agreement, measures designed to further the establishment or expansion of <u>regional industries</u> (italics added) directed towards a Central American common market and of particular interest to the economic integration of Central America" 1/

4. The subsequent General Treaty on Central American Economic Integration, signed in 1960 and adhered also later by Costa Rica, which transformed a limited free trade zone into a Central American common market, dedicated to the issue of industrial integration even more attention. It endorsed the Agreement on the Regime for Central American Integration Industries; called for the establishment of the Central American Bank for Economic Integration (CABEI) "as an instrument for the financing and promotion of a regionally balanced, integrated economic growth" providing that the CABEI members might not use its credit facilities unless they ratify the 1958 Regime for Integration Industries; and committed also the member countries "with a view to establishing uniform tax incentives to industrial development... to ensure as soon as possible a reasonable equalization of the relevant laws and regulations in force". The Charter of the Central American Bank for Economic Integration declares that the purpose of the institution "shall be to promote the economic integration and balanced economic development of the member countries" and that its activities will be primarily designed to promote and finance, <u>inter alia</u>,

> "projects for long-term investment industries of a regional character or of importance for the Central American market which will help to increase the supply of goods available for intra Central American trade or for such trade and the export sector. The Bank's activities shall not include investment in essentially local industries". 2/

1/ Multilateral Treaty on Free Trade and Central American Economic Integration, Tegucigalpa, June 10, 1958, Article XXI, reproduced in United Nations, <u>Multilateral Economic Cooperation in Latin America</u>, Vol. I. Text and Documents, New York, 1961, pp. 17-23.

2/ Agreement establishing the Central American Bank for Economic Integration, [illegible], [illegible], Article 2 [illegible], reproduced in [illegible], <u>op. cit.</u> pp. [illegible].

5. Thus, within several years after the start of the regional integration programme, five Central American republics counted with a series of interrelated legal instruments and regional institutions aimed at expanding zonal trade, financing new regional infrastructure and industrial projects, promoting the inflow of external capital resources and coordinating other activities important for the acceleration of regional industrialization process. In addition to the 1960 General Treaty, the Regime for Integration Industries and the regional development bank, the most important elements of the integration scheme are: the equalization of import duties and charges (1959), uniform tax incentives for industrial development (1962) and a regional industrial research institute (ICAITI), the last one dating from the mid-fifties.

6. Most of these regional integration instruments and institutions have been working satisfactorily. During the seven years following the signature of the first Multilateral Treaty the intra-Central American trade (imports cif) increased more than fivefold from US $20 million in 1958 to some US $105 million in 1964. Its participation in the region's global foreign trade increased from less than 5% to over 20%. By the fall of 1965 the five countries' custom-union was in existence for all practical purposes and external uniform common tariff covered 97% of the foreign trade items. The structure of intra-zonal commercial transactions underwent considerable diversification - in 1964 manufactures accounted for 40% of the regional interchange. Trade fluctuations, characteristic of the past and reflecting marginal and seasonal character of the intra-regional trade until the end of the past decade, largely disappeared. Upon the establishment in 1961 of a multilateral payments clearing house, a large measure of cooperation among monetary authorities and private banking systems has been achieved. The integration bank, well-endowed with zonal and external resources and backed financially by the Inter-American Development Bank and the US aid agencies, extended during its first four years of existence credits totalling US $34 million to public and private projects "of interest to the integration programme". The trade liberalization process resulted in the increase of domestic and foreign investment in the area. It is tentatively estimated that the inflow of foreign capital, induced by the emergence of the Central American common market, amounted in 1961-1964 to a not negligible total of US $100 million. All this contrasts with extremely slow changes in the industrial structure of the area, still mainly limited as in the mid-fifties to light consumers goods, the absence of [illegible] dynamic industrial projects serving the whole zone and the unimpressive performance of the Regime for Integration Industries. Thus, a series of questions arises: is the issue of equitative distribution of industries in an integrating multinational area of paramount or only [illegible] importance;

was the idea of the distributive mechanism as conceived in Central America well thought out; did the failure of the Regime for Integration Industries have any negative effect upon the economic development of the area, and, finally, can other developing areas preparing their own regional integration schemes learn anything from Central American experiences?

7. The idea of the Agreement on the Regime for Integration Industries originated in the early fifties with UN Economic Commission for Latin America (ECLA) experts who had several objectives in mind: (a) to encourage or induce the establishment or expansion of industries which might require immediate free access to the entire regional market in order to operate under reasonable economic and competitive conditions; (b) to promote the utilization - more rational than in the past - of available capital, technical skills and natural resources; and (c) to ensure that industrial development is distributed with relative equity throughout the region. ECLA technicians, without whose assistance the Central American integration programme would have never started, were well aware of the historical record of the intra-area political and economic fights, squabbles and frictions after the break-up of the Spanish colonial empire in the early XIX century, and of failures of numerous previous attempts to bring about some degree of political and economic unification into what for a short time, almost 150 years ago, was one political unit - the Central American Republic.3/ They were not less aware of the lack of economic viability in terms of modern economic development of the five minuscule and underdeveloped countries; considerable differences in <u>per capita</u> income and resources endowment; the foreign-oriented character of five agricultural economies strongly linked to that of the United States, the major market for their primary produces and the major supplier of the consumer and investment goods; the lack of economic complementarity if considered in static and not developmental terms; and the absence of commercial and financial links within the area. Finally, they suspected and were afraid that with the growth of trade in response to the progressive disappearance of intra-zonal custom barriers, serious frictions would arise in a long run among the member countries because of three possible effects of the trade liberalization programme: (a) losses of government revenues as increasing volume of goods would enter each country from the others duty free; (b) negative impact upon existing light consumer goods industries in more and less developed countries as they would begin to face competition from the same industries in other member countries, and [illegible] of the activities induced by a free-trade regime in a

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3/ [illegible] Karnes, Thomas L. <u>The Failure of Union-Central [illegible]</u>, Chapel Hill, The University of North Carolina [illegible].

few existing industrial centers in the more developed republics, offering better external economies than the others. In the minds of ECLA technicians and more sophisticated members of Central American political and economic elites, pushed towards regional economic cooperation by the deterioration of traditional export sector after the short-living international commodity markets boom during the Korean war, the viability of the regional integration scheme would have depended to a very considerable extent upon the adequate solution of one complicated but crucial problem: finding the way to distribute with relative equity the benefits and burdens of economic integration among the prospective members of the Central American common market.

8. Since the economies of the area are by-and-large free-enterprise economies and the local political elites have rather conservative outlook, any attempt to introduce in Central America in the late fifties - whether on national or regional level - planning or the State economic dirigisme would have amounted to an exercise in futility. Thus, a scheme was thought out leaving the existing productive facilities to their more or less spontaneous growth under the influence of market forces, but opening a way to a "rational allocation of resources" in a new field of heavier and intermediate industries. Because of the size of individual national markets, such manufacturing enterprises were absent in Central America a decade ago. Consequently, the 1958 Regime defined as 'integration industries' those which would "comprise one or more plants which require access to the Central American market in order to operate under reasonably economic and competitive conditions even at minimum capacity". According to a number of subsequent market surveys this definition would apply to such industrial branches, as fertilizers, insecticides and fungicides; pharmaceutical products; tires and tubes; paint, varnishes and dyes; glass, plastic and metal containers; pulp and paper products, rolled steel; petroleum refining, and artificial fibers, among others.

9. The Regime offered a number of benefits and protection to firms to be designated to operate as 'integration industries'. The first and foremost was an immediate free access to the whole Central American market, while similar products of other firms - entering the area afterwards without benefit of this special agreement - would receive the same treatment only after ten years through successive gradual reduction of tariffs by 10% a year during the period. Besides, enterprises designated as 'integration industries' would enjoy ample fiscal incentives in the countries where they might decide to establish themselves, obtain sufficient external protection to make its products competitive with imported goods and receive priority as suppliers to governments and other state agencies in the area.

10. The designation of an 'integration industry' would take form of a protocol signed and ratified by all member countries. Such protocol would specify the location of the industry, the minimum capacity of the plant and the conditions under which additional plants would be distributed in case of a growing zonal demand; the quality standards of the products; the measures "deemed convenient for the protection of consumers"; the regulations in regards to the participation of Central American capital and the height of the common external tariff to be set to protect each 'integration industry'. For the purpose of equitable distribution of these industries in the area it was agreed that "the Contracting States shall not award a second plant to any country until all the five Central American countries have been assigned a plant in conformity with the protocols".

11. The initiative in respect to 'integration industries' was to come from individuals or corporations and not from the governments or regional integration authorities. Their application was to be presented - with all pertinent information - to the Secretariat of the Central American Industrial Integration Commission to be created under the Central American Economic Council, the top regional integration agency. Applications would be acted upon through the signature of a protocol only after a favourable technical opinion were received either from the Central American Research Institute for Industry (ICAITI) or "from any other person or body that Commission considers competent". Such advice would have to cover all major technological and economic aspects of each project and, in particular, the longer-term market prospects for an industry applying for the Regime's benefits.

12. The outline of the scheme makes it clear that acting upon the initiative of ECLA advisers, the five Central American republics thought it advisable to reserve the regional market for single enterprises in certain industries for the purpose of avoiding situations, where the mushrooming of several small-scale and high-cost plants competing with each other in a small regional market and putting heavy drain on resources in short supply (such as capital, skilled labour, managerial talents and technology) would perpetuate the industrialization pattern existing in light consumer good fields. Furthermore, it was expected that through opening the way towards both horizontal and vertical combination of new heavier industrial activities to be labelled 'integration industries' and which might be com- [illegible] plant, the Regime would foster both pro- [illegible] relatively large-sized plants. [illegible] development of infrastructure [illegible] in reasonable time the area's

development poles, which in turn would attract ancillary industries and new tertiary activities to each member country. Thus, given reasonably economic location of these new industries in function of varying natural resources endowment, availability of labour and technology, and the principle of multilateral negotiations on their distribution, the danger of industrial agglomeration and concentration in some areas could be avoided, danger ever present under conditions of complete freedom of localization available to any industrial activity ready to enter Central American market. The clause of the Regime, providing in a somewhat obscured language, for distribution of 'integration industries' by rounds of negotiations took into accounts not only their potential effect upon employment and income of each of the member countries and future intrazonal trade flows, but high political prestige attached to industrialization process in any underdeveloped but bent upon the development society. In a way, the Regime represented an attempt to introduce into the area a <u>multilateral industrial licensing mechanism</u> responding to both economic and political considerations. Its final aim was to avoid political frictions which might surge if one or two countries, presumably Guatemala and El Salvador, were to become centers of regional industrial growth, leaving traditional primary activities to the least developed members of the group - Honduras and Nicaragua.

13. The Regime clearly reflects a belief held by the majority of Latin American economists and by ECLA as well that a free play of market forces in the context of developing countries can hardly promote industrial development at a necessary speed and, besides, by increasing the existing gaps in the development levels can bring serious political complications. Without dismissing the market mechanisms, ECLA experts thought it advisable to subject them both in case of Central American integration schemes and in Latin American Free Trade Association established in 1960, with the participation of eight South American countries and Mexico, to a series of corrective measures in form of regulations, special concessions, exceptions from the traditional free trade rules, etc. In Central America a very detailed distribution scheme for new industrial activities within the area had been elaborated by ECLA staff sometime before the Multilateral Treaty had been signed in 1958. This scheme fell through, however, because of the inability of the Central American governments at the time to agree upon its details and not without interference of national and foreign vested interests. In consequence, the 1958 Agreement on the Regime for Integration Industries was drafted in general terms and in somewhat obscure language and led itself immediately to conflicting interpretations.

14. When in late 1961 informal negotiations on the implementation of the Regime started at the first meeting of the *ad hoc* Working Group on Industrial Development, held in Managua, Nicaragua, the politics of the distribution of the integration industries and not its economics became the main issue. The purpose of the meeting was to select the first round of integration industries and draw up necessary protocols. With official delegations of four out of five Central American republics present (Guatemala, Honduras, El Salvador and Nicaragua) and no practical experience available from anywhere, the meeting was very much a trial and error affair. A big step forward came with the amicable preliminary selection by each country of one integration industry. Guatemala chose the already existing tire and tube plant, El Salvador - copper wire extrusion, Nicaragua - caustic soda and insecticides, and Honduras - a small chemical industry project based on imported basic petrochemicals with an option to substitute it within six months with a glass container plant. In opinion of some observers, the 1961 meeting of the *ad hoc* Working Group proceeded with considerable disregard for economics of industrialization. The general attitude seemed to be that if a government chose a particular integration industry upon prodding of prospective or actual local and foreign investors, then there would be no discussion of the wisdom of the decision but only of details of the protocol to be signed jointly at a later date. Virtually no use was made of the existing ECLA industrial studies to relate individual projects to the needs of the region, except in a sense that each project obviously needed access to the whole regional market. Little attention was given to the economics of location also and only one participating country pressed in vain for a general discussion of longer-run aims and objectives of the Regime for Integration Industries.

15. The meeting showed, on the other hand, the preoccupation of the member countries with the issue of foreign capital's role in the 'integration industries' and with the principle of their equitable distribution throughout the area. It became evident - and confirmed in the following years - that the Central American countries would insist on majority participation of the capital originating in the area in all new major manufacturing enterprises and that the least developed countries of the grouping would insist on the principle of negotiations by "rounds", whereby each country would receive the similar number of projects. The discussion disclosed also that the less developed republics considered the equitable distribution in terms of the size of investment involved in each project, a criterion difficult to defend on the basis of economic analysis. In addition, it has become evident that 'integration industries' would receive a high level of protection, following demands from the interested investor groups. For anyone cognizant of these first discussions of the imple-

mentation of the Regime of Integration Industries it became quite obvious that the economics of industrial integration were closely intertwined with the politics of economic cooperation and that any attempt to divorce them might put heavy strain on the orderly functioning of the Central American common market scheme.

16. The Regime did not, however, make spectacular headway in the following years. Although the first protocol signed by five governments in 1963 declared a tire and tube plant in Guatemala and a caustic soda and insecticide plant in Nicaragua, as the first Central American 'integration industries', two years later in the fall of 1965, the protocol has still to be ratified by one of the five member countries - Honduras. Some progress towards its entry into force has been made by the recent assignment to that country of the flat glass industry project and the signature of the corresponding protocol at the Fifth Meeting of the Central American Economic Council, held in November 1965 in San Salvador. The decision to assign to Costa Rica another tire and tube plant continues to be the matter of controversy and El Salvador gave up its insignificant metallurgical industry project.

17. On the other hand, in 1963 the signatories of the Regime for Integration Industries created another regional industrial promotion mechanism partly contradictory to the Regime itself and called a special system for promotion of new productive activities. It provides for periodical joint elaboration of list of new Central American manufactures to be granted special tariff protection in the area from the moment they supply at least 50% of the regional demand. The two lists approved between 1963 and 1965 include, among others certain glass products, electric bulbs, sanitary paper and sulphuric acid. The new scheme aims at eliminating monopolistic implications of the 1958 industrial agreement, but its performance is hardly more impressive than that of the 1958 Regime.

18. The failure until the present date of the Regime for Integration Industries to act as dynamic factor in the Central American economic integration process has been admitted by one of the leading ECLA experts in the regional economic affairs, Carlos M. Castillo, who nevertheless defends a thesis that the achievement of the balanced regional industrial growth through a joint development policy represents the basic precondition of the success of the Central American common market. According to Castillo, various instruments incorporated in a series of regional integration mechanisms, including the 'integration industries' regime -

"fit well into the process of balance and development. They are indispensable rather than incompatible components in this process. The need for uniform tax incentives to industrial development and the equilibrating action of a selective policy with respect to investment on the part of CABEI are generally accepted. *As for industries regime so far it has not been possible to arrive at a working consensus for its application*". (italics added)[4]

19. The absence of a working consensus in the area in respect to the Regime for Integration Industries reflects in some way the inability of the Central American countries to change the industrial structure in the area and to pass from the stage of light consumer commodities to that of industrial complexes producing certain heavier manufactures. This phenomenon, in turn, can hardly be explained by the size of the newly emerged market and the inavailability of factors of production, except technology. Thus, the persistence of the traditional industrial structure is probably due not ony to strictly economic factors but to the socio-political conditions within and outside the area as well.

20. The Central American Regime for Integration Industries has been subject to a detailed critique on economic analysis, regional welfare and private investors policy grounds by many outsiders, including the US aid agencies operating in the area. The main counter-arguments center around its allegedly bringing uncertainties among potential investors which inhibit industrial investment in the area and thus retard economic growth; the arbitrary process of designating "integration industries" involving a clear danger of political favouritism; the monopolistic implications of the scheme; its superfluity in view of the parallel existence of the Central American Bank for Economic Integration and of uniform tax incentives, supposedly easier to administer than the industrial regime itself, and, finally, its interference with the "decision of the market place".[5]

4/ Castillo, Carlos M. - Growth and Integration in Central America (unpublished manuscript). Mexico, 1965, p. 151.

5/ AID "Comments on the Regime of Integration Industries of the Central American Common Market". (Washington, August, 1963) Memorandum.

21. At a somewhat higher level of sophistication, the Regime for Integration Industries has been criticized because of its basic assumption that the economies of scale are decisive for the industrialization of the developing countries in view of the shortage of capital and of the effect of these economies of scale on unit costs and prices. It was alleged that under monopolistic or oligopolistic conditions, fomented by the Regime, prices would be fixed in relation to available tariff protection and not on the basis of costs and consequently no increase in the consumer welfare could be expected. Contrarywise, an alternative policy of a free entry of any industrial firm into Central American Market together with a joint effort to build up a regional infrastructure would give - it was sustained - much better developmental and welfare results. Such policy would eliminate the danger of 'administered prices' and permit new productive facilities to take a full advantage of external economies created by an expanded transportation network, a regional electric power grid, free flow of skilled labour, more advanced financial services, etc.6/

22. In view of the extremely limited progress of the Regime for Integration Industries, a discussion of the relative advantages of economies of scale and external economies in a Central American integration programme remains a purely academic exercise. There is no evidence available that the Regime kept away potential investors nor that it did not permit actual industrial investors to take advantage of external economies emerging from the public investment in infrastructure in each member country and on the regional level. The fact remains that the industrialization patterns hardly changed in Central America between 1958 and 1965.

23. As far as the Regime itself is concerned the available information strongly intimates that the U.S. negative attitude is partly responsible for its failure to take off. It is known, for example, that the US Government, which started in 1960 committing considerable aid resources to the Central American economic integration programme - both directly through the Agency for International Development and by loans to the CABEI - did not limit itself to disapproval of the scheme.

6/ Joseph Pincus "Algunos efectos de la integracion economica centroamericana en los precios de consumo" (Some effects of the Central American Integration on the Consumer Prices), July 1962. (mimeogr.)

According to a good authority with direct access to the US foreign aid agencies -

> "both the Inter-American Development Bank [partly financed with US money] and the Agency for International Development have refused the use of their funds loaned to the Central American Bank for Economic Integration for loans to firms designated as "integration industries" and, therefore, given preferential treatment within the Central American Common Market".7/

24. Such strong US opposition to the Regime is explained by the rejection by the US Department of Justice of its monopoly clauses; the negative attitudes of some US corporations whether with enterprises in the region or considering setting up new industrial ventures in the area; and the fear of the US Department of State of difficulties with the foreign aid programme in the US Congress in case US public funds were used to finance a scheme clearly interfering with the free enterprise philosophy.8/ It would be too simple, however to blame for the failure of the Regime the US policy of denial of financial resources for its implementation.

7/ Raymond F. Mikesell, "External Financing and Latin American Integration" in M. S. Wionczek (ed), Latin American Economic Integration, New York, Frederick A. Praeger, Inc. 1966

8/ Cochrane, James D. "US Attitudes Towards Central American Economic Integration", Inter-American Economic Affairs (Washington, D.C.) Vol. 18, No. 2 Autumn 1964. In respect to the second point Cochrane wrote that "Although there is no evidence that US investors have expressed any disapproval of 'integrated industries' to government officials, it is quite possible that this has been privately expressed. The fact that 'integrated industries' has several features which might be objectionable to US investors may, even in the absence of over pressures, have influenced the position taken by the United States Government". op cit. p. 85

25. Assuming the political and economic weight carried by the United States in Central America, one might expect in the light of the US negative attitudes the Regime's complete disappearance from the scene. But the Regime did not wither away. An explanation that it was kept alive but dormant by the Central American republics to please its authors, ECLA experts, on the one hand, and to demonstrate independence from the external pressures, on the other, looks very ingenious but far from convincing.[9] It is more probable that some kind of silent agreement has been reached between Central American countries and ECLA experts that, however badly-designed or wrongly-timed the Regime for Integration Industries might have been in 1958, it could become in the future a useful industrialization instrument. With the progress of regional cooperation in non-industrial fields, it seems that a growing number of Central Americans is coming around to the ECLA position that balanced growth and equitable distribution of industrialization benefits would in a long run - once the intensive industrialization programme is underway - represent the best guarantee against the disruption of the integration process by coalitions of domestic and foreign vested economic interests in each country, taking strongly 'nationalistic' line, and trying to get the lion's share of the common market benefits at the neighbours cost.

26. In the retrospect, it seems that the Regime was not too well designed and wrongly timed for reasons beyond control of its authors. Since no other similar experiences were available elsewhere, it was an experimental exercise. The main weaknesses of the scheme consist of the passive role it ascribed to the common market authorities in designating "integration industries", its cumbersome procedures and its limiting - in fact if not in word - the concept of integration industries to single enterprises unrelated to the global industrialization needs of the area. But these weaknesses reflected only the actual stage of Central American industrialization process at the time

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9/ This explanation is offered by James D. Cochrane in another essay "Central American Economic Integration: The 'Integrated Industries' Scheme". Inter-American Economic Affairs (Washington D.C.) Vol. 19 No. 2. Autumn 1965. p. 70

of the 1958 Multilateral Treaty's signature.[10] They reflected also the absence of basic data about the long-term demand and supply trends outside of agricultural and light consumer goods sectors; the non-existence of industrial planning whether on national or regional scale; the extreme shortage of domestic entrepreneurial skills and, finally, the lack of experience in the integration-supporting institutions such as the regional industrial research center (ICAITI), which in the late fifties led still a very precarious life. Neither the interested governments, as the 1961 meeting of the ad hoc Working Group on Industrial Development clearly demonstrated, understood clearly what the General Treaty and the Regime for Integration Industries tried to achieve in the industrial field and how the productive structure of the region would be affected by a relatively rapid trade liberalisation. This explains the choosing at random by the common market members of four unrelated and from the viewpoint of the area insignificant industrial projects for the first round of negotiations. A continuation of multilateral negotiations on similar projects would never be of more than marginal importance for the regional industrialization process, but the actual meager performance of the Regime did not invalidate its two basic premises: that the unnecessary duplication of high-cost small industrial plants and the agglomeration of new manufacturing activities in some member countries would be harmful to the integration process taking place within a political framework which assumes a continued existence of five separate and sovereign state units for a long time to come.

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[10] The substitution of the 1958 Multilateral Treaty by the 1960 General Treaty creating a common market complicated legal aspects of the Regime. Under the earlier treaty it was easy to offer exclusive tariff protection for the new industries, since the free trade covered selected commodities only. Under the General Treaty, when the signatory countries committed themselves to free trade in practically all products and to establish a common external tariff by mid-1966, the offer of special tariff treatment for plants designated as 'integration industries' might be considered as a step backward from the [illegible] commitment of the Central American countries as long as [illegible] traditional attitude that a common tariff in a [illegible] should not be higher than previously in indivi[illegible] [illegible] is clearly not the case in respect to the [illegible] of integration schemes in the developing regions where new industries emerging after the establishment of a custom [illegible] right to be considered "regional infant in[illegible]" [illegible] protection.

27. Some new economic and non-economic factors are appearing on the Central American scene suggesting that although still dormant, the revised and expanded scheme may be a useful means of assuring the balanced development of intermediate and capital goods industries capable of supplying the regional market with inputs, whose imports from the outside world are limited by Central America's slowly growing import capacity. It may as well be also that the Regime, containing a specific clause in respect to the participation of domestic and regional capital in the 'integration industries', is the only mechanism able to dispel growing preoccupation - both in the public and private sectors of Central America - about the undue share of benefits from the integration falling into the hands of foreign industrial enterprises. Paradoxically, this preoccupation is the result of the Central American economic growth registered after 1958 and of the emergence of the new domestic entrepreneur groups in response to the socio-political change sparked by the integration movement.

28. These groups with access to capital resources previously transferred abroad or invested in land cannot, however, by any means match financial and technological resources available to large international corporations, entering the potential market similar in size to that of the middle-sized Latin American republics such as Colombia, Chile and Venezuela.[11] Although during the first stage of integration, the 'forces of the market place' worked largely in favour of foreign manufacturing enterprises, leading to growing frictions and the appearance of Central American economic nationalism, they had a considerable demonstration effect upon Central American entrepreneurs. Now, when the process of regional import substitution in light consumer industries is coming to an end, both domestic and foreign capital start competing for industrial opportunities in the field which would clearly fall under the Regime for 'Integration Industries'. If the scheme were adjusted to new conditions, were to receive technical support from the regional industrial research Institute in the form of well-elaborated concrete projects linked with national industrialisation plans and attractive in each particular case to groups of investors from various Central American countries, the governments of the re-

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11/ For the analysis of problems arising from the clash between Latin American economic nationalism emerging within the framework of economic integration schemes and foreign private capital, see Miguel S. Wionczek "A Latin American Point of View" in Raymond Vernon (ed.), How Latin America Views the U.S. Investor, New York, Frederick A. Praeger, Inc. 1966.

gion might reconsider their lukewarm attitudes and start negotiating distribution of such projects throughout the common market. In such case, negotiations would cover not as in the past individual plants of marginal importance for the regional industrialization, but larger industrial projects jointly financed by Central American entrepreneurs and meant to reestablish some equilibrium in the area between regional and extra-zonal capital and at the same time distribute these major projects among all member countries. The fact that ICAITI together with CABEI organized in mid-1965 the first regional meeting on investment opportunities, pointing out the economic feasibility of some 70 new industrial projects, suggests that the Regime for Integration Industries may face a chance of an early revivial, if adequately revised.

II

29. The second case throwing a considerable light upon difficulties of multilateral arrangements providing for equitable distribution of benefits and burdens of a regional economic integration scheme in the context of the developing countries is that of the still-born Kampala-Mbale Agreement, negotiated by the three members of the East African Common Market (Kenya, Uganda and Tanzania) between April 1964 and January 1965. Although the agreement has never entered into force and only its principal points have been made public officially by the Tanzania Minister of Finance in mid-1964,[12] enough is known about this scheme and the subsequent developments to warrant a detailed discussion of the reasons for its failure.

30. It is not any accident that negotiations leading to the Kampala-Mbale agreement started almost immediately after the last British territory in East Africa, Kenya, got independence in December 1963. As the voluminous literature on trials and tribulations of the East

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12/ Press Release of the Tanganyika High Commission in London, June 16, 1964 - "Extract from the Budget Speech of the Hon. Paul Bomani, Minister of Finance, delivered to the National Constituent Assembly [in Dar-es-Salaam] on the 16th of June, 1964" (mimeogr.)

African Common Market, established in the twenties, suggests, the East African elites, British civil servants in East African Common Service Organization (EASCO) and International experts and missions visiting the region with growing frequency in the post war period have been in agreement since long time ago on two major points: (a) that differences between the development levels of the three former territories were not only considerable but were steadily increasing, and (b) that the distribution of gains from the common market arrangement was heavily weighted in favour of the most developed member - Kenya. Here the consensus of opinions among experts within and without the East African Common Market countries ended, because no generally acceptable measure of the distribution of gains in an economic integration scheme has been elaborated as yet and the traditional way of measuring benefits or losses from integration exclusively by the trade flows has serious theoretical shortcomings. Three alternative and divergent opinions in respect to the East African Common Market results can be discerned: (a) Kenya has been the greatest net beneficiary of the union, but the other two countries got also some benefits - although much smaller and perhaps marginal - from the participation in the arrangement, mainly through the spread effect of the Kenya industrialization in the less developed neighbours, their access to the Kenya's growing market for certain primary goods and external economies offered to Uganda and Tanzania through joint common market services in fields such as transportation and communications;13/ (b) Kenya has been the greatest beneficiary, Uganda has on balance gained rather than lost and Tanganyika has suffered slight net loss; 14/ and (c) Kenya gained from the common market at the cost of its much poorer neighbours.

13/ Benton F. Massell in his East-African Economic Union: An Evaluation and Some Implication for Policy (The Rand Corporation, Santa Monica, California, December 1963) seems to lean towards this school of thought, although he states also that "it is not possible to determine whether Uganda and Tanganyika are made better or worse off as a result of economic union". p. 96.

14/ Dharam Ghai - "Territorial Distribution of Benefits and Costs of the East African Customs Union" (Kampala, 1963).

Although there is no available factual evidence supporting the third position, it cannot be dismissed lightly. Its wide and uncritical acceptance in the political circles in what is today the Federal Republic of Tanzania explains to a considerable degree Tanzania's policy towards the East African Common Market in the most recent past.

31. The three distinct evaluations of the distribution of benefits from the East African economic integration programme link the unevenness of this distribution to the advantages of Kenya in respect to the location of new industrial activities, advantage gained because of British economic policies in East Africa in the colonial period. A paper written in 1963 by a Ugandan economist, unaware of problems which faced ECLA economists attempting to build a viable common market in Central America at the same time, contains a paragraph describing succinctly the nature of the difficulties arising in both areas:

> "The location of industry is determined by a complex of historical and economic factors. In a laissez faire economy where market forces govern economic activity, industries will gravitate towards areas which possess certain economic advantages. These include, *inter alia*, proximity to markets for the products, availability and cost of raw materials, and efficient and developed system of transport, availability of cheap and skilled labour and of other economic overheads - electric power, banking commercial and financial services. In general, areas which are relatively more developed tend to possess these economic advantages. This tendency for new industries to be concentrated in relatively developed areas *gathers momentum as development proceeds* (italics added) with the result that large areas of the economy will fail to feel the impact of the growth generated by the existence of the customs union. This is especially true of underdeveloped areas which are characterized by the existence of a few pockets of development surrounded by vast areas scarcely touched by market forces. 15/

32. In the light of failure to restore intraregional balanced development through fiscal compensatory measures, suggested before the East Africa's independence by Raisman Commission (officially known as the UK Colonial

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15/ [illegible] Ghai - *op. cit.* p. [illegible]

Office Economic and Fiscal Commission for East Africa),[16] the three governments made immediately after the British withdrawal a serious attempt to establish a new framework attenuating political and economic frictions inherited from the colonial past. The Kampala scheme, as subsequently revised and approved in Mbale in January 1965 by the heads of state of the three nations, - after nine months of difficult negotiations - provided for dealing with the inequitable distribution of gains from the common market - as reflected in <u>intra-territorial trade imbalances</u> - through an early implementation of five measures:

a) immediate action with respect to certain inter-territorially connected enterprises aimed at their shifting productive activities in such a way as to increase production in a deficit country and thereby reduce imports from a surplus country;

b) agreement as to the immediate allocation of certain major industrial projects;

c) application of a system of quotas and suspended quotas whereby exports from surplus countries would be progressively reduced, and local production increased in the deficit countries according to the building up of the productive capacity of the deficit country;

d) increased sales from a country in deficit to a country in surplus; and

e) early agreement within the East African Common Market on a system of incentives and equitable allocation of future industrial activities among the three countries.

16/ One might still defend such redistribution mechanism by arguing that Raisman Commission proposals were not distributive <u>enough</u>. But the problem still does not disappear on two gounnds: 1) fiscal revenue compensation proposals address themselves mainly to the issue of net gains and losses from the customs proceeds from the foreign trade of the area under conditions of intra-trade liberalization; 2) assuming that a formula were found to measure correctly <u>all</u> gains and losses from an integration scheme, it would be difficult to envisage as politically palatable net transfer of aid for development from one underdeveloped but relatively better off country to another more underdeveloped for the sake of probable, but not certain, future gains from integration for all parties concerned.

[illegible]. Although the Kampala-Mbale Agreement established an immediate link between regulation of regional trade flows and distribution of new industrial enterprises throughout the region, it seems that it gave the first priority to the problem of allocation, understandingly chosen because of general expectations of the rapid inflow of foreign investment into the common market area and high political prestige attached to industrial projects by each member country. Thus, in respect to immediate channelling to the rest of the area of certain firms having productive facilities in more than one country (cigarettes, footwear, beer and cement), Kenya and Tanzania agreed to promote shift of some of their production lines to Tanzania because of that country's large trade deficit with Kenya. Similar joint persuasive action was expected to be followed by Kenya and Uganda. Immediate allocation of certain major industries covered aluminium, bicycle manufacture, electric light bulbs, radio assembly and manufacture, nitrogenous fertilizers and motor vehicle tires and tubes. It was agreed that these industries will be distributed under the territorial Industrial Licensing Ordinance 17/ on the basis of an exclusive license to a firm operating in the agreed territory. Tanzania was allocated the manufacture of aluminium sheets and foil; tires and tubes, and radio assembly and parts production. Uganda received the sole rights for the production of bicycles and fertilizers

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17/ The Industrial Licensing Ordinance was introduced in the three East African territories in 1948 for the purpose of encouraging "the orderly establishment and setting up of new industries to the best advantage of East Africa as a whole while providing protection to consumers and workers" (Part II, Section 3(2)). According to one source"...the industrial licensing system rapidly became a means for preventing competition [from Uganda and Tanganyika] with plants already established in Kenya"and"not unnaturally, the latter two countries became unwilling to agree to the addition of any new industries to the licensing schedule under such conditions", Sidney Dell, Trade Blocs and Common Markets, New York, Alfred A. Knopf. 1963, p. 238. The Raisman Commission concluded that by 1960 the system served very little useful purpose in relation to industrial development of East Africa as a whole.

and Kenya was left with the manufacture of electric light bulbs and possibly neon and fluorescent tubes. Finally, it was agreed that the problem of future allocation of industry and differential incentives for new industrial activities will be studied by a regional committee of industrial experts. This committee would draw lists of "East African industries" according to one of two alternative definitions of their economic feasibility: (a) only if a given industry would have had access to the entire regional market or (b) only if it would have needed access to a market larger than that of any one country in East Africa. When examining a possible distribution of these regional industries, particular regard was expected to be given also the need for an equitable distribution within the region and the concrete industrial location of new projects.

34. In the fall of 1965, less than a year after the revised version of the Kampala Agreement had been approved in Mbale, the scheme has already been considered in East Africa a dead letter. Events in each of the three countries have overtaken the interested parties in this particular issue and in fact, the whole future of the East African Common Market became highly doubtful inspite of a series of joint efforts to save at least its backbone - EASCO.[18]

35. The difficulties in implementing the Kampala Agreement arose from the day of its signature and reflect the interplay of many internal and external factors. The agreement represented a considerable immediate sacrifice on the part of Kenya and it was signed by that country under the understanding that not only the East African Common Market and EASCO will continue but, in particular, that there will continue to be a common single currency in the area. The East African Currency Board, supposed to be converted into a single central bank for the three countries at an early date, actually disappeared from the scene in the spring of 1965 by a unilateral step of Tanzania to establish its own state bank in charge of currency issue and separate monetary policy, what led, in turn, to a decision of the two remaining countries to

18/ In the early fall of 1965 the EASCO Authority decided to establish a commission comprising three high officials from each country and an independent chairman to inquire into ways and means of salvaging the common market and preserving regional common services. The commission is to report to the three governments by May 1, 1966.

[illegible] currency arrangements in the area in 196[illegible]. Under [illegible], Kenya, at least, is no more legally bound by the [illegible] Tanzania's decision to have its own monetary policies is only one of many developments leading to the progressive [illegible] of regional economic cooperation. Shortly after the Kampala [illegible] had been set up and before its ratification (which never took place) Kenya unilaterally withdrew its original approval to allocate to Tanzania an automobile assembly plant as a consequence of an offer from a group of local and foreign investors to build such a plant in its own territory. This relatively small incident forced prolonged multilateral negotiations of a revised list of allocated industries, injected a large measure of bitterness into Kenya-Tanzania relations and was largely responsible for Tanzania's putting into motion in mid-1965 of the second part of the Kampala agreement providing for the imposition of quota restrictions in case of persistent trade imbalance with other member countries of the East African Common Market. Such trade imbalance was supposed to be cured by the switch of some productive activities by enterprises with plants in various East African countries and by the orderly implementation of the agreement on allocation of major industries. Since none of these two schemes started working immediately, the patterns of trade hardly changed in the past two years, increasing grievances of Tanzania and Uganda. The seriousness of the situation from the viewpoint of the whole future of the East African Common Market could hardly be described better than in the following brief report written in early August 1965 from Dar-es-Salaam by an outside observer:

> President Nyerere explained why Tanzania had found it necessary to impose trade restrictions on Kenya. Speaking at the opening session of the Central Legislative Assembly he said that Tanzania had waited, following the Kampala Agreement last year, for ratification by the three East African Governments.
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> As the months went by without ratification Tanzania felt she had no option but to take action on her own, though in accordance with the princiles agreed in Kampala. It therefore decided to impose temporary quotas on certain Kenya imports with the sole object of promoting their production in Tanzania. This was an indication that Tanzania was taking only the very minimum action and then only when it became imperative for her own development. President Nyerere said that it was important to realize that even if the quotas cut imports from Kenya by as much as 2 million pound sterling annually, which was unlikely, Tanzania would still be the largest national importer of Kenya goods.19/

19/ "Tanzania [illegible] Curbs on Kenya" a cable from Dar-es-Salaam [illegible] *The Financial Times*, London, August 11, 1965.

[illegible] Tanzania's urgent development [illegible] a regional economic integration programme finds it necessary to threaten or apply trade reprisals to another member country, participating in the same scheme, the situation is hardly propitious - politically and otherwise - for an orderly and continuous expansion of cooperation in commercial, industrial and other fields. The future of East African Common Market seems to be further complicated by the absence of any progress with respect to a regional uniform treatment of foreign investment which - given the overall economic underdevelopment of East Africa - would have to provide a major share of financial resources for industrialization. In this respect East Africa witnesses today a race of three countries both to attract foreign industrial investment under almost any conditions and to find outside of the region new markets for their respective manufacturing output. In early 1965, the Kenya Parliament passed a foreign investment protection law, whose generosity can hardly be excelled by any other country and which aims at attracting foreign capital both from sterling and other hard currencies areas to, among others, tourist facilities, transportation, mining, agricultural machinery industry and alike.[20] A national licensing system for foreign-owned ventures have been set up at the Kenya Treasury, suggesting that any regional agreement on uniform tax incentives is presently further away than at any time in the past. Uganda on its part "amid the growing deterioration of the East African Common Market...has begun to look elsewhere in Africa for people to do business with"[21] and its Government was reported to order the Ministry of Commerce and Industry to organize trade missions to Rwanda, Burundi, Congo and Sudan to find new outlets for Uganda's growing industries in the view of trade restrictions being progressively imposed by Tanzania. Thus, instead of the growing coordination of economic policies and of the strengthening of institutional links and regional authorities implied in any dynamic common market arrangement, one witnesses the progressive disintegration of the only scheme of that sort which inspite of its shortcomings functioned in Africa for some forty years.

20/ Elisabeth Gillett, "Kenya Offers Incentives to Lure New Investment", The Journal of Commerce (New York), January 22, 1965

21/ Lawrence Fellows, "Uganda Looking for New Markets" (a cable datelined from Kampala), The New York Times (July 31, 1965)

37. The fate of the Kampala Agreement demonstrates that industrialization policy which under certain conditions could be the greatest potential source of economic and social gains from close East African integration, became within the extremely short time the most important source of economic tensions within the region and may lead soon to a disruption of the East African Common Market, substituted by three "beggar-your-neighbour" import substitution policies which will in a longer run only increase the unviability of three economies involved. Judging by experiences of smaller Latin American republics with a level of overall development similar to that of each of the three East African republics, they have about five-years time, if finally decide to "go it alone", to reach the stage in which no additional substitution of imports will be feasible, independently of all possible national tax incentive laws aimed at attracting foreign investment and of all efforts to find outside outlets for their manufacturing output. This goes not only for Tanzania and Uganda but for Kenya as well, which because of the common market arrangements has moved ahead of the two other countries, by accounting in 1962 for some 45% of manufacturing employment in the region, 60% of gross product in the industrial activities and over 75% of interterritorial exports of non-food manufactures. Whereas it is obvious that Kenya was the biggest gainer from the regional arrangement, the break-up of the common market will inexorably make all three countries net losers in a new situation and will retard their national economic development which would have been possible only through raising dramatically total investment in the region.

38. Without forgetting political difficulties between the three members of the East African Common Market after the independence, which have in part their roots in the three distinct political and economic policies followed in the area by the colonial authorities in the pre-independence days, one is forced to conclude that the major reason for the failure of the Kampala Agreement was the fact that it established a close link between the distribution of industrial projects and the problem of persistent imbalances in visible intra-territorial trade. Although the institution of quota systems applicable to imports from surplus to deficit countries was probably considered by the largest deficit country - Tanzania-as the only weapon at its disposal to force Kenya (principally) to abide to the terms of the agreement, the link was based on a wrong assumption that the distribution of new industrial activities will immediately result in the radical change in the patterns and flows of trade. The obvious lag between the decision to allocate the majority of new plants or branches of existing enterprises to the less developed members of the common market and the appearance of new trade flows, the lag which in any part of the world would last several years, was obviously disregarded and, consequently, at the first sign of stress in mutual economic relations, the restric-

tive and not expansive part of the mechanism was put into the motion. Thus, the signatories of the Kampala Agreement got the worst of the possible worlds - interterritorial trade imbalances diminished somewhat but at the cost of its overall decline while no benefits of the accelerated regional industrialization accrued to the region. Whatever immediate gains such development might have brought to Tanzania and Uganda by forcing some industries to establish themselves in their respective territories, it resulted, in fact, only in the substitution of their imports from the rest of East Africa instead of fostering the regional substitution of imports from the rest of East Africa instead of fostering the <u>regional</u> substitution of imports from the rest of the world, a primary objective of any economic integration scheme undertaken in the context of the underdevelopment for the purpose of industrialization.

39. The additional reasons for the failure of the Kampala Agreement were the inability of the interested parties to incorporate in it any instruments of regional industrialization policy other than licensing arrangements. Such potential instruments include (a) close cooperation in the field of building up the infrastructure conducive to economic and industrial integration; (b) strengthening of the already available mechanism for consultations among the finance ministers in respect to industrial tax incentives; (c) formal agreement on uniform customs protection for new enterprises considered as 'regional industries'; and (d) agreement on the role of the national state-owned development corporations in respect to regional industrial projects. In these matters, at least, inspite of its forty-years of existence, the East African Common Market seems to be much behind the Central American integration scheme set-up less than a decade ago.

40. The final weakness of the Kampala agreement originates not from national economic policies of the signatory governments but from international conditions under which at present the underdeveloped countries - jointly or individually - try to implement their industrialization policies and programmes. Since the exporters from the industrial countries to the underdeveloped regions in Africa and elsewhere are covered by their own governments against any kind of risks involving their sales of the most liberally defined capital goods, a growing competition for external markets develops with very little regard for viability of the developing economies. In the face of increasing barriers to traditional exports of consumer goods, reflecting industrialization ambitions of the newly independent countries of Africa, the manufacturing and commercial interests of the advanced countries are willing and ready to jump these barriers in one of two ways: either by setting up productive facilities whenever enough protection is offered or by selling equipment to local manufacturers or national

[illegible] or the [illegible] risks of direct investment are too [illegible] of the market does not warrant direct involvement. [illegible] external interests [illegible] allies of domestic groups [illegible] lack of viability of the industrialization [illegible] exclusively to national frontiers and of the high price paid for that type of self-defeating industrialization. The ability of a small underdeveloped country to sell almost any protection to attract a foreign industrial firm and the willingness of the advanced countries to offer bilateral industrial credits as long as they are tied to exports of specific goods represent probably the single major external obstacle to economic integration schemes in the poor regions, by effectively blocking attempts to elaborate some regional integration policies. Any future work on subregional economic cooperation in Africa will necessarily have to take these partly political and partly economic facts of life into serious account.

III

41. The failures of the Central American Regime for Integration Industries and of the Kampala agreement on regional licensing of industries point toward a great practical difficulty to elaborate and implement a scheme for a politically acceptable and economically viable distribution of industrial activities among the underdeveloped participants of a regional integration scheme. The principal lesson of the Central American and the East African experiences is twofold: (a) the distribution of benefits of the integration scheme, whether a freetrade zone, a customs union or a common market, cannot be left to the free play of market forces as they do not operate efficiently in an underdeveloped environment; (b) the equitable distribution of new industries cannot be attempted in isolation from other aspects of the integration process. On the other hand, taking into consideration institutional weaknesses present in the underdeveloped areas and the persistent shortage of skilled administrative and entrepreneurial resources one can hardly put too much confidence in the full-scale regional economic planning or in the harmonization of national industrial policies. In most cases, whether in Africa, Asia or Latin America, national development plans exist only on paper and national industrial policies amount to a series of improvisations imposed upon the governments by domestic difficulties and external economic problems.

42. This diagnosis should not be construed, however, as a flat denial of a possibility to foster regional industrialization in the developing areas. It attempts rather to defend a proposition that the [illegible] of multinational cooperation in this field [illegible] of minimum conditions for limited cooperation

and coordination among a limited number of [illegible] countries and not for grandiose plans for integration [illegible] hope-ful but unrealistic assumption that a large number of countries without any previous integration experience will somewhat and some day harmonize their divergent economic policies and pool their natural and capital resources. This last position greatly underestimates the force of economic nationalism and the power of vested interests. As demonstrated in Latin America, both within nine-countries LAFTA and in the much smaller Central American Common Market, the economic integration amounts to a slow, complicated and painstaking process of building up step by step regional institutions and cooperation mechanisms and of creating political support both in the public and private sectors in the area to assure the functioning of such multinational economic arrangements.

43. The success of industrial integration would depend, thus, to a considerable extent upon the previous emergence of an overall institutional framework, preferably in a form of a customs union, providing for gradual freeing of practically all trade - with possible special regime for agricultural products - but not equating benefits of integration with the balance of trade flows. The introduction of such concept would tend to equilibrate the commercial interchange at the lowest and not highest potential level and eliminate the dynamic long-run effect of regional trade on development prospects of the area. Assuming - what is doubtful - that the regional trade balance and not the overall trade position of each country vis-a-vis the rest of the world in an objective worthwhile to pursue, the correction of possible regional trade disequilibria should be left to non-trade mechanisms and the success in this field will obviously depend on a regional investment policy. Such a regional investment policy is possible only either when the economic integration process is fairly advanced, which is not the case of the emerging free trade zones or common markets in the developing countries, or when the capital exporting rich countries show readiness to support fully and on a multilateral basis a given integration experiment. The second condition has not been fulfilled as yet any place. Under those circumstances, it is left to the participating underdeveloped countries to work out a limited regional investment policy through the following steps:

(a) identifying first productive sectors which could take advantage of available external economies and potential economies of scale offered by the multinational market;

(b) elaborating a series of concrete projects within these sectors;

(c) agreeing upon a regional uniform system for customs protection and tax incentives so as to avoid cut-throat competition for scarce production factors among prospective domestic and foreign investors;

(d) putting jointly at the disposal of potential investors certain development finance facilities; and

(e) setting up a permanent regional negotiation mechanism distributing periodically throughout the area new projects of regional interest.

44. Such a limited regional investment policy implies the early establishment in addition to a free trade or common market general treaty, of a few important legal instruments mentioned above under point c; and, furthermore, the availability of a regional development bank or corporation and a regional industrial research institute. This last institution is probably decisive since any attempt to allocate regionally not yet-existing industries in expectation of favourable response from potential investors or to distribute projects one-by-one when they are submitted by private interested parties is bound to end in failure, increasing political frictions and reciprocal recriminations. The negotiations on equitable distribution of new industrial projects in a multinational set-up represent the last and not the first step of a limited regional investment policy and their success or failure will depend upon the number and the quality of projects, subject to negotiations. Here, the importance of a regional industrial research organization and its ability to elaborate concrete feasibility studies become clear. If a group of countries embarking on an economic integration venture cannot assure a relatively effective functioning of such regional body, then any talk about regional industrial planning or harmonization of national development plans, which involve much bigger organizational and operational effort, represents a clear case of self-defeating although well-sounding mass delusion.

45. It is sometimes sustained that the allocation of new productive activities among a group of developing countries is an extremely difficult exercise on economic grounds, because of the alleged unavailability of external economies except in few selected places. But anyone acquainted with the present conditions in respect to infrastructure and natural resources endowment in Central America and East Africa and having some idea of the modern technology can hardly accept such pessimistic proposition. As one of experts working on economic integration

problems put it:

> except in industries tied closely to highly specific natural resources that are expensive to ship, the advance of modern technology has greatly reduced the natural advantages of siting manufacturing activities in one place rather than another. By now, the advantages of one site over another are largely man-made rather than nature-made. And if advantages are made by man, they can also be changed by man in accordance with rational and deliberate planning criteria.[22]

46. Leaving aside aluminium smelting, iron and steel industry and few others, scores of possible industrial projects, and practically all of them in the field of consumer durables and intermediate manufactures, could be both in case of Central America and East Africa located alternatively in many places. If this is the case, then in the final analysis, the success of industrial distributive mechanisms must depend on the broad availability of projects and the failure of past mechanisms cannot be ascribed to the limitations of possible locations but exactly to the shortage of well-prepared projects and the scarcity of financial and entrepreneurial skills. Fulfilled the basic conditions - the broad range of feasibility studies and well-elaborated projects - whose preparation could be financed with funds forthcoming from UN Special Fund, the World Bank or the regional development institutions such as the African Development Bank, the field would be cleared for putting into motion the multinational negotiation mechanisms in each integrating area.

47. The rules of those negotiations would have to take into consideration two important facts: (a) although there must exist a number of alternative locations - acceptable on economic analysis grounds - for any given project in a multinational region, the least developed countries have lesser possibility in that respect than the more developed member nations; and (b) even given the high quality of projects, there is no assurance that all of them would attract potential investors whether from within or without the area. Consequently,

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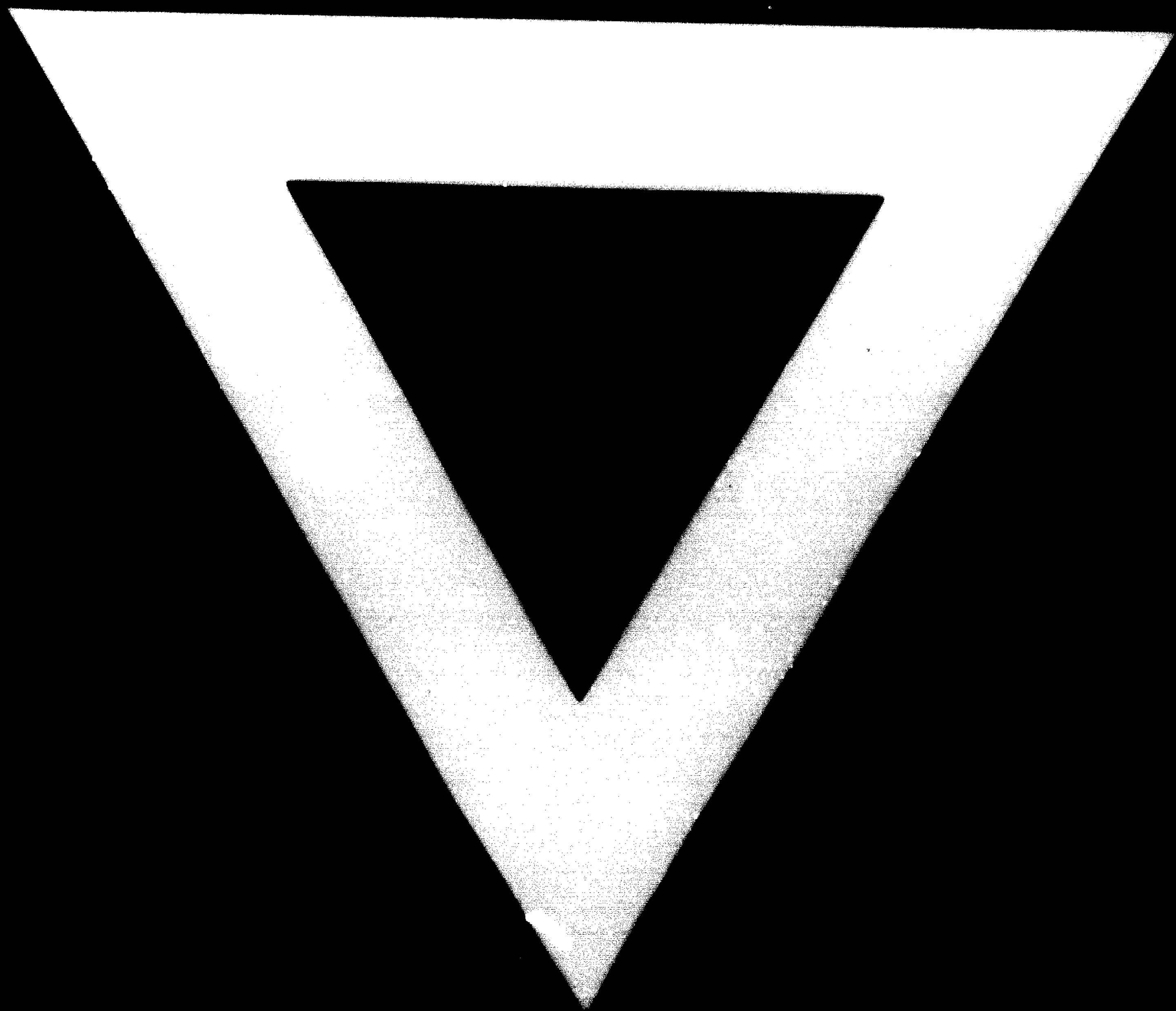
22/ Sidney Dell, A Latin American Common Market? Oxford University Press, London-New York-Toronto, 1966. p.69.

[illegible] "forum" of [illegible] first proposal to the [illegible] assumption that [illegible] project can [illegible] into the [illegible] Secondly, once the [illegible] of the integration scheme [illegible] from potential investors [illegible] within previously agreed [illegible] would appear on the regional [illegible] corporation would undertake the [illegible] participation of the [illegible] of nationals of the country to which the project had been allocated. Even in this last case, the provision would have to be made for the regional corporation to divest itself of the enterprise once the prospective buyer were found. This provision tries to avoid the tying up to industrial projects of scarce capital resources badly needed in any underdeveloped area for social overhead investment.

48. It well may be that some variant of the above outlined scheme should be tried on an experimental basis in one of the proposed common market arrangements in Africa. In the opinion of this writer, the future of these integration programmes will depend to a considerable degree upon the successful introduction of a scheme which would assure all the members some kind of participation in the industrialization process. As of now, no such mechanisms are available and prospects for ambitious regional industrialization programmes or the so-called harmonization of national industrial policies, starting from the top and not from the project level, seem - frankly speaking - exceedingly dim.

Mexico City December 1965



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