

**A CRITICAL OVERVIEW OF REGIONAL TRADE  
INTEGRATION: LESSONS FOR COMESA**

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## **KEY WORDS.**

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Trade Creation

Trade diversion

Static gains

Dynamic gains

European Union

ASEAN (Association of Southeast Asian Nations)

SADC (Southern African Development Community)

COMESA (Common Market for Eastern and Southern Africa)



## **ABSTRACT**

### **A CRITICAL OVERVIEW OF REGIONAL TRADE INTEGRATION: LESSONS FOR COMESA**

Regional trade integration is considered as trade discrimination, thus as a second best solution if compared to the unilateral trade liberalization advocated by the WTO. However, starting after the Second World War, the number of regional trade arrangements (RTAs) continues to grow as a result of the benefits that countries engaged in trade integration expect to get from that process.

Theoretical experiences indicate that if all other things are equal, a regional trade integration arrangement may provide economic gains (ranging from static to dynamic gains) to its member countries. Empirical evidence proves that developed countries such as those of Europe, have benefited from regional trade integration, whilst the gains from regional trade integration failed to materialize in developing countries. COMESA is one of the biggest RTAs in Sub-Saharan Africa with twenty members including Rwanda. Rwanda joined COMESA in the hope that this will help to develop its economy which is underdeveloped and which situation has been worsened by the 1994 war and genocide.

Given the poor performance of RTAs in developing countries, the main aim of this study was to determine which strategy would be most appropriate to enhance regional trade integration in COMESA so that it can provide to its member states the benefits they expect to have from it.

Statistic descriptive and comparative analysis methods were used to investigate what the COMESA region can learn from other trade regions in order to enhance its intra-regional trade, as this is its main objective. The study was limited to the experiences of integration in the European Union, the ASEAN and the SADC regions. These regions have

experienced successes and failures and some of them have some resemblance with COMESA countries.

The findings are that for regional trade integration to be successful there are many conditions that need to be complied with, such as a favourable macroeconomic environment, a diversified export base and adequate infrastructure. Experiences in the European Union, ASEAN and SADC indicate that the satisfaction of these conditions may be possible through government activity coordination and the project cooperation approach to regional integration. Thus this study recommends that the market integration in COMESA should be supplemented with government activity coordination and project cooperation in order to ameliorate economic conditions in member states and enhance regional trade integration.



## DECLARATION

I declare that “ *A critical overview of regional trade integration: lessons for COMESA?*” is my own work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Francine UMURUNGI

November 2005

Signed:.....



## **DEDICATION**

To my mother Murebwayire M. Regine, my husband Dr Ngoga Eugene, my two lovely daughters Usanase Anais and Teteri Sybille, for their prayers, love and support.



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## ABBREVIATIONS AND ACRONYMS

AFTA:	ASEAN free trade area
APEC:	Asia Pacific Economic Cooperation
CACM:	Central American Common Market
CEPII:	Centre d'Etude Prospective et d'Information International
CREFSA:	Centre for Research into Economics and Finance in South Africa.
CU:	Customs Union
CUSTA:	Canada-US Trade Area
DRC:	Democratic Republic of Congo
ECCAS:	Economic Community for Central African States
ECOWAS:	Economic Community of West African States
GATT:	General Agreement on Tariffs and Trade
HWWA:	Hamburg Institute of International Economics
MERCOSUR:	Southern Cone Common Market (Mercado Comun del Sur)
NAFTA:	North American Common Market
NIC:	New Industrialized Countries
PIDS:	Philippine Institute for Development Studies
PTA:	Preferential Trade Area
RTA:	Regional Trade Arrangement
TC:	Trade Creation
TD:	Trade Diversion

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# CHAPTER ONE: INTRODUCTION

## 1.1 THE BACKGROUND OF THE STUDY

Rwanda is a small<sup>1</sup>, low income, landlocked country situated in east-central Africa, 1600 km away from the nearest port (RIPA I, 2002:3)<sup>2</sup>. Its neighbouring countries are Uganda to the north, Tanzania to the east, Burundi to the south and the Democratic Republic of Congo to the west.

In 1999, the Rwandan population was approximately 8 million people, with an average annual population growth rate of 2.9 % between 1990 and 1999. In 1996, more than 90 % of the population lived in rural areas with subsistence farming being the main economic activity. With regards to education, Rwanda has a relatively high primary enrolment rate (87 % of children in the relevant age group), as compared to that of the sub-Saharan as a whole (78%). However, it also has a high dropout rate. Of the relevant age group only 7% and 1% respectively have access to secondary and tertiary education (compared to 27% and 2% respectively of the Sub-Saharan region as a whole). The adult literacy rate is also among the lowest in the region (RIPA I, 2002:3).

Although the Rwandan economy has been severely affected by the war and genocide that occurred in 1994, it has recovered considerably thanks to the good governance of its political leaders. In 1999, Rwanda had a GDP of US\$ 1,531 million with the agriculture contributing 41%, the manufacturing industry 20% and the service sector 39% (RIPA I, 2002:4). Two commodities, namely coffee and tea, constitute the main exports of Rwanda. In 1999, these two commodities contributed 43% and 28% respectively to the total export value of US\$ 61.2 million. However, Rwanda is also trying to promote non-traditional exports such as fruits and flowers. In the same year (1999), the imports were estimated at US\$ 224.5 million, which is three times higher than the estimated exports (RIPA I, 2002:7).

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<sup>1</sup> The total area of Rwanda is 26 338 km<sup>2</sup>

<sup>2</sup> The Rwanda Investment Promotion Agency (RIPA) Reports were compiled in two volumes. In the text, volume I is referred to as RIPA I, while volume II is referred to as RIPA II.

Although the Rwandan economy recovered considerably after the war and genocide of 1994, economic indicators show that much remains to be done. In order to step up efforts to reduce the trade deficit, diversify the export base, create more employment<sup>3</sup>, increase foreign reserves, in brief to develop the economy, Rwanda adopted, among other things, a liberalized trade policy. In order to benefit from all possible export opportunities, trade liberalization in Rwanda has been both multilateral and regional.

On the regional front, Rwanda is a member of several regional integration agreements. These are the Regional Integration Facilitation Forum (RIFF)<sup>4</sup>, the Common Market for Eastern and Southern Africa (COMESA), the Economic Community of Central African States (ECCAS), the Akagera Bassin Organisation and the Communauté Economique des Pays des Grands Lacs (CEPGL). However, only two of these regional integration arrangements are active, namely the CBI and COMESA.

This study focuses on COMESA because it is the most important regional integration group in the Sub-Saharan region in terms of its membership. COMESA's success will boost Africa's economy in general and will particularly benefit Rwanda, which is on its way to economic recovery and development.

As is clearly stipulated in the RIPA II (2002: 74), the benefits that Rwanda expects to gain from COMESA membership are as follows:

- First, because of the larger market, it will be possible to realize economies of scale and greater efficiency, which will improve industrial capabilities.
- Second, with the expansion of the industrial base, new investments will be attracted and more employment created.
- Lastly, the diversification of the economic structure in the areas of manufacturing and services will also enable the country to deal with economic and other setbacks.

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<sup>3</sup> On this note, following the example of Mauritius, Rwanda intends to establish an export-processing zone that will make it possible to create new employment to absorb its unskilled people in fields such as clothing, textile and footwear industries (RIPA I, 2002:133-134).

<sup>4</sup> The CBI changed its name in 2001 to become the Regional Integration Facilitation Forum (RIFF). It is not a regional integration as such; its aim is to facilitate the effective implementation of regional integration initiatives taken by member countries at the national level and it is open to countries from multiple regional arrangements including the COMESA.

However, in order for these benefits to materialize, COMESA must be successful, unlike many other organizations, such as the CEPGL, the Akagera Bassin Organisation and the former East African Community, which have failed to achieve their objectives of developing the economies of their respective member countries.

## 1.2 THE PROBLEM STATEMENT

According to the theory of international trade, unilateral free trade is superior to trade discrimination<sup>5</sup> among trade partners, through regional trade integration. However, Lloyd and Maclaren (2004:446) point out that, at the time of GATT in the 1948s, regional trade integration was considered advantageous to partner countries, as it constituted a removal of barriers to mutual trade between those countries, a process that could help to increase intra-regional trade. Furthermore, if the formed trade bloc had not raised trade barriers against the rest of the world, the process could have been regarded as a step towards global free trade, which is the first-best solution in international trade.



After the Second World War, the number of regional trade arrangements (RTA)<sup>6</sup> did not cease growing, despite the second-best solution nature of regional trade integration. The World Bank (2000:1) lists 194 regional agreements notified to the WTO until 1999. In addition to this, according to Kreinin and Plummer (2002:1), each country in the world is a member of at least one RTA, with Japan and Korea being the only large countries that are not affiliated to any regional group.

This is due to the benefits that the countries, engaged in forming trade blocs, expect to gain from the integration. After the Second World War, countries were eager to re-establish security and peace and to reconstruct their economies, which had been devastated by the war. Regional trade integration was thus used as an instrument to

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<sup>5</sup> There may be two kind of trade discrimination; the first one is commodity discrimination when a given country imposes different import tariffs on different commodities. There is also country discrimination when a country imposes different import tariffs on the same community depending on the country of origin.

<sup>6</sup> In the rest of the report, the abbreviation RTA will be used.

restore political unity, stability and economic development. The process was better developed in Europe<sup>7</sup> while the USA favoured unilateral trade liberalisation under GATT (Pomfret, 1997:81).

Further reasons for the proliferation of the RTAs included firstly the slow-down of global trade negotiations under the WTO (Murinde, 2001:1). This changed the trade policy of the USA in the 1980s, which swung in favour of regional trade integration. Secondly, trade imbalances between developed and developing countries encouraged trade among developing countries under the formation of RTAs, based on the assumption that, since those countries were at the same level of development, the economic integration among them would bring about competition, which in turn would increase efficiency in production and trade at the regional level.

Thus, regional trade arrangements are formed mainly for political and economic reasons and they are formed between developed countries (EU: 1957)<sup>8</sup>, between developing countries (ASEAN: 1967, SADC: 1980, COMESA: 1981)<sup>9</sup> and between developed and developing countries (NAFTA: 1992, CAFTA-DR: 2004)<sup>10</sup>.

As we shall see in the next chapter, there are multiple forms of trade discrimination between countries through regional trade integration. These forms include the

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<sup>7</sup> This may be explained by the fact that European countries suffered immense destruction during the World Wars.

<sup>8</sup> The EU refers to the European Union, which was formed in 1957. The actual members of the EU are: Belgium, France, the Federal Republic of Germany, Italy, Luxembourg, Netherlands, Denmark, Ireland, United Kingdom, Greece, Portugal, Spain, Austria, Finland and Sweden.

<sup>9</sup> The ASEAN refers to the Association of Southeast Asian Nations formed in 1967; its member countries are Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Darussalam, Vietnam, Myanmar, Lao People's Democratic Republic, and Cambodia.

The SADC is the Southern African Developed Community formed in 1980 and its members are: Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia, Namibia, South Africa, Mauritius, Democratic Republic of Congo and Seychelles.

COMESA is the Common Market for Eastern and Southern Africa formerly the PTA (Preferential Trade Area), formed in 1982. Its members are: Angola, Burundi, Comoros, Djibouti, Egypt, Eritrea, Kenya, Madagascar, Mauritius, Malawi, Namibia, the Republic Democratic of Congo, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe

<sup>10</sup> NAFTA is the North American Free Trade Area comprising of Canada, the United States of America and Mexico and CAFTA-DR is a free trade area between the Central American countries (El Salvador, Guatemala, Honduras, Nicaragua, Costa Rica), the USA and the Dominican Republic.

Preferential Trade Arrangement (PTA), the Free Trade Area (FTA), the Customs Union (CU) and the Common Market (CM). However, the most important theory to which all others refer concerning the benefits of RTAs, has been that of Customs Unions developed by Viner (1950).

Viner (1950) and his successors, as well as the experiences of Europe and North America, have demonstrated that regional trade integration brings benefits to countries that are united under trade integration. These benefits range from static gains (efficient resource reallocation, trade increase, welfare improvement, etc.) to more dynamic gains (industrial development and economic growth).

The theory of customs unions, however, does not draw any distinction between developed and developing countries concerning the benefits to be obtained, which means that, all other things being equal, any regional trade bloc should bring the above-mentioned benefits to its member countries, regardless of whether it is formed between developed or developing countries.



However, this has not been the case. On the one hand, developed countries managed to benefit from RTAs formed among them. The EU constitutes a typical example of this. On the other hand, benefits from regional trade integration within developing countries failed to materialize. This has been the case in the COMESA region where, despite efforts to reduce trade barriers and to deepen integration among member countries, intra-regional trade remained very low compared to other trade regions.

This suggests that certain prerequisites exist in order for the benefits from regional trade integration to be obtained. These include sound macro-economic policies, adequate infrastructure and diversification in the production of export goods.

Given the problems indicated above, the objectives of this study are:

- To determine why RTAs among developing countries failed, whereas they succeeded in developed countries (The examples of the EU, ASEAN and SADC are cases in point.)
- To assess the performance of integration in the COMESA region,
- To identify the failures and successes in other RTAs and determine to what extent these may serve as guidelines for promoting integration in the COMESA region,
- To identify the potential for increasing intra-regional trade in the COMESA region,
- To make recommendations regarding the specific strategy COMESA should adopt to promote trade integration among its member countries.

### **1.3 RESEARCH QUESTIONS**



The objectives of the study lead to ask the following questions:

- What is the economic theory behind regional trade integration?
- What are the gains from regional trade integration and through which mechanisms do these gains materialize?
- What were the motives behind the formation of regional trade blocs?
- What have been the costs and benefits of regional trade integration in different trade blocs?
- How does regional trade integration in COMESA perform?
- What can COMESA member countries, and especially Rwanda learn from similar developing countries in SADC and ASEAN and from developed countries in the EU?

## 1.4 METHODOLOGY

The methodology is descriptive, but also investigative. This study is based on qualitative research methods and uses available data from the following sources:

- The United Nations Conference for Trade and Development (UNCTAD) reports,
- Statistics from the World Bank (World Development Indicators),
- Statistics from the COMESA secretariat available online,
- Data compiled from academic journals and research reports,
- Various Internet sources have also been consulted.

Descriptive statistics is used to analyse the data. Simple averages and comparison of data from different regions are used to answer the research questions. As this method has been used in other research of this kind, the researcher is confident that it will help to obtain results that are reconcilable with the existing evidence.

## 1.5 LIMITS OF THE STUDY



Regional integration covers a wide range of integration forms, which encompasses trade integration, monetary and even political integration. As the title of this work indicates, the study, however, focuses only on trade integration.

The study is limited to the analysis of the experiences of trade integration in the EU, the ASEAN and SADC. COMESA has more to learn from them than from other regional arrangements. For practical purposes, only founder member countries in the case of the EU and ASEAN were taken into account, as the actual membership list is very long. Regarding COMESA, the research took into account only those countries, which had eliminated all their tariffs by the end of 2000. The countries which were investigated in COMESA and which are, at the same time, members of SADC, have not been considered in the case of SADC.

Experience has shown that there are many requirements for a RTA to be successful. This research examines only three of them: macro-economic policies, infrastructure and the diversification of export goods.

## **1.6 LIMITATIONS OF THE STUDY**

Many studies assessing the successes and failures of regional trade integration schemes have investigated the benefits accruing from regional trade integration in terms of trade creation and trade diversion (or other kinds of benefits). They have also examined the causal relationship between tariff elimination and the change in intra-regional trade, as well as the impact of this change on the economies of member countries.

Most studies evaluating relationships of this nature have used the CGE and the gravity models. Given limited technical knowledge and the lack of required data, it has not been possible to undertake a study of this kind. This may be a field for further research.

## **1.7 ORGANISATION OF THE STUDY**

The study is organized as follows:

- Chapter two reviews the theory on regional integration and the emphasis is placed on the explanation of the gains from trade integration.
- Chapter three concerns the empirical review, in which a brief overview of the experiences of trade integration arrangements on different continents is presented and the impediments to trade integration, such as bad macro-economic conditions are exposed.
- Chapter four assesses the performance of regional trade integration in COMESA.
- Chapter five gives the general conclusion and recommendations.

## CHAPTER TWO: THEORETICAL FRAMEWORK

### 2.1 INTRODUCTION

As has been explained in the preceding chapter, in brief the main aim of this study is to review the experiences of regional trade integration in different RTAs, which can provide lessons to member countries of COMESA, to make it an instrument of trade promotion and economic development. However, before this, a theoretical framework must be established in order to understand how RTAs work and through which mechanisms they provide benefits to their member countries. This is the aim of this chapter.

Section 2.2 reviews the different forms of regional integration and explains how these are related. Section 2.3 explains the relevance of the Customs Union to the sustainability level in trade integration. Section 2.4 defines the gains from regional trade integration, which are presented under static and dynamic gains. Section 2.5 gives the summary and conclusion.



### 2.2 DEFINITIONS AND FORMS OF REGIONAL INTEGRATION

As defined by Carim (1997: 336), trade integration “is a condition (or process) wherein separate national economies maintain (or progressively) lower barriers to mutual trade, while sustaining relatively higher barriers to third parties”. Carim (1997) also gives two different types of classification of regional trade integration. The first one complies with the sequential progression<sup>11</sup> of degrees of integration, which are the following:

- *A preferential trade area (PTA)* where member countries reduce barriers to the intra-trade but maintain tariffs on trade with non-members
- *A free trade area (FTA)* where member countries eliminate all barriers to the intra-trade but maintain their separate tariffs vis-à-vis non-members
- *A customs union (CU)* is a free trade area where member countries establish a common external tariff on goods from non-members.

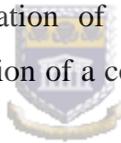
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<sup>11</sup> This means that the countries which want to be united under a regional integration arrangement, must progressively go through each form of integration, from the PTA to the EU.

- *A common market (CM)* is a customs union where member countries also allow free movement of labour and capital in their territories.
- *An economic union (EU)* is a common market where member countries harmonize their economic policies.

Another classification of regional integration comprises the following forms: trade or goods market integration, labour market integration, capital market integration, monetary integration and integration of government activity and regulation.

The first three forms in this classification imply the removal of barriers to the free movement of goods, services and production factors, while monetary integration is viewed as an “adoption of a common currency, a common central monetary authority, and a surrender of national autonomy in the field of monetary and exchange rate policy” (Foroutan, 1993:239). The integration of government activity and regulation, also called government co-operation, is viewed by Foroutan (1993; 239) as an “adoption of similar tax and investment codes, harmonization of administrative and bureaucratic rules, creation of a joint administration, creation of a common infrastructure, and the provision of common services...”



For Carim (1997) and Foroutan (1993), the second classification of integration is preferable to the first, as it allows the five forms of integration to occur either together or separately. Carim (1997) furthermore argues that the combination of government co-operation and trade integration is the most appropriate form of integration for African countries, as long as this combination can provide an adequate environment for producers that are starting to compete in the world market.

The European Union may be regarded as an example of a successful regional integration scheme that has followed the first classification of integration from the PTA up to the EU. In Africa, some RTAs have also followed the same classification, but have encountered implementation problems, so that after several decades they are still at the level of a FTA. COMESA achieved that level in 2000, with only 9 out of 20 of its

member countries<sup>12</sup>. Owing to problems that arise between countries forming the FTA (which may be solved by forming the CU), COMESA member countries must make sure that they reach the CU level if they want their integration process to be sustainable. The next section briefly explains the relevance of the CU level.

### **2.3 THE RELEVANCE OF THE CUSTOMS UNION LEVEL**

As discussed in the next section, countries under the same regional trade integration do not always have equal chances to benefit from the integration and some of them even end up losing, through switching their imports from the lower-cost non-partner producer to the high-cost partner producer. For example, in the COMESA region, countries such as Kenya, Zambia and Zimbabwe, which have relatively more developed economies, gain more than countries such as Rwanda, Burundi, and Madagascar, which are still at a low level of economic development. One way of helping the losing countries is to pool the revenue from trade and share it. This kind of revenue-sharing has greatly helped small countries in the South African Customs Union (SACU)<sup>13</sup>.



In a free trade area (FTA), countries cannot pull the revenue together, because the external tariffs differ. Therefore, it will not only be impossible to help the disadvantaged countries, but the imports from outside the FTA will also always be deflected by the lower-tariff member, who will receive all the FTA's tariff revenue. This will exacerbate the problem of the distribution of gains from regional trade integration.

As Pomfret suggested (1997:186), this problem can be solved by the rules of origin that prevent direct trade deflection by banning duty-free trans-shipment of external goods. The author goes on to say, however, that in most cases, the rules of origin turn out to be economically irrelevant if sufficient indirect trade deflection is possible; that means if the goods on which the tariff is eliminated, are also produced in the lower-tariff FTA member country.

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<sup>12</sup> Countries that were members of FTA in COMESA in 2000 were: Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia and Zimbabwe. Rwanda joined in 2004.

<sup>13</sup> SACU was created in 1910 between Botswana, Lesotho, Namibia, South Africa and Swaziland.

Pomfret (1997) quotes Vousden (1990) and Shibata (1967) and argues that the higher-tariff country cannot afford to lose all its income to the profit of its partner. It will rather reduce its inordinately high tariff to below that of the lower-tariff member and the process will be repeated until all FTA member countries' external tariffs are zero.

The only way to stop this vicious circle of lowering external tariffs by FTA member countries is to agree upon a common external tariff and presumably share the tariff revenue. This may lead to the conclusion that CUs are more stable than FTAs. Moreover, the low level of the external tariff will allow the industries in the region to become more competitive and increase the incentives for technological improvements. In addition to this, Vanek (1965), Kemp (1969) and Kemp and Wan (1976) are of the opinion that, if countries manage to agree on a common low external tariff, the disadvantaged countries may keep on importing from the lower non-partner producer.

In the light of the above discussion, the implementation problems that COMESA countries encountered and the time it took to achieve the level of an FTA, one may suggest once again that it is imperative for COMESA countries to invest more effort and commitment in the integration process to make it sustainable.

In the meantime, however, there is much that COMESA member countries can gain even under FTA. The following section discusses the possible gains from regional integration.

## 2.4 THE GAINS FROM REGIONAL TRADE INTEGRATION

The gains from regional integration are classified into two categories: static gains and dynamic gains.

### 2.4.1 Static gains

Regional trade integration is regarded as advantageous, because it allows for an increase of trade between partner countries, as there is a reduction of tariffs. Therefore, regional trade integration is not seen as a stumbling block to free trade but as a way towards it. However, the question arises as to whether the increase of trade between member countries of a RTA is always beneficial to those countries individually and as a group.

Before the work of Viner in 1950 on *The Customs Union Issue*, the answer to the above question was ambiguous and non-measurable. Viner's analysis introduced the theory of trade creation and trade diversion that has called into question the desirability of regional trade integration.



#### *2.4.1.1 Traditional Static gains: trade creation and trade diversion*

Viner took into account only trade-creation and trade-diversion effects, which are considered by Cline (1978) as traditional static gains. Trade creation occurs when there is a shift in domestic consumption from the high-cost domestic source to a lower-cost partner source, due to the elimination of tariffs on intra-regional trade. Trade diversion occurs when there is a shift in consumption from a low-cost world source to a high-cost partner source as a result of the elimination of tariffs on imports from the partner (Hine, 1994).

Thus, according to Viner's analysis, trade creation will bring gains to the union, while trade diversion will lead to a loss. This means that regional trade integration will be beneficial only if the effect of trade creation is big enough to outweigh that of trade diversion. Referring to Viner (1950), Lipsey (1960) declares that trade creation can

occur if both countries, the importer and exporter in the union, are producing the same commodities. With reference to Makower and Morton (1953), the same author adds that the larger the difference between the cost at which the same commodity is produced in the country; the larger trade creation will be. Moreover, according to Waschik (2004), the more elastic the import demand curve of the importing country, the greater will be the trade creation. Trade creation will also be greater the higher the initial tariff.

Carim (1997) describes two situations in which trade creation is more likely to outweigh trade diversion: This may happen firstly if trade between member countries is large or has the potential to become large as compared to their overall trade; secondly, if the productive structures of the member countries are complementary.

Thus, according to Viner's theory, although the increase in intra-trade between member countries of a RTA may be a necessary condition, it is not a sufficient one. For a regional trade integration to be successful, the trade created must be big enough to outweigh the trade diverted.



Viner's successors, such as Meade (1955), Gehrels (1956-7), Lipsey (1960) and Johnson (1960), showed that Viner's analysis was based on unrealistic assumptions of inelastic demand and perfect competition. These authors pointed out that, once these assumptions are relaxed, even a purely trade diversion union may be beneficial. In effect, Viner limits his analysis to inter-country substitution in the production of traded goods and ignores the inter-commodity substitution in consumption that follows from changes in relative prices resulting from tariff elimination. As the consumer in the importing country is now able to alter his consumption, following the price change, he will increase or at least maintain his utility. At the same time there will be an increase in trade for the whole union. Thus even a trade-diverting union can be beneficial.

Elkan (1975) also suggested that a trade diverting union could be beneficial. In fact, in the presence of trade diversion, the importing country incurs costs, which are represented by the difference between the price at which the newly imported goods from a partner

country are purchased and the price at which comparable imports could be obtained from third countries. A trade-diverting union will be beneficial if the benefits from the integration outweigh the costs. In this case, trade diversion may not be a problem. The biggest and most serious problems arise when there is a “polarization of economic development on the territory of one or a few member countries” (Elkan, 1975: 59).

Along the same line of thought, Baldwin and Venables (1995) argue that if the integrating countries were at different levels of development prior to the integration, the overall gains from it will not be equally shared and the more-developed will gain at the expense of the less developed. Furthermore, the mechanisms to compensate the losing countries are mostly difficult to establish, especially in developing countries. Empirical studies have shown that regional trade integration succeeded in developed countries, whereas it failed in developing ones, mainly because of unequal distribution of the gains and a lack of compensation mechanisms. This was the case in the old East African Community formed in early 1960s between Kenya, Uganda and Tanzania.



#### *2.4.1.2 Non-traditional static gains*

Cline (1978) also refers to additional non-traditional static effects from regional trade integration, which are as follows: firstly, there is what has been termed the “labour opportunity cost”- effect. This occurs when an increase of output made possible by regional trade integration allows for the employment of extra labour at a wage below the minimum wage rate. In fact, this occurs because the extra labour is withdrawn from family farm agriculture or non-organised urban services, where the salary was absent or very small.

Secondly, there is the ‘economies of scale’- effect, which occurs when firms become able to produce at their capacity, thanks to the increase of the market made possible by the integration. Lastly, there is the ‘foreign exchange savings’- effect. The foreign exchange that is referred to here, is that of non-member countries, because, in effect, when a group of countries forms an RTA, they increase imports from within the union and reduce the level of imports from outside the union, thus saving foreign exchange.

Further studies have uncovered more static gains from regional trade integration, depending on the models used. Following the classification of Baldwin and Venables (1995) and that of Lloyd and Maclaren (2004), the models assuming perfect competition and constant returns to scale identified trade volume, trade cost and terms of trade as beneficial effects of regional trade integration. However, models assuming imperfect competition and increasing returns to scale identified benefits from regional trade integration in the form of output, scale and variety effect.

According to Cline (1978:63), all the above-mentioned gains from regional trade integration are static gains or allocation gains, as they constitute a once-off outward shift in the production possibility frontier attainable by the country, given its resources. However, considering the dynamic path of the economy, more gains from regional trade integration have been identified. These will be discussed in the next section.

#### **2.4.2 Dynamic gains**



First, there is the competition effect, brought about by freeing imports from partner countries. Second, there is the investment effect, which appears when there are new foreign and domestic investments that have not occurred in the absence of regional trade integration. Lastly, there is the structural transformation effect, which is a shift from traditional primary-products export to new industrial-products export.

In contrast to the static gains from regional trade integration, the dynamic gains are presumed to continue to generate annual benefits, even after the withdrawal of a country from the union. This happened, for example, to Honduras, after its withdrawal from the CACM (Cline, 1978).

Hine (1994:235) claims that the dynamic effects of regional trade integration are potentially more significant than the static effects, because of their cumulative nature. However, these dynamic effects are much more difficult to measure, as a satisfactory framework for analysing them does not yet exist. In this regard, the World Bank (2000),

referring to Francois and Shiells (1994) and Harrison, Rutherford, and Tarr (1994), pointed out that models assuming that the cost and benefits of regional trade integration arise only from trade diversion and trade creation, found that the gains were about 1% of the GDP. Models that include the scale- and competition effect, found that the gains were about 2 – 3 % of the GDP, while models that contain some dynamic effect and allow for capital accumulation and technical progress, found the gains to be approximately 5% of the GDP.

Also according to Cline (1978:112), the dynamic gains for small countries in the union, with a small industrial base, will far exceed the static gains. Therefore, small countries need not be afraid to participate in the integration. Although they may lose at first, they may benefit much more in the long term, for example in the case of the Central American Common Market, it has take about 12 years for this to happen as is mentioned by Cline (1978:112), the time horizon for the gains to accrue is a matter of empirical experience. However, Cline (1978) goes on to say that, in order for this to happen, the prerequisites are good governance, a favourable investment environment, political stability and security. Thus, all countries whether big or not, developed or not, can benefit from regional trade integration.

What, in actual fact, did happen? Did these gains really materialize? The following chapter discusses the empirical experiences of different regional trade integration groupings.

# CHAPTER THREE: REVIEW OF EMPIRICAL EVIDENCE ON REGIONAL TRADE INTEGRATION

## 3.1 INTRODUCTION

Whereas Chapter two presents a brief overview of the theory on regional trade integration, which helped to understand how RTAs work and through which mechanisms they provide benefits to member countries; this chapter focuses on the empirical experiences of RTAs in different areas in order to understand the relationship between them; what are the costs and benefits accompanying those arrangements and what were done to solve problems that impede regional economic integration?

Section 3.2 focuses on the experiences of regional trade integration in different areas, section 3.3 reviews the macro-economic conditions of different countries forming the trade arrangements under scrutiny, in order to understand to what extent these conditions can erode the benefits from trade liberalization. The EU countries have not been taken into account, as individual countries cannot use monetary policy to fill the gap in their macro-economic imbalances, because they have a central organ that controls their monetary policy. Furthermore, the European countries do not depend on either external aid or debt. They use private savings, which exceed the private investments, to finance their fiscal deficit.

Section 3.4 concerns trade integration experiences in EU, ASEAN and SADC regions, as arrangements, which have achieved some success at different levels. This will help to draw some lessons for the COMESA region.

## 3.2 EXPERIENCES OF REGIONAL TRADE INTEGRATION IN DIFFERENT AREAS

### 3.2.1 Rationale for RTI

Regional trade integration has been adopted in many countries for many reasons. The following are some of the reasons for trade integration.

#### 3.2.1.1 Political motives

Economic co-operation has been adopted in different cases to overcome political tensions between countries, in the belief that, as long as member states obtain economic gains from the co-operation, the conflicts between them will be reduced in order to protect these benefits. The World Bank (2000) observes that the idea that increased trade between member countries reduces the risk of conflicts amongst the countries goes back to Emanuel Kant's Perpetual Peace (1795). Investigations into the relationship between trade and security and the direction of causation also found that "doubling of trade between two countries lowers the risk of conflict between them by 17 percent" (World Bank, 2000:13).



Examples may be quoted to illustrate cases where regional economic integration has been used as an instrument to promote security between members. The European Coal and Steel Community, out of which the EU was formed, had been created to solve the conflict between France and Germany. In MERCOSUR<sup>14</sup> countries, the steel and automobile agreements were signed in 1980, in an attempt to reduce tensions between Argentine and Brazil and the formation of the ASEAN region was agreed upon in order to mitigate the communist threat in the region.

However, an increase of trade in the region will not always promote peace within the region. It may indeed obstruct it, "particularly when enhancing security is not the main concern" (World Bank, 2000:14). This may happen when the more developed countries

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<sup>14</sup> MERCOSUR is the Southern Cone Common MARKET formed in 1991 between Argentina, Brazil, Paraguay and Uruguay.

with developed industries sell their exports to less-developed countries in the union at a price far above the world level, because of the tariff barriers in the rest of the world. In this case, there will be a transfer of income from the less-developed countries to the more developed ones, and, if there are no mechanisms for the redistribution of the benefits, conflicts will arise. This has been the case in the East African Common Market where Kenya was gaining more than its partner countries, Uganda and Tanzania.

### *3.2.1.2 Industrialization*

In the 1960's, many developing countries formed regional trade arrangements with the aim of promoting industrialization of their economies. A belief existed that industrialization was possible through import-substitution trade policies<sup>15</sup>.

As Balassa and Stoutjesdijk (1975) pointed out, the reasons for the import-substitution strategy were, on the one hand, that, firstly, the exports of developing countries were, and still are, constituted essentially of primary commodities. Secondly, there was a decline in the demand for these commodities in the importing countries. Furthermore, the price was determined by the latter. Moreover, manufactured goods from developing countries not only faced high import barriers in the developed countries, but also were not competitive.

On the other hand, developing countries still need to import such goods from developed countries as inputs for their manufacturing industries and even final goods. Thus, they ultimately earn less from their exports and pay more for their imports, because of a need of import substitution industries. It was believed that import-substitution would be possible through regional integration, in the sense that it would allow the enlargement of the market needed for the industries in the region in order to realize economies of scale and improve their competitiveness.

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<sup>15</sup> These are policies that promote and protect domestic industries which produce imported goods in order to reduce imports especially in developing countries where the low export income cannot cover import expenses.

The most challenging reality, however, remains the fact that developing countries face a big market problem. Balassa and Stoutjesdijk (1975:38), for example, indicate that, until at least 1975 no developing country had as large a domestic market for manufactured goods as that of the Netherlands, Sweden or Belgium, which are among the smaller developed countries and which had signed integration agreements with other developed countries, in order to enlarge their markets. McCarthy (1999:17) also argues that, even if developing countries are united under a regional trade arrangement, their economies are still small compared to world standards. This is the reason why developing countries have changed their policy from import substitution to export promotion, while remaining under regional integration. This has been the case in ASEAN and the Latin American countries.

### *3.2.1.3 Bargaining power*

Regional trade integration has also been adopted with a view to increasing the bargaining power of member states in trade negotiations. As an illustration of this kind of motive, the World Bank (2000:18) argues: “the formation of the original European Economic Community (EEC) in 1957 was the desire to increase bargaining power relative to the United States”.

Whalley (1993) also observed that the typical characteristic of trade arrangements in Canada-US Free-Trade Agreement (CUSTA), and in NAFTA (CUSTA and Mexico) is not the same as that usually seen within the developing countries that seek to enlarge the market between them. Rather, CUSTA and NAFTA were initiated by small countries (Canada and Mexico), seeking protection from a large country (US) against stronger or increasing trade barriers by larger trading partners outside the union. The larger country also benefits in the sense that it enlarges its sphere of trade policy influence for subsequent bargaining with other large blocs. The arrangement also helps to exclude third parties from the markets of smaller countries. Therefore, an increase in intra-trade, though important for those arrangements, is not of such great consequence as in the developing countries. Indeed, the agreements did not greatly change the trade pattern of the three countries.

However, as pointed out by the World Bank (2000), regionalism not only invests member states with the power to intimidate and obtain more concessions in trade negotiations, it can also give member states the opportunity to be noticed. This kind of power negotiation suits developing countries, as they are still too weak to exercise their power against developed countries in trade negotiations. An illustration of this is the solidarity in CARICOM<sup>16</sup> countries, which allowed them to get “their nationals elected to the key international positions such as Commonwealth Secretary General and African, Caribbean, and Pacific countries Secretary General” (World Bank, 2000:20).

### **3.2.2 Costs and benefits of RTI**

As explained in chapter two, the benefits of regional integration range from static to dynamic gains and encompass trade creation effects, competition and scale effects, investment effects, etc. More specifically, in developing countries, regional integration solves the problem of small markets for individual countries and helps to protect the infant industries against imports from developed countries. Regional integration has also contributed to the promotion of peace and stability.

However, regional integration also has its costs, which appear in different forms, such as the higher price paid for imports from partner countries, the diminution of national sovereignty and unequal development of member countries, which results from the imbalances in intra-regional trade and uneven distribution of manufacturing industries. The EU is an example of how the problem of unequal distribution of benefits was solved, either by compensation mechanisms (the British case), or by granting a gradual adjustment process, as in the case of Ireland, Portugal, Greece and Turkey, which were granted free entry for their exports in the union market, while the elimination of duties on imports from partner countries to those countries was postponed (Balassa and Stoutjesdijk, 1975:44).

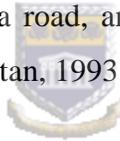
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<sup>16</sup> CARICOM is the Caribbean Community and Common Market formed in 1973. Its members are: Antigua and Barbuda, Barbados, Jamaica, St Kitts and Nevis, Trinidad and Tobago, Belize, Dominica, Grenada, Montserrat, St Lucia, St Vincent and the Grenadines.

In developing countries, compensating for losses incurred by the less-developed countries in the union has been very difficult, mainly because of the costs this entails for the more developed countries, while the benefits from integration have not been large enough to outweigh these costs. Alternatively, the project approach to economic integration has been proved successful in some integration schemes in developing countries, as it is not burdened with the problem of the unequal distribution of benefits among members.

### **3.2.3 The project approach to regional integration**

The economic integration projects entail the establishment of projects that will serve a wider market than the regional and national ones in different fields, such as transport and communication, electricity, education, research and public utilities. The integration projects approach has been applied in Europe, Asia and Africa. The well-known success case of this type of project in Africa is the SADCC Beira transportation project, which is a corridor of 300 km from Beira on the coast of Mozambique to the border of Zimbabwe, encompassing Beira Port, a railway, a road, an oil pipeline, an electricity line, and a number of development projects (Foroutan, 1993:250).



In developing countries, especially Africa, an increase in infrastructure in such sectors as energy, water transport and telecommunication is very important. It has also been proved that the potential in these sectors has not yet been fully exploited. Robinson (1996) points out, for example, that, despite the potential for hydro-electricity of over 300,000 MW in the whole Sub-Saharan Africa, less than 15,000 MW has yet been developed. Robinson (1996:88) also remarks that, in the transport sector, studies conducted on the Great Lakes countries suggest, “Potential savings for the landlocked countries from simple policy changes (improvements in roads services and transit trade procedures) would be... equivalent to between 14% and 13% of the typical value of the commodities being carried”.

However, although implementing integration projects in developing countries may seem simple, only a few of them have been established. Among the many reasons for the limited success of integration projects are the lack of technical capacity to select and

evaluate optimal projects and the problem of data collection deserves mention. In fact, even as regards the data available, there are differences in coverage and classification between the countries that hamper the construction of a regional data set that could help create regional projects (Balassa and Stoutjesdijk, 1975).

Most of the time, there is also disagreement between countries on the location of the project, as this has positive externalities, which each country will struggle to obtain. To solve this problem, the researcher agrees with Balassa and Stoutjesdijk (1975) who recommend the package approach. This is a regional integration project that contains many more sub-projects, so that each country may be able to secure one of them, as was done in ASEAN countries.

The lack of finance and the inappropriate institutions responsible for the co-ordination of those projects, place further constraints on the success of regional projects in Africa. In the light of these issues, a joint venture between public and private sectors has been proposed, with the private sector providing resources and management, while the public sector plays the role of regulator.



Co-ordination is imperative in infrastructure, as well as in the overall economic policy, because, as explained by McCarthy (1999), convergent monetary and fiscal policy will enhance the long-term viability of the integration arrangement. Co-ordination in the overall economic policy will require harmonization of the management of public finance, debt, external payments and pricing policy.

### **3.3 THE RELEVANCE OF MACRO-ECONOMIC STABILITY**

#### **3.3.1 Role of macro-economic policies in the promotion of regional trade**

As put forward by Gaulier and Chauvin (2002) and discussed in the CREFSA Quarterly Review number 2, one of the aims of regional trade integration is to diversify the export base and reduce the dependence of countries on primary-commodity exports. This

diversification calls for greater investment in new sectors, as well as in the existing sectors, to upgrade their production capacity.

In the presence of a huge and persistent budget deficit, however, financing this deficit may lead to macro-economic situations that will not allow countries to gain from regional trade integration. When there is a huge budget deficit, the government may either finance this deficit by printing money, which, without an accompanying increase in the demand for money, will lead to an increase in prices (inflation), including the interest rate; thus increasing both the cost and the risk attached to the investment required in the export sector.

Another way in which the fiscal deficit can be financed is by borrowing on the domestic market. In this case, “savings in the financial system are lent to the government and consequently are not available for private investment” (CREFSA Review no 2:11). Finally, the government can finance its deficit by borrowing on the international market, thus increasing its level of foreign debt. If the government does not have sufficient foreign reserves to service the debt, it will use the money supply, which leads to a growth in inflation, as seen before.

Thus, in order to benefit from regional trade integration, a country must apply tight fiscal and monetary policies. This will allow the country to increase its potential for investing in export sectors, without which the gains from regional trade integration cannot materialize.

Furthermore, an appropriate exchange rate policy is necessary to support trade liberalization. In this regard, Gaulier and Chauvin (2002:17) explain: “a removal of trade restrictions must be accompanied by currency depreciation to provide some short-term protection for domestic producers. Moreover, an overvalued exchange rate will not enhance investment in the production of processed exports”. In countries where the rate of inflation is high, a nominal depreciation of the exchange rate may be useless, unless it is big enough to offset the effect of inflation that leads to an appreciation of the real

exchange rate. Thus, an appropriate exchange rate policy should be accompanied by a tight monetary policy to avoid inflation, which infringes on a stable investment climate.

### **3.3.2 Comparison of macro-economic conditions in ASEAN and SADC countries**

This section analyses only the macro-economic conditions of the countries under regional groupings that have been chosen to serve as an example to the COMESA region and whose macro-economic conditions will later be compared with those of the countries of COMESA. The European Union countries are not examined here, only because they have a central monetary authority, which controls their monetary and fiscal policies. Furthermore, their dependence on foreign aid and on foreign debt is limited or absent.

Table 1 (See Appendix 3.1) explains the macro-economic conditions in ASEAN and SADC, and indicates to which extent they can undermine the effectiveness of trade liberalization in those countries.

Considering the economic growth (annual average) during the period 1990-2000, it is evident that all the countries in ASEAN and SADC, have experienced a growth rate of over 2 %, except the DRC and Zambia, which have had – 5.1% and 0.5 % GDP growth respectively. On average, the ASEAN countries have enjoyed a higher economic growth rate (5.3%) than the SADC countries (2.5%).

On average, ASEAN countries applied tight fiscal and monetary policies in the period 1990-2000, resulting in low levels of inflation (ranging between 2.7% and 10.3%), and low levels of aid dependency (between 2.6% and 0% of their imports). In contrast, the economic growth in SADC countries was not necessarily due to good macro-economic policies, as is clear from Table 1 (See Appendix 3.1).

Of the SADC countries, only Botswana, Lesotho, Namibia and South Africa tightened their fiscal and monetary policies and experienced low inflation rates. Moreover, these countries depend less on foreign aid and external debt. However, as declared in CREFSA review number 2: 4-8, the fiscal deficit was financed by private savings in South Africa

and Malawi, thus crowding out private investment, while Lesotho increased its dependence on external debt, which may lead to a growth in money supply in order to service the debt, thus increasing the inflation rate.

The four remaining countries: Angola, DRC, Mozambique and Tanzania, have experienced high inflation rates, with the lowest rate in Tanzania (31.3%) and the highest in the DRC (5,444.5%). Moreover, they depend on external debt at a level above 100% of their GDP. Mozambique and Tanzania also depend on foreign aid at a level above 35 % of their imports.

Thus, macroeconomic conditions in more than half of the eight countries taken into account in the case of SADC, do not allow them to take advantage of trade liberalization to increase their exports and economic growth. In order to do so, these countries will have to tighten their fiscal and monetary policies. Others need to reduce the drain of resources from the private sector.



### **3.4 TRADE INTEGRATION IN THE EU, ASEAN AND SADC**

The following sections investigate the factors that are considered relevant to the success of integration in the European Union, ASEAN and COMESA regions respectively.

#### **3.4.1 The European Union**

The European Union is recognized as the largest and most successful regional integration scheme in the world, as it has managed to expand<sup>17</sup>, deepen<sup>18</sup> and bring great material well being to its member countries (Winters, 1993:202). It is for this reason in particular that the report also focuses on the EU experience of trade integration, to see whether it can provide an example for the integration process in the COMESA region. Some outstanding aspects are highlighted in the following paragraphs.

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<sup>17</sup> The EU expanded in terms of membership. From 6 members it has now expanded to 25 members.

<sup>18</sup> The EU deepened in the sense that it achieved an Economic Union, which is the deepest level of regional economic integration that any organization has achieved

#### *3.4.1.1 Co-operation in industrial revolution*

The economic co-operation in Europe goes far beyond the formation of the European Economic Community in 1957. Starting from the nineteenth century, after the industrial revolution in Great Britain, British experts travelled to other European countries to advise them and transmit their technological know-how into different sectors such as textiles, mines, engineering and other innovations. Furthermore, the free movement of capital and trade expansion were added to the free movement of ideas and innovations as was pointed out by Pollard (1974:15): “European nations were exporting not only commodities and services, but capital, people, ideas and entrepreneurship: in a very real sense they were exporting the industrial revolution to each other”.

#### *3.4.1.2 Political will to maintain security and stability*

Besides the co-operation during the industrial revolution, there was also a strong political will to maintain political, social and economic stability and unity among member countries. As indicated earlier, the formation of the EEC was not primarily for economic purposes, but mainly for political reasons. There was a need, not only to solve the long-standing problems between France and Germany, but also to find a solution to political threats from outside, such as the Soviet military-strategic challenge and American economic domination (Angresano, 2003: 911). All these factors helped to strengthen, deepen and widen the European Union.

#### *3.4.1.3 Importance of transport infrastructure*

However, in the absence of developed transport infrastructures, the European economic integration would not have been as advanced, as it was at that time. The great revolution in the transport infrastructure in Europe occurred towards the 1830's. Remarkable advances were made with regards to the development of roads, waterways and railways. Although the development of transport infrastructures was undertaken for multiple purposes, it played a very important role in the economic co-operation between European countries in the nineteenth century (Pollard, 1974:37-50).

Unfortunately, the two World Wars and the Great Depression of the 1930's were great setbacks to development and co-operation in Europe. Most of the investments were destroyed, especially in transport, where, for example, the railways, which were more important than other means of transport to intra-European trade, were at 75% of their pre-war level. Many industries, such as coal and steel, suffered as well (Neal and Barbezat, 1998:28).

#### *3.4.1.4 Relevance of sectoral cooperation*

After the destruction of their economies by the two World Wars and supported with financial aid from the US, all European countries worked together in order to revive their economies by putting in place productivity centres in each country. These were charged with disseminating information and co-ordinating productivity programmes (Neal and Barbezat, 1998: 41-43). The centres were then co-ordinated by the European Productivity Agency. In the process of recovery, more efforts were invested in sectors that were considered to have the largest impact on their respective economies. Among others, these were the coal industry, the steel industry and agriculture. The European Coal and Steel Community, created in 1951 with France, Germany, Italy, Belgium, the Netherlands and Luxembourg as members, was the first major sectoral integration in Europe.

#### *3.4.1.5 Benefits from trade integration in the European Union*

Analysing the evolution of intra-regional trade in the European Union, Neal and Barbezat (1998) point out that in 1928 one-fourth of the imports of the countries that later formed the European Community came from within those countries. After the Second World War, the figure dropped to one-sixth, became one-third by 1958 and by 1990 the six original members obtained more than two-thirds of their imports from within the union, which had doubled its membership to twelve countries. Table 3 (See Appendix 3.1) also shows that, from 1990 onwards, the share of intra-trade (exports) for the whole union was above 66% of the total trade and that this intra-trade increased by more than 100% in

1990, although the increase was smaller in the years after 1990 (Table 4; See Appendix 3.1).

Moreover, the increase in intra- trade was accompanied by the net benefits from trade generated by the trade creation, which far exceeded the trade diversion. Balassa (1967) reported that trade creation for all goods was \$11.3 billion, while trade diversion was \$0.3 billion for all goods. This change of trade pattern and the benefits resulting from it occurred, not only in the six original member countries, but also in the six other countries that joined later.

Besides the static gains, it was claimed, that dynamic gains, such as economies of scale, high productivity and lower production costs, were also realized, although it was difficult to establish the relationship between this realization and the integration. Economic growth was also due to the improvement in the investment climate, which in turn attracted foreign investment and promoted productivity. This was the case, for example, in Ireland, Portugal and Spain (Angresano, 2003: 914).



From the foregoing discussion of trade integration in the European economies, it can be concluded that the European Union owes its success to the old culture of co-operation among its members, the goodwill of its political leaders to promote political and economic unity among its members, the importance attached to transport and other infrastructures and the ability to choose appropriate sectors on which to place more emphasis during the integration process.

### **3.4.2 The ASEAN**

The Association of South-East Asian Nations (ASEAN) is said to be the oldest and best-known regional grouping in East Asia (Saxonhouse, 1993). ASEAN recorded great success in bringing about political stability, which helped to develop the economies of its member countries. The project co-ordination approach to regional integration played an important role in the economic development of the ASEAN countries. Some important aspects are covered in the following sections.

### *3.4.2.1 Political stability in ASEAN*

Similarly to the European Union, the formation in 1967 of the Association of Southeast Asian Nations was also driven by political and security motives, although the Bangkok Declaration<sup>19</sup> also emphasized the pursuit of economic, social and cultural development. The five founding member countries, viz. Indonesia, Malaysia, the Philippines, Singapore and Thailand, wanted to promote regional peace, stability and security. These were under threat from the external and internal communist movements, as well as inter-country disputes over territories and many other kinds of tensions between countries (Angresano, 2003: 918, Ponciano, 1997:2 and Pasadilla, 2004: 2-3)

The association succeeded in establishing and maintaining regional political stability and, as Ponciano (1997:1-2) points out, many studies have shown that the political and diplomatic success contribute to the economic success. Some of the member countries managed to achieve rapid economic growth, which benefited the whole association.



After securing political stability, the ASEAN member countries turned to economic co-operation in the late 1970's. With this in mind, the ASEAN Industrial Project (AIP) was introduced in 1976, the ASEAN Preferential Trade Arrangement (PTA) in 1977, the ASEAN Industrial Complementation (AIC) scheme in 1981 and the ASEAN Industrial Joint Ventures (AIJV) scheme in 1983 (Ponciano, 1997:2). However, all these initiatives failed, mainly because some member countries were not ready for this kind of integration, as they did not yet realize the benefits that they could obtain from it. For instance, Indonesia and the Philippines, having large domestic markets, did not see the need for integration and therefore remained largely protectionist and inward looking.

### *3.4.2.2 Factors that contributed to economic co-operation and integration in ASEAN*

ASEAN countries have managed to achieve rapid economic growth through the development of labour-intensive industries, the shift towards export promotion and the

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<sup>19</sup> It was in Bangkok that the formation of ASEAN was agreed upon by its founder member countries.

ability to attract direct foreign investment (Angresano, 2003). These economic changes have forced economic co-operation on ASEAN countries.

Ponciano declares (1997:8-9) that structural economic changes in the ASEAN countries occurred mainly due to a combination of the following factors: firstly, the raising of wages in north-east Asia (Japan, South Korea, and Taiwan) and an appreciation of the Japanese Yen forced labour-intensive, export-oriented firms in these countries to relocate to the lower-wage countries of ASEAN and China. Secondly, the good governance and the favourable economic environment<sup>20</sup> that prevailed in the ASEAN countries facilitated the establishment of the new firms. Lastly, the evolution in international trade forced the ASEAN inward-looking economies to turn to export-oriented strategies, which helped to revitalize the economic co-operation among ASEAN countries.

The ASEAN economic co-operation was further strengthened by the 1997 Asian crisis, the worldwide recession and the mounting protection measures within the European Union and NAFTA, which negatively affected ASEAN member exports. One can also regard the smallness of the ASEAN countries' market as an important reason for promoting economic co-operation.

The ASEAN internal market is relatively small in comparison to its external market<sup>21</sup>. Plummer (1996:6) reports that, while the total value of ASEAN exports increased from US\$ 6 billion in 1970, and to US\$ 106 billion in 1988, the share of intra- regional exports decreased from 21%(of total) to 18% respectively in the same period. Table 3 (See Appendix 3.1) shows that this share was only 17.2% in 1980 and that until 2003 it did not exceed 23% which is a small share if compared, for example, with that of EU, which was 67.7% in 2003.

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<sup>20</sup> The favourable economic environment was due to the low inflation rate, an adequate infrastructure, prudent fiscal management and strong institutions that prevailed in ASEAN countries at that time.

<sup>21</sup> The major ASEAN external markets are: US, Japan Europe and the NICs.

The USA is ASEAN's major trading partner, especially in manufactured goods<sup>22</sup>, which is the key sector for the outward-industrialization strategy, while the NIC's constitute the major importers of ASEAN raw materials. That is why the ASEAN outward-oriented export strategy has been beneficial to its members. However, the protection of the external market, especially the formation and strengthening of trade blocs in Europe, USA and APEC between the end of 1980's and the early 1990's, has led the ASEAN countries to reconsider their economic co-operation (which has been very loose), in order to strengthen their competitiveness and enhance their bargaining power.

It is with this in mind that the ASEAN free trade area (AFTA), proposed originally in 1992, became operative in 2002. Besides AFTA, however, there have also been sectoral co-operation projects, which had bid contributed greatly to the economic development of ASEAN countries.

#### *3.4.2.3 The project co-ordination approach to regional trade integration in ASEAN*

The ASEAN experienced slow economic co-operation through different types of industrial cooperation agreements, such as the ASEAN Industrial Projects (AIP) agreement and the ASEAN Industrial Complementation (AIC). While the AIP was a government-oriented project, in which each member country was supposed to host at least one large-scale industry that would serve the ASEAN market. The AIC was more private-sector oriented and constituted the liberalization of intra-ASEAN trade in intermediate products at various stages of production of the commodity in ASEAN.

The AIP failed, however two of the AIC projects in the automobile sector succeeded and are still in operation. These are joint ventures with the Japanese automobile manufacturers Mitsubishi and Toyota. Besides the co-operation in the automobile sector, there are other co-operation projects, such as the ASEAN Energy Agreement, the Agreement on ASEAN Food Security Reserve and the ASEAN Petroleum Security Agreement. All these joint ventures are the result of efforts by all sectors of society: policy makers, the private sector and the academics.

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<sup>22</sup> The US market accounts for 38% of the total ASEAN manufactured exports

One may not conclude without mentioning that ASEAN countries also concern themselves with the issue of the unequal development among member countries. In the light of this, an ASEAN fund of US\$ 55 million was established to assist the less-developed new members, namely Vietnam, Myanmar and Laos in areas such as infrastructure, human resource development, information and communication technology and regional economic integration (Angresano, 2003: 920-921). This shows how well ASEAN countries understand the importance of the role played by infrastructure in the integration process.

In conclusion, one must point out that, first of all, the ASEAN countries placed more emphasis on political and security issues in their integration process. Thereafter, political stability enabled them to develop their economies and facilitated economic co-operation among them. In 2002, economic co-operation in different sectors was supplemented by market integration, to facilitate the movement of goods across borders. This is the kind of integration that is recommended for developing countries, especially those with a low level of industrial development and inadequate infrastructure.

### **3.4.3 The Southern African Development Community (SADC)**

The SADC region was created in 1992, out of the Southern African Development Coordination Conference (SADCC), which was formed in 1980 between Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe. Foroutan (1993:250) claims: “SADCC has been considered by many inside and outside the region as a successful example of regional integration to emulate elsewhere in SSA”. It is for this reason that the present study considers the SADC, among other regional groups, to be an organization that may serve as an example for enhancing the integration in the COMESA region.

#### *3.4.3.1 Integration motives and approaches in SADC*

At its inception, the main SADCC objectives were to reduce the economic dependence of member countries on South Africa and to foster regional development. At that time, SADCC countries agreed that these objectives were to be achieved through regional co-operation instead of trade integration, because they regarded regional co-operation as a precursor to trade integration (Lee, 2003:45).

The reason given by Lee (2003:47) for the inappropriateness of the extent of trade integration in the SADCC region, was that economies were not diversified. Indeed, Table 5 (See Appendix 3.1) shows that the diversification indices for SADC countries in the period 1980-1983 were around 4, reaching a high of 8.4 in Mozambique, while in the same period they were above 5 in ASEAN countries, reaching a high of 14.2 in the Philippines. Furthermore, these indices remained relatively stable in the SADC countries, while they increased in the ASEAN countries. For example, in the period of 1996-1999, only South Africa was at the same level as ASEAN countries, with diversification indices around 20. An additional reason was that the infrastructure was inadequate. Lee (2003) declares that there is no rationale to integrate the markets if there are no goods to trade and no infrastructure to get the goods to the market.

In 1992, at the end of the apartheid regime in SA, member countries of SADCC agreed that the objective of reducing their dependence on SA was no longer important and they changed from SADCC to the South African Development Community (SADC), which by 1994 included also SA. At the same time, SADC countries changed their integration strategy from regional co-ordination to trade integration, established a free trade area in 1996 and agreed to liberalize 85% of their intra-regional trade by 2008 and 100% by 2012 (Shams, 2003:25).

However, Lee (2003) points out that this decision was unrealistic, in the sense that the reasons for the inappropriateness of market integration in the region still existed. Lee (2003) further claims that SADC member countries were very well aware of this fact, but were forced into agreeing by external forces that supported approximately 86% of

SADC's funding. In 1980, the dependence on foreign aid to finance SADCC projects was higher than 90% (Takirambudde, 1999).

#### *3.4.3.2 Outcome of the integration in SADC*

SADCC countries have recorded some success in regional project co-operation, although this could not be sustained. The most successful project was the Beira corridor, which joined the Mozambican coast to the Zimbabwean border and consisted of a road, a railway, an oil pipeline and an electricity line (Foroutan, 1993:250). This corridor helped SADCC countries reduce the transportation costs of their export or import goods through SA. This independence did not last long, however, because of efforts by SA, backed by the USA, to destabilize the unity of SADCC countries.

As regards trade integration, despite the liberalization attempt started in the region in the 1990's, the volume of intra-trade (imports and exports) remained low (13% of SADC's world trade in 2001) as compared to the other regions (Shams, 2003:26). Table 3 (See Appendix 3.1) also shows that the share of intra-trade (exports) in total trade remained below 10% from 1980 until 2003, although it was growing. This share remains low in comparison to other regions. In the ASEAN countries, for example, it is around 22%, while that of the EU is around 68% of the total trade for the same period.

Regarding the constraints on regional integration in the SADC region, Takirambudde (1999) declares that, among other things, there is a lack of political will "which is a crucial ingredient in the process of regional integration"(Takirambudde, 1999:155). Other constraints are the unequal distribution of gains from integration, a lack of compensation mechanisms for the losers and overlapping membership.

The above overview of the integration in SADC leads one to conclude that member states of the SADC have succeeded in attaining their political objective, viz. that of reducing their dependence on the apartheid regime of SA. This was achieved through the project co-operation, from which every member benefited. Trade integration in SADC failed to

achieve its main objective of increasing trade between member countries, mainly because of the nature of their economies and the lack of a will to co-operate.

### **3.5 SUMMARY AND CONCLUSION**

This chapter presented an overview of the empirical evidence regarding the performance of regional integration. Most regional integration arrangements were driven by political motives and economic achievements helped to solve the political problems among member countries. Whether in the EU, ASEAN or SADC countries, the idea of integration to solve a common problem came from within member countries and to a certain extent all these regional groups have succeeded, although some constraints remain.

Macro-economic instability and the lack of adequate infrastructure have been found to erode the benefits from regional integration in developing countries. The nature of the economies, the lack of a will to co-operate, unequal distribution of the gains from integration and the lack of mechanisms to compensate the losers are additional impediments to regional integration. The project co-operation approach provided an alternative method of overcoming the obstacles. This approach can help member countries to change the structure of their economies and to co-ordinate their macro-economic policies; furthermore, it does not involve the cost of compensating losers, as all countries have their shares.

### APPENDIX 3.1

**Table 1: Macro-economic indicators**

	GDP growth	Overall budget balance		Money growth (M2)		Inflation	Aid dependency		External debt	
	(Annual average)	(% of GDP)				(Annual average)	(as % of imports)		(% of GDP)	
	1990-2000	1990	1999	1990	2000	1990-1995	1995	2000	1990	2000
<b>ASEAN</b>										
Indonesia	4.2	0.4	-1.1	44.6	15.9	8.7	2.3	2.6	79.4	92.5
Malaysia	7	-2	2.9	10.6	9.9	3.7	0.1	0	34.8	46.6
Philippines	3.3	-3.5	-3.8	22.4	8.1	10.3	2.5	1.4	68.9	66.9
Singapore	7.8	10.8	7	20	-2	2.7	0	0	-----	-----
Thailand	4.2	4.6	-10.4	26.7	3.4	5	1	0.8	32.9	65.2
<b>COMESA</b>										
Egypt	4.6	-5.7	-2	28.7	11.6	14.3	11	5.6	76.5	29.3
Kenya	2.1	-3.8	0.6	20.1	4.5	23.6	18.9	13	82.7	60.8
Madagascar	2	-1.1	-2.7	4.5	17.2	22.1	25.9	20.3	120.2	121.2
Malawi	3.8	-1.6	---	11.1	41.4	31.4	49	43.3	82.8	160
Mauritius	5.3	-0.4	-1.5	21.2	9.2	8.1	0.9	0.7	37.2	54.2
Sudan	8.1	---	-1	48.8	36.9	98.6	10.7	7.1	112.1	136.7
Zambia	0.5	---	----	47.9	73.8	107.2	103.7	48.7	210.3	196.8
Zimbabwe	2.5	-5.3	-5	15.1	68.9	25.8	14.9	7.9	36.9	54.1
<b>SADC</b>										
Angola	1.3	----	----	----	309	870.3	9.7	3.8	83.7	114.9
Botswana	4.7	11.3	----	-14	1.4	12.5	3.5	0.9	14.8	7.8
D R Congo	-5.1	-6.5	0	195.4	----	5444.5	8.9	5.5	109.9	208.5
Lesotho	4.1	-1.1	-3.6	8.4	1.4	12.9	9.4	5	64.4	79.6
Mozambique	6.4	----	-----	37.2	38.4	47.5	84.8	49.7	188.8	190
Namibia	4.1	-1.1	-3.2	30.3	13	11.8	8.2	6.9	----	-----
Tanzania	2.9	---	---	41.9	14.8	31.3	38.5	48.6	151.5	82.5
South Africa	2	-4.1	-2	11.4	7.2	11.8	1	1.3	-----	19.7

**Source** : compiled from the world Bank, World Development Indicators.

**Table 2: Value of total trade (imports and exports) and intra-trade (exports), in millions of US\$**

	1980	1990	1995	2000	2002	2003
<b>EU(25)</b>						
total trade	821,020	1,547,400	2,146,174	2,369,069	2,554,030	3,047,551
intra-trade	483,141	1,022,932	1,385,805	1,618,929	1,732,227	2,063,450
<b>ASEAN</b>						
total trade	71,916	144,152	321,417	427,678	406,357	453,081
intra-trade	12,413	27,365	79,544	98,060	91,765	102,281
<b>SADC</b>						
total trade	34,884	38,425	43,803	49,573	50,690	60,450
intra-trade	108	1,058	4,124	4,453	4,240	5,345
<b>COMESA</b>						
total trade	14,204	19,911	20,335	25,772	26,861	30,950
intra-trade	555	890	1,027	1,281	1,465	1,812

Source: compiled from UNCTAD trade statistics.



**Table 3: Share (%) of intra-trade (exports) in total trade**

	1980	1990	1995	2000	2002	2003
<b>EU(25)</b>	<b>58.8</b>	<b>66.1</b>	<b>64.5</b>	<b>68.3</b>	<b>67.8</b>	<b>67.7</b>
<b>ASEAN</b>	<b>17.2</b>	<b>18.9</b>	<b>24.7</b>	<b>22.9</b>	<b>22.5</b>	<b>22.5</b>
<b>SADC</b>	<b>0.3</b>	<b>2.8</b>	<b>9.4</b>	<b>9.0</b>	<b>8.3</b>	<b>8.8</b>
<b>COMESA</b>	<b>3.9</b>	<b>4.5</b>	<b>5.0</b>	<b>5.0</b>	<b>5.4</b>	<b>5.8</b>

Source: computed from table 2.

**Table 4: Growth (%) of intra-regional trade (exports)**

	1980	1990	1995	2000	2002	2003
<b>EU(25)</b>	0	112	35	17	7	19
<b>ASEAN</b>	-	120	190	23	(-6)	11
<b>SADC</b>	0	880	290	8	(-5)	26
<b>COMESA</b>	0	60	15	25	14	24

Source: computed from table 2.

**Table 5: Evolution of diversification indices (oil excluded) for SADC and ASEAN countries (period average)**

	1980-1983	1984-1987	1988-1991	1992-1995	1996-1999
Angola	2.3	7.4	3.1	2.4	1.6
DRC	3.1	2.9	2.5	3.2	2.1
Malawi	3.4	2.8	2.0	2.0	2.2
Mauritius	2.2	3.0	2.8	2.8	2.6
Mozambique	8.4	7.5	5.8	5.5	6.0
South Africa	2.8	10.6	11.0	8.7	21.4
Seychelles	4.1	5.3	2.1	1.5	1.7
Tanzania	4.0	3.0	5.7	7.5	8.1
Zambia	1.2	1.2	1.2	1.3	2.0
Zimbabwe	6.3	9.2	7.8	8.0	7.7
Indonesia	6.2	7.2	11.7	17.8	24.1
Malaysia	5.3	7.4	11.0	13.4	10.5
Philippines	14.2	14.2	18.7	14.8	6.3
Thailand	10.5	15.2	23.1	24.6	21.2

**Source:** Compiled from Gaulier and Chauvin (2002)



## **CHAPTER FOUR: THE PERFORMANCE OF REGIONAL TRADE INTEGRATION IN COMESA**

### **4.1 INTRODUCTION**

The Common Market for Eastern and Southern Africa (COMESA) is a regional trade integration group consisting of 20 members (see chapter one) and in 2001, its combined population numbered 388.1 million, more than half of Sub-Saharan Africa's total population (679.3 million in the same year). COMESA was established in 1993, replacing the Preferential Trade Area (PTA) that existed from 1984. The idea of creating the PTA came from the OAU's Lagos Plan, which aimed to create an African Economic community through sub-regional economic organization. In Sub-Saharan Africa, three sub-regions were identified: East and Southern Africa (PTA), West Africa (ECOWAS) and Central Africa (ECCAS) (Lee, 2003:85). Thus, contrary to the EU, ASEAN and SADCC, in which the countries themselves decided to come together to solve their common political and economic problems, the idea to create the PTA was not internal.

COMESA is the largest regional grouping in Africa in terms of the number of member countries and in terms of its population (Muuka, Harrison and McCoy, 1998:2). Although this may be regarded as a positive factor to promote integration within the region, Gibb (1998:305) points out that, "...with membership stretching from Lesotho to the Horn of Africa, COMESA lacks regional identity and cohesion". With a per capita GNP of around US\$ 200 in 1993, some countries in COMESA have been identified as the poorest in the world. These are Angola, Burundi, Malawi, Mozambique, Rwanda, Somalia, Sudan and the DRC. Rwanda, the country of interest in this study, has tried to revive its economy after the 1994 civil war and genocide. From a GDP growth rate of - 50% in 1994, the economy of Rwanda has recovered quickly and attained a GDP growth of 35% by 1995. Nevertheless, as is evident in chapter one, Rwanda still has much to accomplish in the development of its economy and one of its strategies was to join the COMESA.

Given the prospects and challenges facing COMESA, how can it ensure economic development for its member countries, especially the needy ones like Rwanda? This is the question that this chapter tries to answer. Section 4.2 analyses the macro-economic conditions in COMESA countries to understand what impact they may have on trade integration in the region. Sections 4.3 and 4.4 review trade performance and constraints to integration in COMESA respectively and section 4.5 concludes by pointing out the lessons that COMESA may learn from other regional integration groupings.

## **4.2 MACRO -ECONOMIC CONDITIONS IN COMESA COUNTRIES**

As described above, the effectiveness of regional trade integration depends strongly on the macro-economic situations of the countries engaged in the integration process. It is, therefore, imperative to analyse the macro-economic conditions in the different countries<sup>23</sup> constituting COMESA in order to understand what impact those conditions may have on the performance of trade integration in COMESA.



The figures in Table 1 (See Appendix 3.1) indicate that for the period 1990-2000, all the countries experienced an average annual GDP growth rate above 2%, except Zambia, which had only a 0.5% GDP growth rate. However, considering other macro-economic indicators, it cannot be claimed that this growth was due to good macro-economic policies.

Figures indicate that only Egypt and Mauritius experienced a low level of inflation (14.3% and 8.1% respectively during 1990-1995) with a low level of aid dependency (5.6% and 0.7% of imports respectively in 2000) and a manageable external debt (29.3% and 54.2% of GDP in 2000 respectively). Madagascar, Kenya and Zimbabwe are next, with a relatively high level of inflation (22.1%, 23.6% and 25.6% respectively). Zimbabwe, with a budget deficit above 5%, has a low level of aid dependency (7.9% in

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<sup>23</sup> It is important to keep in mind that, only those countries that were members of the COMESA free trade area in 2000 were considered.

2000) and a manageable external debt (54.1% of GDP in 2000). This suggests that it has financed its deficit with a combination of the money supply and borrowing on the domestic market.

Madagascar, despite a relatively low level of fiscal deficit (2.7% of GDP in 2000), depends on external debt of more than 100% of its GDP. The levels of monetary growth aid dependency on external debt in Kenya suggest that this country used monetary expansion and borrowing on the domestic as well as the foreign market to finance its fiscal deficit of 3.8 in 1990. Finally, Sudan and Zambia applied highly expansionary monetary policies, which led to high inflation rates (around 100%). In addition to this, the two countries depend on external debt at a level far beyond 100% of their GDP. Zambia also has a high level of aid dependency.

From the analysis above, a conclusion can be drawn that, except for Egypt and Mauritius, where the situation is manageable, other COMESA members need to revise their macro-economic policies by tightening their fiscal and monetary policies and reducing their rates of inflation, which impact negatively on regional trade integration.

#### **4.3 PERFORMANCE OF TRADE INTEGRATION IN COMESA**

Although the PTA objectives were to promote peace, security, political stability and economic development of its respective member countries, the increase of intra-regional trade was its major objective<sup>24</sup>. In fact, it is believed that the increase of intra-regional trade in a Regional Trade Integration constitutes a basis for obtaining other economic and political benefits from Integration.

Numerous institutions were created to enhance intra-regional trade and these include: the PTA Trade and Development Bank, the Trade Information Document Centre, the PTA Clearing- house, and the like. In order to increase intra-trade, the organization also

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<sup>24</sup> See the Common Market for Eastern and Southern Africa (COMESA) page 3, available on <http://www.Itcilo.it/English/actrav/telearn/global/ilo/blokit/comesa.htm>.

adopted a progressive liberalization through the five consecutive forms of trade liberalization as indicated above (PTA, FTA, CU, CM and EU). In view of the PTA goals, the FTA proposed in 1992 became operative by 2000 and the intention was to achieve the common market. That is why the PTA changed its name to COMESA. However, some sources also claim that the change from PTA to COMESA was an attempt to attract South Africa (as a strong economy) into the regional arrangement after the end of the apartheid regime.

On the one hand, one should mention the positive outcome of all those efforts in COMESA: Intra-trade grew from US\$ 890 million in 1990 to US\$ 1.3 billion in 2000 and to US\$ 1.8 billion in 2003 (see Table 2; Appendix 3.1). As a result of traffic facilitation measures in COMESA, transport costs were reduced by 25%<sup>25</sup> and the PTA Bank played a role in providing trade-financing facilities, for example the bank's cumulative project approvals in 1995-1996 amounted to US\$ 148 million.

On the other hand, one must admit that, although the intra-regional trade increased, its share in the COMESA world trade remains small. For example, in the period from 1985 to 1992, the intra-trade was between 5% and 6 % of COMESA's world trade. These figures are very low in comparison to the other regions, e.g. around 9% in SADC, 23% in ASEAN and 65% in the EU (Lee, 2003:87; Geda and Kibret, 2002:6). Furthermore, the implementation of the agreements was very slow. For example, the original target to attain a free trade area by 1992 was postponed to 2000 and even then, only nine countries out of twenty eliminated all the tariffs.

The slow progress in the COMESA region is due to many constraints, namely the lack of political will, concern about government revenue loss, concern about unequal distribution of gains and the lack of mechanisms to compensate losers.

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<sup>25</sup> Ibid, page 9

## **4.4 CONSTRAINTS ON TRADE INTEGRATION IN COMESA**

The following sections discuss various factors constraining efficient trade integration, such as political issues, overlapping membership and the unequal distribution of benefits.

### **4.4.1 Political obstacles to integration**

One of the political obstacles to integration in COMESA was the fear of losing sovereignty, as this is raised by Geda and Kibret (2002:13). Muuka, Harrison, and McCoy (1998: 12) point out the different ideological and political perspectives of member countries of COMESA that hamper the progress of trade integration, because these countries have different conceptions of how the goals of COMESA can be attained. Furthermore, most of the COMESA countries have experienced civil wars for many years, which have prevented them from participating effectively in the integration process. These countries are Angola, Burundi, Rwanda, Sudan, Somalia, DRC and war-torn Ethiopia and Eritrea.



### **4.4.2 Overlapping membership**

Overlapping membership (being a member of many organizations at the same time) has been an obstacle to regional integration, especially regarding SADC and COMESA, which have the same objectives. Table 6 (See Appendix 4.1) shows that in SADC, excepting Botswana, South Africa and Mozambique, the countries are simultaneously members of COMESA.

There are many ways in which overlapping membership can constitute an obstacle to the process of regional trade integration, Muuka, Harrison, and McCoy (1998: 12) point out the unnecessary duplication of functions and costs associated with the membership and the fragmentation of markets. Adding to the list, Geda and Kibret (2002:14) emphasise the problems of harmonising policies, especially in the areas of rules of origin and customs procedures.

As regards the rules of origin for example, there have been conflicts between Kenya and South Africa over South African goods' penetrating freely into the Kenyan market via other countries, which are simultaneously members of COMESA and SADC, while South Africa imposes tariffs on Kenyan goods entering its market, because Kenya is not a member of SADC.

#### **4.4.3 Unequal distribution of benefits**

The unequal distribution of benefits among member countries of a regional trade arrangement is the root cause of conflicts between such countries. This problem arises because the more developed countries benefit more than the less developed ones, whilst there are mostly no compensation mechanisms to help the losers.

Table 7 and 8 (See Appendix 4.1) indicate that only a few countries, by their dominance of intra-COMESA trade, are economically more developed than the others. It is clear from Table 7 (See Appendix 4.1) that only three countries are dominant in intra-COMESA exports, namely Kenya, Zambia and Zimbabwe. Mauritius is also increasing its exports to COMESA countries. On the import side, Egypt, Uganda and the DRC to a certain extent, hold the high records, although Kenya, Sudan, Zambia and Zimbabwe are also increasing their imports from COMESA countries.

The fact that only a few countries (which are not even the biggest importers from COMESA) dominate intra-COMESA exports raises the problem of revenue transfer. For example, in the first COMESA technical workshop on Customs Union held in Lusaka, Zambia, in March 2004, Rwanda raised the problem of compensation mechanisms for countries that may have lost revenue as a result of joining the FTA and implementing the common external tariff. However, COMESA "has no redistributive or compensatory mechanisms to help alleviate regional inequalities, one of the principal reasons behind South Africa's decision not to join" Gibb (1998:305).

#### **4.4.4 Further constraints on trade integration in COMESA**

The other constraints on integration in COMESA, which are also common to other regional trading blocs in developing countries and which have constituted the subject of this study, are as follows:

##### *4.4.4.1 The dependence on few and similar primary exports*

The goods produced and traded among and outside member countries of COMESA are a few similar, primary commodities such as coffee, tea, cocoa, cotton and copper, which are legacies of the colonial period. COMESA countries face a challenge to change their industrial structures and introduce new export products if they want their integration process to succeed.

##### *4.4.4.2 Inadequate infrastructure*

Muuka, Harrison and McCoy (1998) highlight this point when they point out, for instance, that Burundi, Comoros, Mauritius, Rwanda and Lesotho do not have railway systems, which would be a cheap way to transport goods. As a result of the inadequate infrastructure, especially in telecommunication services, there exists a general lack of information. Muuka, Harrison and McCoy (1998) also add that, according to Nomvete, the first Secretary-General of COMESA, member countries of COMESA, as well as other African countries, are not aware of what other African countries can offer as substitutes for products they import from developed countries.

Gunning (2002) thinks that the way to overcome this problem is to co-operate in infrastructure projects that may, for example, lower electricity costs by linking grids. Infrastructure projects may also lower transport costs through investments in the construction of roads, railways and ports.

##### *4.4.4.3 Harmonization of macro-economic policies*

Geda and Kibret (2002) note that the importance of macro-economic policy coordination on economic integration does not receive the attention it deserves. Quoting O'Connell (1997), Geda and Kibret (2002: 15) add, "Among the most often cited constraints to

greater intra-African trade is the inhospitable macro-economic environment associated with overvalued exchange rates and non-convertible currencies”.

Geda and Kibret (2002: 15) further argue that the overvalued currency is not such an important issue these days, as many countries have adopted exchange rate liberalization policies. The major obstacles are, rather, the currency inconvertibility and currency instability that have occurred in some member countries of COMESA, such as Malawi, Zambia and Zimbabwe. Co-ordination of macro-economic policies is therefore essential to facilitate the implementation of economic integration.

#### **4.5 WHAT LESSONS ARE TO BE LEARNT FROM THE EXPERIENCES OF OTHER ORGANISATIONS?**

Regional integration has achieved success in developed countries such as Europe (EU) and North America (NAFTA). In developing countries, however, experiences have been mixed. In ASEAN, regional integration helped countries to establish peace, security and political stability. Although the markets are not fully integrated in ASEAN, countries have managed to develop their economies and to establish some regional projects from which all countries are benefiting.

Geda and Kibret (2002) point out that in Africa, many studies using the gravity model to assess the performance of regional blocs have concluded that regional trade integration has failed to achieve its main goals of increasing intra-regional trade and fostering policy co-ordination. This has been the case in the COMESA region.

In contrast to other regional trading blocs, regional integration in COMESA failed to increase trade between the member countries. Table 4 (See Appendix 3.1) shows that the growth in intra-trade in ASEAN and SADC from 1980 to 1990<sup>26</sup> was 120% and 880% respectively, while in COMESA it was only 60%. From 1990 to 1995, the period in which the three regions decided to establish an FTA among their respective member

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<sup>26</sup> There was not yet full liberalization of trade during that period in the three trade regions.

countries, the growth of intra-regional trade was 190% for ASEAN, 290% for SADC and only 15% for COMESA.

The limited growth in intra-regional trade in COMESA can be attributed to many causes, However, the lack of diversity and the similarity of the products exported by member countries, the lack of political commitment to integration, lack of security and political stability, poor physical infrastructure, macro-economic imbalances and unequal distribution of gains from integration are considered to be major constraints on increasing intra-regional trade in COMESA.

The lack of progress in the regional trade integration process has led some authors, such as Robinson (1996), Geda and Kibret (2002) and Gunning (2002), to suggest that Africa should re-orient its integration approach from trade integration to projects co-operation and co-ordination. This also suggests co-operation in some sectors found to be relevant to the economy of member countries, by creating projects in those sectors that will benefit all the countries.



This kind of integration has been effective in other trade arrangements. In Europe, for example, countries started to co-operate in only a few sectors, such as coal, steel and agriculture, which were found to be more relevant to their economies. In ASEAN, countries have succeeded in putting in place two projects in the automobile sector from which each country may benefit. In SADC, it has been proved by the success of the Beira project that co-operation with infrastructure is possible.

In COMESA countries, this approach did not receive enough attention, although it may help to solve many problems concerning infrastructures, macro-economic co-ordination and diversification of export products, as these do not necessarily involve trade integration and its accompanying problems of unequal distribution of benefits.

## APPENDIX 4.1

**Table 6: Overlapping membership in COMESA, SADC, CBI and SACU**

	COMESA	SADC	CBI	SACU
Angola	*	*		
Burundi	*		*	
Botswana		*		*
Comoros	*		*	
Djibouti	*			
DRC	*	*		
Ethiopia	*			
Egypt	*			
Eritrea	*			
Kenya	*		*	
Lesotho	*	*		*
Malawi	*	*	*	
Mauritius	*	*	*	
Madagascar	*		*	
Mozambique		*	*	
Namibia	*	*	*	*
Swaziland	*	*	*	*
South Africa		*		*
Zambia	*	*	*	
Zimbabwe	*	*	*	

**Source:** compiled from World Bank (2000)

**Table 7: Intra COMESA domestic exports (FOB) from 1997 to 2001 (million US\$)**

Member states	1997	1998	1999	2000	2001
Angola	1.75	5.58	1.88	1.89	1.62
Burundi	6.32	1.88	1.62	4.67	8.02
Djibouti	11.84	6.81	4.57	4.08	10.76
Egypt	36.76	31.59	38.89	51.56	68.5
Eritrea	1.63	3.92	0.85	0.18	0.12
Ethiopia	71.99	67.17	61.41	60.56	68.52
Kenya	<b>547.88</b>	<b>561.92</b>	<b>563.31</b>	<b>445.49</b>	<b>441.43</b>
Comoros	0.49	0.42	0.13	0.1	0.06
Madagascar	11.2	15.03	14.36	16.6	9.23
Mauritius	71.54	76.01	93.13	76.93	88.78
Malawi	47.05	22.68	38.50	39.42	77.00
Namibia	46.1	125.06	50.55	57.50	85.71
Rwanda	39.9	26.09	35.43	33.19	30.34
Seychelles	0.52	0.35	0.96	2.22	3.65
Sudan	2.87	2.67	3.42	52.95	38.94
Swaziland	31.24	32.75	31.08	69.63	51.39
Uganda	64.92	37.92	37.34	68.86	93.82
Zambia	<b>95.02</b>	<b>150.8</b>	<b>96.78</b>	<b>152.56</b>	<b>86.89</b>
Congo DR	8.89	2.49	4.24	33.69	61.46
Zimbabwe	<b>255.75</b>	<b>262.39</b>	<b>201.75</b>	<b>179.4</b>	45.23
<b>Total</b>	<b>1,353.64</b>	<b>1,433.52</b>	<b>1,280.17</b>	<b>1,351.52</b>	<b>1,271.47</b>

Source: COMESA web site (www.comesa.int)

**Table 8: Intra COMESA imports (CIF) from 1997 to 2001 (million of US\$)**

Member states	1997	1998	1999	2000	2001
Angola	55.01	59.07	55.27	68.14	96.57
Burundi	19.84	26.07	20.88	19.92	50.52
Djibouti	59.20	67.05	59.64	73.44	72.53
Egypt	<b>138.65</b>	<b>124.64</b>	<b>140.19</b>	<b>186.32</b>	<b>236.35</b>
Eritrea	1.05	4.89	3.75	7.8	1.56
Ethiopia	36.89	40.88	40.63	42.20	47.06
Kenya	99.95	36.81	48.92	77.5	<b>144.57</b>
Comoros	5.12	4.81	3.89	5.03	3.64
Madagascar	41.64	30.42	53.56	63.47	29.93
Mauritius	58.13	60.74	47.15	58.56	66.94
Malawi	103.86	95.92	89.59	52.91	57.83
Namibia	18.98	31.04	7.96	7.60	7.35
Rwanda	81.08	60.45	42.38	28.65	13.07
Seychelles	14.27	12.07	14.98	12.52	11.39
Sudan	10.84	26.94	8.64	<b>101.48</b>	<b>108.94</b>
Swaziland	2.31	3.63	2.76	1.75	0.47
Uganda	<b>237.82</b>	<b>284.64</b>	<b>171.76</b>	<b>152.53</b>	<b>281.43</b>
Zambia	77.62	121.46	91.62	86.71	139.49
Congo DR	<b>97.0</b>	<b>110.76</b>	<b>94.74</b>	<b>107.29</b>	51.31
Zimbabwe	85.01	64.41	56.69	62.65	104.35
<b>Total</b>	<b>1,247.28</b>	<b>1,266.7</b>	<b>1,055.01</b>	<b>1,216.48</b>	<b>1,525.32</b>

Source: COMESA web site ([www.comesa.int](http://www.comesa.int))

## **CHAPTER FIVE: GENERAL CONCLUSION AND RECOMMENDATIONS**

### **5.1 CONCLUSION**

As explained in Chapter one, Rwanda is a small, very poor and populous country, with more than of 90% of people living in rural areas with subsistence farming as the main activity. Although the Rwandan economy is recovering after the destruction of the war and genocide, much more needs to be done to put the country on a path of sustainable economic growth and development.

One of the strategies that were adopted is to liberalize trade either unilaterally or by joining some regional trade groups. COMESA is the biggest regional group that Rwanda joined. COMESA is constituted by twenty countries, most of them poor, with very small and similar industrial bases, which undermine the increase in intra-trade, the main aim of COMESA. Given the poor performance of RTI in developing countries, compared to the success in the developed world, the main objective of this study was to analyze the performance of COMESA and to determine what it can learn from other regional trading blocs in order to promote the development of its member countries.

According to economic theory RTA confer to its member states gains ranging from static to dynamic. The static gains range from trade creation and diversion effects, trade volume, trade cost terms of trade and scale effects. It implies a once-off increase in the production of a country given its resources, while the dynamic gains stimulate competition, investment and structural change effects and continue to generate annual welfare gains even after the withdrawal of a country from the trade bloc. Although much more complicated to measure, dynamic gains have been found to be more important than static gains, especially for small countries in the union, because of their cumulative effects.

However, empirical experiences indicate that Regional Trade Integration has been successful in developed countries, the example being the European Union, which is referred to as the most successful RTA in the world. In developing countries, although some RTAs such as ASEAN and SADC have made some progress, especially regarding political stability and project cooperation, there are still some constraints that prevent the gains from Regional Trade Integration to fully materialize.

These constraints are most importantly the lack of macro-economic stability and of inadequate infrastructure, the structure of the economy (which is at a very low level of industrial development), unequal distribution of the benefits between member states and a lack of appropriate mechanisms to compensate the losers. Empirical evidence indicates that these are prerequisites for regional trade integration to be successful. It also proves that these prerequisites may be attained through projects cooperation, which did not get enough attention in COMESA. Furthermore COMESA has two very specific problems, i.e. the political instability in most of its member states and the sharing of members with SADC, which has the same objectives.



Given all these constraints, COMESA failed to reach its main goal, that of increasing intra-regional trade. For example, in the period from 1985 to 1992, the intra-trade was between 5 and 6 % of COMESA's world trade. These figures are very small compared to those from other regions, which are around 9% for SADC, 23% for ASEAN and 65% for the EU.

## **5.2 RECOMMENDATIONS**

The following are some recommendations that are relevant in order to promote a sustainable trade integration process in COMESA.

The main recommendation for COMESA is to supplement the market integration, which has made progress, by government activity coordination and projects cooperation. Cooperation between COMESA countries is crucial in the field of macro-economic policy in order to harmonize fiscal, monetary and exchange rate policies. As has been explained, most of the member countries of COMESA experience instable macro-economic conditions that may be responsible for the slow progress in the integration process; thus the coordination of macro-economic policies will enhance the long-term viability of the integration process.

Cooperation is also useful in the creation of common infrastructure needed to promote regional trade integration. Poor transport and communication infrastructure and poor provision of electricity have been the cause of the failure to increase intra-regional trade and to attract new investments. Much more can be done in this field if there is the goodwill to cooperate. For example the project of the construction of a railway that may join such countries like Rwanda, Burundi and Lesotho (which are landlocked and which do not have a railway system) with other country members of COMESA, which are not landlocked will enhance regional trade integration.

Finally, the cooperation in the production of such goods in which member countries of COMESA are found to be more competitive will help to change the production structure of the economies of member states. This happened in ASEAN countries where they managed to establish a joint venture in the automobile sector.

It is strongly recommended that thorough research should be conducted to identify those sectors in which COMESA countries may invest collectively in such a way that each participant will benefit. Textile, clothing and footwear industries may be for example some of those sectors as they are labour intensive and COMESA countries have a high level of unskilled people unemployed. Furthermore, some of COMESA countries such as Mauritius have already developed a comparative advantage in those sectors.

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