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Integration

Transferability of Integration Models

by Dr Hans-Jürgen Harborth, Aachen *

The establishment of a Common Market in Europe encouraged many of the less developed countries (LDCs) to model their own efforts at integration on similar lines. Only gradually did doubts begin to be expressed about the advisability of unquestioningly adopting the European model.

The subject of the following discussion is to be economic cooperation and integration agreements between sovereign states which as a rule are neighbours. The ascending scale of possible agreements extends from bilateral technical and economic agreements to the various higher forms of cooperation — free trade zone, customs union, common market and economic union¹.

The efforts at integration in Western Europe, Latin America and in other parts of the world originally proceeded from a common conceptional point of departure and are to some extent continuing along these lines as evidenced by J. Viner's and J. E. Meade's customs union theory². More recently, however, there have come to the fore new, so-called "dynamic" arguments which amount to a specific integration theory for LDCs³.

Among the economically less developed countries the idea of integration has appeared first and in its most intensive form in Latin America where it has found its most fervent advocates in the UN

Economic Commission for Latin America (ECLA). Nobody denies that the Western Europe of the post-war period has been the most outstanding prototype for integration. Gradually, however, doubts began to be felt as to the relevance of this particular integration concept to the problem of the LDCs, and—what has to be taken much more seriously—views began to be expressed to the effect that LDCs were altogether unsuitable subjects for multinational integration.

The "Traditional" Integration Argument

The "traditional integration theory" combines the free-trade postulate—based on D. Ricardo's theory of comparative costs—with F. List's protection postulate of free trade within. The latter implies that integration should be limited to a number of neighbouring states which would have to shut themselves off more or less rigidly from the outside world.

This type of integration is based on the following idea:⁴ The abolition of customs barriers and other restrictions on the free flow of goods within a free-trade zone or customs union is likely to lead to the displacement of high-cost producers now

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¹ cf. P. Robson: "Economic Integration in Africa", London 1968, p. 25.

² cf. J. Viner: "The Customs Union Issue", New York 1950, and J. E. Meade: "The Theory of Customs Unions", Amsterdam 1955.

³ cf. inter alia P. Robson, op. cit. pp. 33 et seqq. which also contains some further references.

⁴ A useful survey of the "traditional" integration theory and some of its critics is given by R. G. Lipsey: "The Theory of Customs Unions: A General Survey" in: Economic Journal, Sept. 1960, pp. 498 — 513.

having to work without their former national protection by the low-cost producers. The producers whose business remains profitable will now also be able to supply the needs of those member-states of the union whose own manufacturers have been forced out of business. This effect which is reflected in the creation of additional internal trade ("trade creation"), is an expression of higher productivity and as such is to be welcomed as a positive achievement. It is supposed that the countries which have to give up producing certain lines of goods will find alternative uses for their output capacity in fields where they enjoy comparative advantages.

Relevance of the Integration Theory

But this same integration procedure can also result in a loss of prosperity. One can take as an example a country that has never manufactured a certain product but has always imported it from cheap third countries. Now that it has become a member of a trade association, it may well have to stop these imports from third countries and force its nationals to buy it from producers operating inside the integrated area, and at higher prices. In this case there is a shift from low-cost to higher-cost producers. This type of shift, called "trade diversion", is to be regarded as a step in the wrong direction.

According to the traditional customs-union theory, a trade association is desirable, if the "trade creation" that may be expected to result is greater than the likely "trade diversion". At this point the question arises: when will this be? The answer, according to the theory, is as follows: "trade creation" will be strong, if, firstly, "the member-countries have little external trade in proportion to their internal production", and, secondly, if they "undertake a high proportion of that external trade with their prospective fellow members"⁵.

These criteria are often cited by those who consider that as far as the majority of LDCs is concerned there is no point in trying to form trade associations⁶. For one thing, it is said, many LDCs—particularly the smaller and sparsely populated ones—export a high proportion of their total production because their domestic output is relatively small. If overall production is small, there is little that can be rearranged. Secondly, almost all LDCs—and this includes those whose exports are relatively small⁷—conduct by far the greater part of their external trade not with their neigh-

bours, but with frequently far distant industrial centres. Here, too, there is not much that can be "shifted", in any event not in the direction of neighbouring member-states of the same association.

In the light of these negative findings one is tempted to ask whether the traditional theory has any relevance at all to the specific situation of the LDCs. The manner in which the problem is posed by the integration theory as outlined above and the way it points to a solution clearly shows that this theory is tailored to suit the post-war situation in Western Europe; it has little relevance to the LDCs. The reason is that the said theory is essentially a static re-allocation theory which means it is concerned with a productivity-orientated re-arrangement of output-capacities which already existed in the individual countries, probably over a more or less prolonged period of self-sufficiency. This was precisely the problem that Western Europe was facing after the Second World War, but it was also what gave it its great chance — the chance of once again putting together the isolated and partly deformed pieces and thus re-integrating them into the economic entity to which, some decades previously, they had already belonged.

Provident Allocation of Resources

The LDCs are facing, however, an entirely different problem. Here—to continue the metaphor—ways will have to be found to construct first of all the individual pieces which are intended to be put together. Here the task is not re-allocation of already existing resources, but "to serve the development of these resources"⁸. There is therefore today hardly anybody left willing to evaluate the usefulness of integration projects. Nowadays the emphasis is on the need to fuse the elements of "trade creation" and "trade diversion" into one single concept — the concept of "efficient trade diversion"⁹.

In an endeavour to find arguments in favour of integration—arguments that take account of conditions in LDCs—the point that is nowadays most frequently made is what formerly tended to be rather in the background of the more ambitious, but irrelevant re-allocation theory. It is that markets enlarged by the formation of an economic association enable the member-states to benefit from the "economies of scale". The importance

⁵ P. Robson, *op. cit.*, p. 32. For details cf. R. G. Lipsey, *op. cit.* His general conclusions are on pp. 308/309.

⁶ cf. inter alia B. Balassa: "Toward a theory of Economic Integration". In: M. S. Wionczek (ed.), *Latin American Integration*, New York 1968, p. 31, and P. Robson, *op. cit.* p. 32.

⁷ It is typical for large and densely populated countries like for instance India, Pakistan, Indonesia, Brazil and Mexico to export relatively small proportions of their output.

⁸ B. Balassa, *op. cit.*, p. 30.

⁹ cf. St. B. Linder: "Customs Unions and Economic Development". In: M. S. Wionczek (ed.), *Latin American Integration*, *op. cit.*, p. 40.

of this argument, though intrinsically valid, often tends to be overrated. For one thing, there are not so many industries that for compelling technical reasons can only exist as mammoth entities, as for instance a refinery. For another, practical experience has disproved the assumption that the largest units invariably operate at the lowest costs¹⁰. Thirdly, small businesses are not necessarily the worse for having higher unit-costs. For against the savings of costs one hopes to achieve through mass production must be set the higher transport and other distribution charges which would be incurred if production were to be concentrated in a few spots from where the needs of a vast market would have to be supplied. Such costs would for instance be considerable in the event of Latin America becoming integrated, for a Latin-American Common Market would extend over an area 15 times that of the EEC.

Apart from the "economies of scale" argument, another and more ambitious attempt is being made to infuse fresh blood into the traditional integration concept and to bring it into line with the integration policy which is actually being pursued in various developing regions. The attempt consists in "...the proposition that it is necessary to look beyond existing patterns of production to what is likely to emerge in the future, when comparative advantages and trade patterns are likely to be different"¹¹.

Optimum Size for Integration

According to this theory, an attempt should be made straightaway to allocate scarce resources to the areas and zones belonging to the various countries to be integrated so that any subsequent "re-allocation" becomes unnecessary. As clearly definable the problem is, as difficult—if not impossible—it is to pierce through the veil of economic underdevelopment and to foresee the comparative advantages every country or every region is likely to have some time in the future. Yet some tentative steps are nonetheless being taken in this direction by the advocates of so-called "industrial complementary agreements" for which propaganda is being made, particularly in Latin America.

Another theoretical problem which is still far from being solved is that of the optimum size for regional integration. The West-European Market Area is probably short of the ideal size by the area of the EFTA-countries. In the case of the

Latin-American integration concept, it is likewise appropriate to ask oneself whether sufficient attention is being paid to the various economic aspects of space, though from a different point of view. The special developments in Central America and in the Andes-States as well as the concentration of economic activity that are becoming evident in South-East Brazil, in the La Plata region and in Mexico, they all give rise to the suspicion that the concept of a single integrated Latin-American area may be excessive in its dimensions. More clearly utopian still from the political and economic points of view is the idea of a Pan-African Economic Community.

Integration presents however not only external problems, but also problems of an internal nature. The latter were of no importance for the formation of the EEC, for each of the constituent European states had already undergone a process of "national" or "internal" integration before they merged into a de-facto economic community¹². Their productive activities had already been brought into line with each other, at least to an extent sufficient to form a broad basis for mass-production and mass-consumption. Anyone attempting to work out an integration theory will be faced with the following question: Is it not essential to pursue also a determined internal integration policy instead of concentrating exclusively on the external aspects of economic integration as the traditional theorists tend to do? Such a political effort is needed to lead the broad masses of subsistence-farmers out of their isolation and into the main stream of the economy. This would result in a broadening of the market from within. Such a policy has apparently been successful in the Chinese People's Republic, but for it to be successful the concept of "mass-production" must be re-thought, possibly on the lines of Mahatma Gandhi who insisted that "mass-production" should be understood to mean "production by the masses".

The results achieved so far in the field of integration theory are by no means conclusive. As long as six years ago B. Balassa made a confession which is as valid today as it was at the time he made it. He said: "Undoubtedly, much painstaking research and empirical investigation is necessary further to reduce the area of ignorance on the economics of integration in developing countries"¹³.

¹⁰ cf. inter alia J. Jewkes: "Are the Economies of Scale Unlimited?" In: E. A. G. Robinson (ed.): "The Economic Consequences of the Size of Nations", London, New York 1963, pp. 95 et seqq.

¹¹ P. Robinson, op. cit., p. 33.

¹² cf. G. Myrdal: "An International Economy", New York 1956, pp. 17 et seqq., and H. Priebe: "Lehren aus der europäischen Wirtschaftsintegration für die Entwicklungsländer" (Lessons to be drawn by the developing countries from the European Economic Integration), in: W. Guth (ed.), "Probleme der Wirtschaftspolitik in Entwicklungsländern" (Problems of Economic Policy in Developing Countries), Berlin 1967, pp. 58 – 75.

¹³ B. Balassa: op. cit., p. 31.