

Straubhaar, Thomas

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# South-South Trade: Is Integration a Solution?

by Thomas Straubhaar, Berne\*

**The actual effects of integration among developing countries often diverge considerably from the gains which the participants had expected. Thomas Straubhaar examines the reasons for this and outlines the conditions which must be fulfilled for integration to be successful.**

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In order to pay for the import of capital goods, raw materials and intermediate products – necessary for the process of economic development – LDCs have to earn the necessary foreign exchange by exporting goods and services either to the developed countries (DCs) or to other LDCs. While during a period of slow growth and high protectionism in the DCs an increase in trade flows towards the DCs is not a very viable option, the expansion of trade among LDCs can be stimulated by various types of measures characterized by different degrees of co-operation:

□ A first method of expanding trade among the LDCs is the application of the traditional technique of trade liberalization without commitments regarding the co-ordination of policies in other fields. Special measures might be a reduction of tariffs in favour of other LDCs only (not necessarily to all LDCs, but not to DCs) within a most-favoured-nation agreement.

□ Another method of stimulating trade among the LDCs involving a higher degree of economic co-operation would be an agreement on the co-ordination of investment and/or production policies in certain sectors where industries could be established economically only on a regional or multinational basis. This method, which goes beyond the mere exchange of information on investment projects, could stimulate the establishment of entirely new industries, the expansion

of existing industries and the degree of specialization among existing plants. Such agreements could relate to a single, or a number of, specific industrial sectors, and to one, or to a group of, other LDCs and lead to a vertical or horizontal pattern of specialization.

□ A third method, finally, could take a more ambitious form by establishing an integrated area. Although the difficulties to be overcome are larger than those for the other two, LDCs have been highly attracted to this method because greater advantages have been expected from it.

## Expected Gains from Integration

A first set of expectations is based on the static effects derived from the theory of customs unions. By reducing tariffs and/or relaxing quantitative import controls (which corresponds to the first method described above) it is expected that the following effects appear:

□ trade creation (= shift from the consumption of higher-cost domestic products to lower-cost products of other member states) and

□ trade diversion (= shift from the consumption of lower-cost non-member countries' products to higher-cost products of member states).

These effects have been evaluated to be the more beneficial the more competitive and the less complementary the economies of the members, the larger the integrated area, the more prohibitive the

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\* University of Berne.

transport costs between members and non-members, the higher the original tariff walls, and the lower the common external tariff.

In co-ordinating the investment and/or production programmes or in establishing a regional integrated area, expectations are based on the dynamic effects (neglected in the original customs union theory) of an enlarged economic area:

- First, it is expected that increased economic co-operation will allow the benefit of economies of large-scale production (cost reduction depending on an increase in the size of the market) to be realised. This expectation seems to be particularly true for the many LDCs with small populations as well as low per capita incomes. Beyond a certain point, industrialization on the basis of a domestic market (import substitution) becomes extremely costly to the countries concerned. An efficient way out is to create a wider market with other LDCs. Such integration allows the benefits of internal economies of scale (by specialization), and external economies of scale (intra-industrial spread of technology and human skills) to be realised.
- Second, the integration of national markets also makes it possible to intensify competition within the area and, therefore, to achieve a higher overall level of productivity.
- Third, the co-ordination of investment and production programmes contributes to a more rational division of labour within the integrated area. It widens the scope for efficient investments via reallocation of investment funds within the integrated area and inflows of investment capital, new technologies and know-how from outside the integrated area, which makes possible industrial expansion in those industries where economies of scale are likely to exist, and a co-ordinated planning for large public services (transport and communication systems).
- Finally, for the area as a whole it is expected that integration will improve its terms of trade (by pooling their exports the member countries get more influence over the price for their products on the world market), increase its bargaining power (by pooling their market power the member countries get more influence on the world market), and decrease its external dependence. These expected gains from an integrated area have stimulated the establishment of several integration arrangements in the developing world. We will now consider the actual success of these agreements.

<sup>1</sup> C. Vaitsos: Crisis in Regional Economic Cooperation (Integration) Among Developing Countries: A Survey, in: World Development, Vol. 6, 1978, pp. 719-769.

### Actual Effects of Integrated Areas

Since 1960 about a dozen integrated areas have been established among the LDCs. In Table 1 we concentrate on the most important ones, by summarizing very briefly their intended degree of co-operation and showing some of the problems and conflicts in achieving it.

When measured against the expected economic benefits mentioned above, the progress and achievements of integration in many LDC-areas must be judged to have been less than satisfactory. Although only the EAC has actually broken up, progress elsewhere has been slow and sometimes interrupted. Most of the groupings are examples of negative rather than positive integration and their progress has been accompanied by controversy over distributional issues. Vaitsos has even spoken of a "crisis in regional economic cooperation (integration) among developing countries".<sup>1</sup> While his article is based mainly on the more qualitative interpretation of the experiences of various co-operation efforts among LDCs, we will now show some of the quantitative effects of the integration arrangements.

Because we are interested in the extent to which integration among LDCs might stimulate South-South trade, we shall look at the relative shares of intra-group trade and at changes in those shares over time.

Table 2 shows the share of intra-trade within an integrated area as a per cent of the total exports of the area for 1983. It is evident that

- for the LDC-groupings, intra-trade as a share of the total exports of the integrated area is very modest in the best case (ASEAN 23.1%; CACM 21.8%) and insignificant (less than 10%) in most cases;
- the value of intra-trade exceeded US \$ 1 billion in 1983 only in the cases of ASEAN and ALADI;
- compared to the EC or the CMEA (Council for Mutual Economic Assistance), intra-trade among the LDC-groupings has evidently been less important, accounting in both the EC and the CMEA for more than half of total trade.

To give an estimate as to how far trade flows have been affected by the integration arrangements, Table 2 presents the (uncompounded) growth rates of intra-trade within an integrated area and compares them to the rates for external trade. Summarized briefly, Table 2 shows:

- At the beginning of a new integrated area the elimination of trade restrictions increased the volume of intra-trade. Intra-trade grew more rapidly than external trade. Accordingly, for the ALADI the intra-trade of the

group increased from 7.7 % (1960) to 10.2 % (1970), while for CACM it increased from 7.5 % (1960) to 26.8 % (1970). But not only for the Latin American cooperation agreements did the establishment of an integrated area provide a trade-stimulating effect. This effect was also seen in the African groupings: in the case of CEAO intra-trade increased from 2.0 % (1960) to 9.1 % (1970) and in that of UDAC from 1.6 % (1960) to 3.4 % (1970).

□ After this successful start the trade-stimulating effect became weaker, with the exception of the ASEAN.<sup>2</sup>

Intra-trade did not increase significantly more than external trade. For the UDEAC the difference was negative and for the ALADI even more so.

These results should not be taken as more than an indication of the actual effects. In contrast to the integration agreements among the DCs, the results for the LDCs are disturbed very heavily by

<sup>2</sup> Possible reasons why the ASEAN might have been more successful than the other groupings are shown by N. Wagner: Regional Economic Integration between Developing Countries, in: INTERECONOMICS, Vol. 18, No. 6, 1983, pp. 270-277.

**Table 1**  
**Economic Groupings Among LDCs**

Grouping	Year of Establishment	Members	Degree of Co-operation <sup>1</sup>	Problems and Conflicts
<b>Africa</b>				
UDEAC (Union Douanière et Economique de l'Afrique Centrale)	1964	Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon	3	Because of remaining trade barriers within the area rather a PTA <sup>2</sup> than a CU <sup>3</sup> or even a CM. <sup>4</sup> No large common industrial projects.
MRU (Mano River Union)	1973	Liberia, Sierra Leone, Guinea (after 1980)	2	Overlapped by the policy of ECOWAS.
CEAO (Communauté Economique de l'Afrique Centrale), preceded by the West African Customs Union, established in 1959	1974	Benin, Burkina Faso, Ivory Coast, Mali, Mauritania, Niger, Senegal	2	The area has reached the level of a monetary integration with a relatively well operating compensation system.
ECOWAS (Economic Community of West African States)	1975	All members of the MRU, the CEAO and Cape Verde, Gambia, Ghana, Guinea-Bissau, Nigeria, Togo	3	The declared and intended steps towards a CU and a monetary integration have been realized only to a very limited extent.
CEPGL (Communauté Economique de Pays des Grands Lacs)	1976	Burundi, Rwanda, Zaire	3	
SENE-GAMBIA (Senegambian Confederation)	1981	Senegal, Gambia		
EAC (East African Community)	1967	Kenya, Uganda, United Republic of Tanzania	2	Broke up in 1978.
<b>Latin America</b>				
CACM (Central American Common Market)	1960	Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua	1	Relatively successful by eliminating the trade barriers within the area, until 1970 when Honduras did break out. Since the political tension has increased, the economic co-operation declined.
ANDEAN (Andean Group)	1969	Bolivia, Colombia, Ecuador, Peru, Venezuela	2	Where a joint industrialization has taken place (in only three sectors) there have appeared disagreements about the going on.
CARICOM (Caribbean Common Market)	1968	Bahamas, Barbados, Belize, Guayana, Jamaica, Trinidad and Tobago	3	
ALADI (Asociación Latino Americana de Integración preceded by the Latin American Free Trade Area established in 1960)	1980	Andean Group plus CACM plus CARICOM plus Argentina, Brazil, Chile, Mexico, Paraguay, Uruguay, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Christopher and Nevis, Saint Lucia, Saint Vincent and the Grenadines	1	After a successful beginning, large divergences between more and less industrialized members led to the break-up of the LAFTA and to the formation of a new sub-grouping (ANDEAN), in 1969, and ALADI, which is a weaker alliance than LAFTA, in 1980.
<b>Asia</b>				
RCD (Regional Co-operation for Development)	1964	Iran, Pakistan and Turkey	2	
ASEAN (Association of South-East Asian Nations)	1967	Indonesia, Malaysia, Philippines, Singapore, Thailand	2	The speed of the integration process is very slow by intention. A stepwise procedure beginning with a PTA has been planned and seems to be effective now.

<sup>1</sup> According to the options mentioned at the beginning of this article. <sup>2</sup> Preferential Trade Agreement. <sup>3</sup> Customs Union. <sup>4</sup> Common Market.

Sources: Peter Robson: The Economics of International Integration, Second Edition, London 1984; UNCTAD: Handbook of International Trade and Development Statistics, New York, various years.

## INTERNATIONAL TRADE

□ frequent and repeated fundamental *socio-economic and political changes* within the integrated area: almost no group among the LDCs has been spared from multiple, and often violent, uprisings in one or more countries within the area; and by

□ frequent and repeated changes in the *composition* of the group and in the *degree of co-ordination* within the group.

### Discrepancy between Actual and Expected Results

The success of the EC but also of the ASEAN, where the value of intra-trade takes a much higher share of total exports than in the other groups leads us to ask: why has the actual implementation of integration agreements among the LDCs been a story of conflicts and failures which are in contrast to the (abstract) expectations of integration theory and to the (actual) results of the EC? The answer to this question has several sources:

□ *False expectations.* The theory of customs unions was developed in the fifties with regard to industrialized countries. The belief that this theory could be applied unaltered to the LDCs was an error and led to false expectations. Compared to Western Europe, there are nearly no production factors engaged in the industrial sector in the LDCs which could be moved (without costs) from one place to another. As long as the LDCs are mainly producers of agricultural products and raw materials and as long as industrial production is based on the manufacturing of these primary products, the theory of customs unions is of limited value for these countries: the application of this theory requires a minimal degree of industrialization to yield the dynamic (long-run) effects of an enlarged "domestic" market. Otherwise there are no possibilities for cost-reducing shifts in the industrial sector within the integrated area, and small chances of potential economies of scale.

□ *Unequal members.* If within an integrated area some countries are much more developed than others, the gains from being integrated are very likely to be

**Table 2**  
**Annual Growth Rates of Intra-Trade and External Trade of Integrated Areas, 1976-1983**

	Growth Rates Intra-Trade		Growth Rates External Trade		Difference	
	1976-80	1980-83	1976-80	1980-83	1976-80	1980-83
ASEAN	57.3	14.4	36.4	1.1	21.0	13.3
ALADI	-19.2	232.8	-19.6	332.4	0.3	-30.0
ANDEAN	15.2	2.9	23.6	-4.1	-8.4	7.0
ECOWAS	30.2	-6.2	18.5	-7.6	11.7	1.4
CACM	18.7	-8.8	17.7	-8.5	1.0	-0.3
CARICOM	16.7	0.6	18.8	-10.7	-2.1	11.3
CEAO	16.8	12.4	15.5	-7.5	1.3	19.9
UDEAC	41.7	-20.0	38.3	-5.4	3.4	-14.6
CEPGL	16.7	0.0	-4.2	0.0	20.9	0.0
MRU	0.0	83.3	25.1	83.3	-25.1	0.0
EC	34.5	-4.6	26.9	-4.2	7.6	-0.5
EFTA	18.5	-6.5	21.4	-4.7	-2.9	-1.9
CMEA	19.5	6.0	25.1	4.0	-5.6	2.0

  

	Value of Intra-Trade (\$ million)			Intra-Trade as a % of Total Exports of the Area				
	1976	1980	1983	1960	1970	1976	1980	1983
ASEAN	3619.0	11918.0	17080.0	21.7	14.9	13.9	17.8	23.1
ALADI	4434.0	1027.0	8200.0	7.7	10.2	12.8	13.5	10.2
ANDEAN	594.0	955.0	1037.0	0.7	2.3	4.2	3.5	4.3
ECOWAS	478.0	1056.0	860.0	1.2	2.1	3.1	3.9	4.1
CACM	653.0	1141.0	840.0	7.5	26.8	21.6	22.0	21.8
CARICOM	212.0	354.0	360.0	4.5	7.3	6.7	6.4	9.3
CEAO	177.0	296.0	406.0	2.0	9.1	6.7	6.9	11.6
UDEAC	75.0	200.0	80.0	1.6	3.4	3.9	4.1	2.0
CEPGL	3.0	5.0	5.0	0.0	0.2	0.1	0.2	0.2
MRU	2.0	2.0	7.0	0.0	0.1	0.2	0.1	0.1
EC	145900.0	347000.0	298900.0	34.6	49.5	49.4	52.8	52.4
EFTA	8500.0	14800.0	11900.0	15.7	21.8	12.8	12.1	11.4
CMEA	44400.0	79000.0	93100.0	62.3	59.4	57.4	51.0	53.7

Source: UNCTAD: Handbook of International Trade and Development Statistics, New York, various years.

distributed unequally. The advanced countries tend to attract more new industries than the less advanced. The possible consequence is a widening gap between the members: the already industrialized area becomes more industrialized and the already rural areas on a subsistence level are condemned to stay at their low level of development. If, under such conditions, the already poorer countries are not very eager to join their richer neighbour in an integrated area, this must be seen as rational behaviour. In a recent study, however, Langhammer and Spinanger have questioned this belief in the inequality of the members as a reason for the conflicts and failures within the integration agreements among LDCs. By looking at income per capita (as an index for development level) and at the level of industrialization, they found no statistical evidence that the variations within integrated areas of LDCs were significantly higher than in the EC.<sup>3</sup>

□ *Unequal economic systems.* If there are large differences between the economic systems of the members the integration agreement is plagued by political tensions. The end of the EAC in 1977 was a good example: the socialist experiment by Nyerere in Tanzania led to political tensions among the members (especially with the very conservative government in Uganda) and finally to the break-up of the most advanced LDC integration agreement.

<sup>3</sup> R. J. Langhammer and D. Spinanger: *Wirtschaftliche Zusammenarbeit zwischen den Entwicklungsländern (Chancen und Risiken)*, Tübingen 1984, pp. 15-17. It must be said that the indicators used by Langhammer and Spinanger might be not the correct measures to reflect inequality within an integrated area. These indicators are rather rough and do not reflect differences in the nationally different level of protectionism before the integrated area has been built.

□ *Missing political will.* The knowledge that (at least in the short run) the gains from integration are unequally distributed makes the negotiation process very difficult. Every member wishes to attract as many as possible of the potentially successful common industries. To resign short-term national interests in favour of long-term common goals within the integrated area requires a high level of political statesmanship. It should not be very surprising if this will is often missing. The example of the time-absorbing and lengthy negotiations within the EC shows clearly enough how difficult this task is even within a successful industrialized area.

□ *Financing problems.*<sup>4</sup> Nearly every LDC has a separate currency, so that clearing agreements are required. Otherwise LDC traders must do business in one or more DC currencies and are constrained by their relative scarcity.

#### Conditions for Successful Integration

The failure of most of the integration agreements among LDCs leads us to ask whether the building of integrated regional groups is inefficient for the LDCs and cannot be seen as an option to stimulate trade among them. We do not agree with this negative conclusion. But to be successful in the integration process and to serve, therefore, as a potential measure for stimulating South-South trade in the future a few conditions have to be respected and fulfilled.

If we know that the expectations of the orthodox theory of international integration have not been met in

<sup>4</sup> Cf. T. Straubhaar: *South-South Trade: Some Recent Trends*, in: *INTERECONOMICS*, Vol. 21, No. 5, 1986, p. 244.

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the case of the LDCs we have to adjust the theory to the specific conditions in LDCs on at least three points:<sup>5</sup>

- Unemployment, managed price systems and chronic foreign exchange scarcity, typical for many LDCs, have been excluded by assumption in the orthodox theory of integration. Considering these factors would lead to a different reallocation of production factors, to different patterns of specialization and to a different degree of integration than the orthodox theory would indicate.
- The unequal distribution of the benefits of being integrated requires an adjustment of the theoretically most efficient way to a politically practicable path.
- The industrialization of the LDCs is determined partly by transnational enterprises (TNE), which introduce new patterns of production into an area, according to the nationally varying costs at which technology and specialized intermediate inputs and other factors are imported from the parent enterprises, and which may transfer profits from one member state to another which has more liberal tax or profit repatriation policies towards business enterprises.

“Where TNEs have a major role, as they do in most LDCs, their operations thus provide further important reasons for supposing that market integration and trade liberalisation constitute inadequate and inappropriate technologies for promoting improved resource allocations, an equitable distribution of benefits and other major development objectives.”<sup>6</sup> The possible reactions of the TNEs towards the establishment of an integrated area therefore have to be taken into account in the theory of international integration among LDCs.

If we know that the usefulness of an integrated area is maximized in spreading out industries with substantial economies of scale, extending over the whole regional market, we have to look for such industries and ensure that they can be moved and spread. The level and the homogeneity of industrial development and the size of the area become the key variables in the integration process. They are the determinants which decide the pace of the procedure.

If we know that the gains of integration are spread unequally over the members we require a corrective policy to promote the balanced spread of the gains over the whole area. Possible distribution instruments could be:

- Direct compensation for the foregone tariff revenues and future gains of the common industries situated in

another member country, and the costs of losing existing industries.

- Distributing industrial production over the whole area via fiscal incentives to influence the location of industry, and planned new industries (especially indicative regional programmes for a specific range of industrial projects).

In considering the question as to how co-operation among LDCs should proceed in practice we recommend a stepwise procedure rather than a too ambitious jump; narrower arrangements limited to particular sectors or industries; rationally co-ordinated productive activities on a regional basis as a first step, which should be succeeded by further steps according to the level and homogeneity of industrial development and the size of the integrated area. These factors become the key variables determining the pace of the integration process.

### Conclusions

It should have emerged from our presentation that to increase trade among LDCs it is not enough simply to liberalize it, and hence that it is essential to find other means of economic co-operation or co-ordination to stimulate it, such as the improvement of transport and communication, the regulation of trade, the programming and execution of regional development projects and the improvement of marketing channels. There are other ways of expanding trade among LDCs which would avoid the problems encountered by some groupings of LDCs mentioned above and which are not too difficult to put into practice. These are:

- The conclusion of agreements concerning the purchase and sale of commodities from another LDC by governmental or semi-governmental foreign trade agencies.
- The granting of temporary preferences for LDC imports (seasonal, annual or for specific periods) in order to substitute imports from DCs.
- The establishment of programmes for the financing and promotion of imports to increase and diversify trade among LDCs.

Once the focus of co-operation among LDCs is concentrated on the realization of these conclusions integration could bring benefits. Accession to an integrated area is a very powerful step for many small and underdeveloped and therefore poor countries. It not only generates positive dynamic effects in their production, but may also stimulate South-South trade and therefore induce the benefits of this trade among the LDCs mentioned at the beginning of this article.

<sup>5</sup> P. R o b s o n : The Economics of International Integration, Second Edition, London 1984, pp. 150-170 (chapter 10).

<sup>6</sup> Ibid., p. 168.