8 Synopsis and Conclusions

The Road Ahead for Developing Countries

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

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

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

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

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

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

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

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

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

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

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

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

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

The Political Dimension

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

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

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

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

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

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

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

The Role of Donors

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

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

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

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

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

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

Learning from Experience

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

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

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

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

Distribution of Costs and Benefits

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

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

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

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

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

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

Regional Adjustment Programmes

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

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

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

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

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

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

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

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

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

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

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

External Linkages

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

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

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

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

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

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

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

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

A Pragmatic Approach to Strengthening RIAs in Developing Countries

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

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

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

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

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

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

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

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

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

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

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

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