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The Prospects and Priorities of Regional Integration in Sub-Saharan Africa

Ernest Aryeetey

I Introduction

For many years, regional integration[1] has been regarded by Sub-Saharan African (SSA) policymakers to be a highly desirable objective. This remains so, despite the lack of decisive and concrete actions to achieve integration. There have been many arguments in support of integration at regional meetings and relatively few against. As a consequence, institutions and protocols for regional integration are available in relative abundance. The integration discussions and efforts in SSA have covered such varied areas as trade integration, labour market integration, capital market integration, monetary integration, etc. Trade integration has naturally attracted greater attention from policymakers[2] and also researchers, and this will be reflected in our initial discussion here, even though the priorities discussed later emphasise other areas of integration.

The intuitive appeal for regional integration is drawn from the smallness of SSA economies and the belief that 'there is comfort in numbers'. The size of the SSA economy has been compared to that of Belgium, a small European economy by Foroutan (1993). Managing such a small economy with over 40 separate governmental and other institutional arrangements is almost certainly less efficient than running the Belgian economy. In this light, regional integration units have traditionally been perceived as vehicles for making SSA economies overcome the constraint of small economic size which has hampered their ability to industrialise efficiently, particularly within the context of the import-substitution industrialisation path they adopted prior to the reforms of the last decade.

While the appeal for integration has remained strong for several decades there are differences in the perception today of how integration should be

1 The expression 'regional integration' is used throughout this paper to cover the full range of public sector activities that involve permanent collaborative ventures, including economic policy, regional security, human rights, education, health, research technology, and natural resource management. Regional integration is generally characterised by the establishment of joint institutional mechanisms and a degree of shared sovereignty.

2 While the number of institutions for promoting and managing integration (particularly trade integration) have grown, intra-regional trade has remained low, and for some countries, actually declined in the last decade.

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conceived and pursued. After a lull in the discussions in the 1980s, there has been a resurgence of academic interest in the subject (Lavergne, 1997). The domination of trade creation in the discussions is amply reflected in the types of arguments often advanced. A number of scholars continue to argue that SSA regional groupings are unlikely to confer net positive static welfare gains on members because they do not have the required conditions to enable their trade creation effects outweigh trade diversion effects (Jebuni, 1997). They therefore argue for a more cautious approach of generalising the removal of tariffs and other barriers to trade. They generally believe that the Asian experience may be relevant; hence formal integration efforts should be abandoned and policymakers concentrate on developing an outward-oriented trade policy which encourages trade and which eventually may result in greater trade integration (Husain, 1992; Jebuni, 1997).

A contrary view is that formal regional integration is imperative for SSA economies. In the present world economy with large trading blocs, SSA needs to be able to attract foreign investment and technology necessary for investment. "Regional integration may be the most practicable way to minimise the costs of African market fragmentation ... It may thus be a precondition for rather than an obstacle to integrating SSA more effectively with the world economy" (Robson, 1993: 341). It is sometimes argued that regardless of the fact of low net gains from trade integration and the institutions that pursue them, the regional groupings and their institutions are essential for making SSA respond to increasing global marginalisation (Onitiri, 1997).

I shall discuss initially in this paper some of the arguments covered in the broad spectrum of integration policy recommendations circulating in SSA, highlighting those that have tended to dominate the debate and are likely to influence to some extent future courses of action. This will be followed by a discussion of some of the more recent attempts to introduce other dimensions of integration, in particular those that go beyond the traditional arguments of trade creation. Here, I pay some attention to interest in integrating financial markets.

II Old and New Debates on Regional Integration in Sub-Saharan Africa

The current context within which SSA governments are taking a look at regional integration differs from that of the past. Since import substitution is no longer the driving force behind integration, most countries are currently pursuing economic reforms that have a strong trade liberalisation component. Indeed, the need to derive more benefits from the liberalisa-

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tion efforts is increasingly being pushed forward as a reason for pursuing integration, while pressure to avoid marginalisation has considerable political appeal. In addition to these, the fact that SSA has been by-passed in the last wave of investment flows to emerging markets has led to considerable soul-searching among SSA policymakers and researchers. Important regional groupings amongst the industrialised countries, particularly NAFTA and the new EU, have also stimulated new efforts towards regional integration. I focus below on the two polar strategies of unilateral liberalisation of trade on a non-preferential basis on the one hand, and the promotion of a pan-African economic union that has a centralised decision structure to coordinate reciprocal preferential policies on the other. This is followed by a discussion of some intermediate positions that embrace a number of other considerations being discussed by African academics.

Unilateral Non-Preferential Trade Liberalisation

As pointed out earlier, Husain (1992) has recommended a focus on unilateral trade liberalisation. Jebuni (1997) takes the case a little further as he comes out strongly in favour of unilateral non-preferential trade liberalisation after questioning "whether inward-looking preferential liberalisation can increase intra-African trade". After observing a high level of protection that has been provided to import-substitution industries, he suggests that so long as protection remains alongside import-substitution strategies, preferential trade liberalisation will be meaningless. This is because preferential trade liberalisation does not provide any incentive for firms to export when there is high protection for import-substitution firms. Indeed the high tariffs placed on imports affect exports in a significant way in many countries

The arguments of Jebuni (1997) rest on the non-recognition of significant positive outcomes from macroeconomic reform in various countries and the little change in domestic policies even when pursuing preferential trade liberalisation. The argument against regional groupings rests mainly on the diversionary effects of preferential tariffs. But those effects remain high because of the relatively high SSA tariffs. "At present, despite considerable reductions in trade barriers over the past decade, most African countries impose fairly high barriers through tariffs and export taxes or through managed exchange rate arrangements" (Oyejide, *et al.*, 1997: 16). Jebuni (1997) observes that, given that manufactures dominate intra-African exports presently, the potential for expanded exports of manufactures and other non-traditional exports exists, but these are hurt unnecessarily by national protective measures. Countries will therefore have to unilaterally bring down tariffs in a general manner in order to establish a

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basic incentive for the growth of exports. SSA trade integration will then take place as an off-shoot of the process of lowering tariffs unilaterally. Jebuni suggests that since tariffs came down somewhat in the last decade through unilateral non-preferential arrangements, SSA's intra-regional trade has expanded more rapidly than its other international trade, even if still slow.

The arguments against this approach are that countries will be pursuing their policy objectives at different speeds, which will inevitably lead to a widening of the disparities in tariff structures and hence discourage intra-regional trade as the task of harmonisation becomes more difficult. On the surface, the promotion of unilateral non-preferential trade liberalisation would appear to be in conflict with the formation of a regional preferential trade area; for, as Oyejide *et al.* (1997) point out, the lower the tariffs, the less opportunity a country has to offer a preferential tariff. On the other hand, as suggested by Fine and Yeo (1997), lower tariffs reduce the costs of trade diversion that will be observed from a preferential trade area.

Even though many SSA governments have pledged to work towards the reduction of tariffs unilaterally as they pursue reforms, the pace continues to be slow and there does not appear to be much prospect in sight for faster action. A major obstacle is the likely loss of tax revenue in the short run, which makes a unilateral tariff reduction appear tantamount to shooting oneself in the foot. I turn now to the other extreme end before looking at intermediate positions.

Pan-African Economic Union

One of the most recent restatements of the need for a pan-African economic union has been by Onitiri (1997). He argues that if SSA is to avoid being marginalised following the 'revolution' in the international economy, it must enhance productivity, a process that requires more than simple trade integration. He says this requires full economic integration. As McCarthy (1996) has pointed out, historically, full economic integration can be achieved through a step-wise graduation of integration units. They may start with economic cooperation, for example, for the purpose of running a joint regional airline or a coordinated rail system. This may be followed by a more narrowly focused trade integration beginning with a free trade area and progressively reaching into customs union, then a common market.[3] Finally, they may have an economic union when they start pursuing common fiscal and monetary policies.

3 When capital and labour join goods and non-factor services in the free flow among member states.

Onitiri's (1997) view of integration is as embodied in the Treaty of the African Economic Community (AEC) assuming that all the intermediate steps have been taken already in the years of experimenting with one grouping or another. For this, 'variable geometry' is at variance with the AEC Treaty. The AEC is conceived as the means for providing "an effective response to the prevalence of regional economic blocs" all over the world. Onitiri (1997) observes that, "Since the Treaty embraces all aspects of African economic and social life, it also provides a convenient framework for re-examining and streamlining the activities of the existing African international government organisations and mobilising them more effectively to address the pressing problems of African economic and social development" (Onitiri, 1997: 417).

The AEC will move beyond trade integration into the integration of production, the harmonisation of fiscal and monetary policies, as well as into conflict resolution and the coordination of policies on the environment. It is proposed under the AEC Treaty, in addition to the large number of implementing mechanisms, to delegate the task of administering and managing the community to a single OAU/AEC secretariat. The restructuring of the present Organisation for African Unity (OAU) to play the new role assigned to it suggests that it will have an enlarged bureaucracy, a proposal which seems to frighten many African intellectuals (Oyejide *et al.*, 1997). It will be running the show in concert with the African Development Bank (AfDB) and the Economic Commission for Africa (ECA).

The concept of the AEC supported by Onitiri has been treated differently by Mistry (1995), who, with an incremental approach, has suggested the adoption of sectoral investment coordination and cooperation, trade integration and the development of an appropriate institutional framework. In Mistry's view, a regional policy environment must be created to allow the gradual integration of markets. This approach differs from the practice of current regional agreements where emphasis is placed on trade integration without addressing adequately the infrastructural and institutional framework which is necessary to facilitate the trade integration process. Rather than dismissing variable geometry, Mistry proposes the adoption of a core group willing to implement a customs union and the existence of "a wider group at the periphery which might constitute itself as a free trade area, and be linked with the former in a free trade agreement ..." (Mistry, 1995: 42).

Arguments that may be pushed forward against the idea of the AEC include the fact that many of the expected benefits do not require preferential tariffs in order to be realised (Oyejide *et al.*, 1997). It is also suggested that in the past, coordination of activities that brought net gains to all participating countries (such as joint infrastructures) was impeded by tying

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their negotiations to trade policies where the gains were not that transparent and discouraged potential losers.

Obviously, for many SSA policymakers, the situation is not one of an either/or choice. Some of the benefits expected under either unilateral non-preferential trade liberalisation or an economic union with preferential tariff arrangements could be attained without necessarily choosing one approach. This is what has encouraged the development of intermediate approaches.

Intermediate Approaches to Regional Integration

Foroutan (1993) accepts the principle of integration but proposes that the trade integration approach be avoided. This view is shared by Langhammer and Hiemenz (1991). They do not consider trade and factor integration feasible because of the dissimilarity of African economies and the difficulties of putting in place an effective compensation mechanism (Foroutan, 1993). What is considered to be essential are cooperation, coordination and harmonisation. Like many others, they emphasise the provision of infrastructural facilities, training and research. The advantage of regional cooperation in infrastructure investment is that all members benefit irrespective of their size and level of economic development thus avoiding the problem of compensation (Robinson, 1996).

Another proposal for enhanced regional integration in Africa is to enter into a union with the European Union, very much after NAFTA (Fine and Yeo, 1997; Collier and Gunning, 1995). A number of advantages are expected to come from such a union. Collier and Gunning (1995) argue that forming an integration unit with the North will generate all the gains from global liberalisation. Also, such a union would enhance the credibility of African trade liberalisation and generate the desired investment inflows. This is because integration with the North would be an effective 'lock-in arrangement'. The possible loss of access to European markets may be an effective means of binding governments to a particular line of action.

The proposal for a North-South integration does not address the issue of distribution of gains. One clearly cannot assume that guaranteed access to EU markets is adequate compensation for the revenue loss accompanying regional trade liberalisation. Since the EU is the largest trading partner for most SSA countries, duty free entry of EU goods will definitely have a negative impact on trade revenues, and possible negative implications for total revenues in the short run. This might be remedied with aid to finance compensatory schemes and support regional infrastructural and industrial projects.

Another difficulty with North-South integration at this stage of Africa's development is that it runs counter to the spirit of self-reliance which has considerable influenced the goal of integration. This lies at the bottom of the revised ECOWAS Treaty and the Lagos Plan of Action. Evidence of how it will be resisted, particularly by SSA regional bureaucrats is provided in the comments by Asante (1996) on the subject. The problem of self-reliance will not be an intractable one, however, if the formation of such a union increases the ability of SSA economies to respond to shocks without external assistance and helps them to diversify their production structures and exports. This is a good reason why a number of regional observers are looking for possible pointers from the UEMOA (West African Economic and Monetary Union) experience.

III New Priorities for Regional Integration in Africa

SSA's problems are wide-ranging. The continent has suffered from prolonged economic and social crises. The state in many countries suffers from loss of credibility, which affects its ability to mobilise resources in order to counter the mounting problems. The growing debt burden pushes governments to support their economies increasingly with aid, in magnitudes that are clearly unsustainable. There are indeed countries such as Tanzania and Senegal, that have aid levels of more than 20 percent of GDP. It is becoming increasingly evident that the institutions of the small countries will have considerable difficulty dealing with these problems on their own. The need to turn to supra-national structures and institutions in order to provide the state with some credibility, and make possible additional resources is becoming more and more urgent.

Current discussions of regional integration "reflect a general desire to break the confines of the nation-state ... including the multiple barriers to the free movement of goods and services, people, and capital among countries, and differences in legal, governmental, and educational structures" (Lavergne, 1997: 3). The growing scope of regional integration is derived partly from the new role of the private sector in various countries. The private sector wishes to see the removal of all impediments to a greater participation in the economic activities of the entire region, as market size continues to shrink within countries. Stronger and more effective supranational bodies that share sovereignty with governments are needed to achieve credibility with the private sector.

While it is obvious that SSA needs to grow as rapidly as possible, this would require considerable investments from both within SSA and from outside. Enhanced trade is an essential requirement for this growth to occur, as well as other fundamental economic undertakings to make good

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use of the investments. Some form of integration may harness the resources that individual countries cannot gain access to. The continent's integration needs to go far beyond trade creation. Its immediate task is to attract as much investment as possible and use it efficiently for both production and exchange.

In order to do this the regional policy choice for SSA countries is not necessarily a choice between one bipolar position and the other; i.e. unilateral non-preferential trade liberalisation versus an all-embracing pan-African economic union. It is more a question of how competently they can use any institutional framework to attract the required investments and stimulate a rational distribution of these across countries. If they have not attracted investments after trade liberalisation and other reforms it is partly because the reforms have not been deemed to be credible. Will any kind of lock-in arrangement provide that kind of credibility? Does SSA need a union with the EU? Can the AEC provide policy credibility? Can individual countries guarantee adequate trade reforms and establish credible industrial development programmes? Should the discussion of regional integration move beyond the economic variables? These are all empirical questions requiring more detailed study. It is obvious, however that, while most unilateral trade policy reform attempts continue to lack credibility for the fear of reversals, a pan-African economic union seems also to be too far-fetched to become the major instrument for attracting the required investments. In the end, the choice will be made not only on rational economic grounds, hut influenced considerably by politics and diplomacy.

On the side of politics and diplomacy, we need to note that SSA countries have already expressed a commitment to establishing the African Economic Community, and it is unlikely that this commitment will diminish soon. The most rational thing to do, therefore, is to ensure that the AEC does what is necessary in order to attract the required investments. It is essential that the AEC will not be perceived as just another regional institution whose existence only marginally affects the economic policies and decisions that various countries and their economic agents make. The priorities I discuss below are issues that the AEC must deal with immediately in order for SSA regional integration to become an effective development strategy. They include:

- developing appropriate macroeconomic frameworks to facilitate greater interaction among the resources of countries;
- establishing mechanisms for attracting both private and public capital flows from the rest of the world;
- establishing and publicising the fact that there are gains to be made from cooperation in investment in infrastructure and market integration,

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indicating clearly the opportunity costs of not cooperating;
- fashioning out an appropriate industrial development policy;
- developing an effective compensatory mechanism to ensure that all countries will receive some of the gains from increased trade;
- developing institutional frameworks for the better management of the region's resources including human resources;
- rationalising (sub-)regional arrangements to reduce replication of efforts and conflicts. In rationalising these existing arrangements, it is essential that the rest of the world sees SSA as speaking with a common voice for a clear purpose in order to strengthen its position vis-à-vis the other regions.

Macroeconomic Reforms to Facilitate Integration

Many countries pursuing integration within the arrangements of existing regional groupings often have different macroeconomic situations that serve as entry points. They generally suffer from macroeconomic instability and are pursuing economic reforms of different intensities. Mistry (1996) has suggested that the considerable variation in intensity, sequencing, scope, etc. has a significant negative impact on the outcomes of both the reform process and on the objective of regional cooperation and integration.

In West Africa, Badiane (1997) has observed that trade liberalisation yielded far less positive outcomes than expected because macroeconomic policy reforms were not uniformly pursued. One aberration was that while the CFA remained overvalued for over a decade, the 1994 devaluation occurred at the same time that Nigeria was revaluing the Naira by a similar margin. Similarly, the Ghanaian Cedi was appreciating in real terms as the CFA was devalued. The lack of synergy in these policy developments harmed the ability to generate substantial benefits from both trade reforms and macroeconomic reforms. Well-tuned and synchronised macroeconomic reforms are far more likely to generate net gains than preferential trading arrangements.

What this means is that, for sustainable macroeconomic reforms, neighbouring countries must share similar visions that lead to the introduction of similar or complementary policies particularly with respect to exchange rates, fiscal policy and monetary policy. The harmonisation of these policies is probably more crucial than trade reforms in the creation of trade. In the absence of such an approach to reforms, the bad policies of neighbouring economies affect performance in other countries. Mistry (1996) showed how unstable situations or destabilising activities in neighbouring countries affect others. There is the example of how Zambia's open capital

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account is used as a convenient route for illicit transactions with South African entrepreneurs to arrange capital flight from Zambia (as South African-made goods are exchanged for US dollars available on the open market). In West Africa, Ghana blamed the instability in its foreign exchange market on Ivorian and Nigerian speculators who obtained unhindered access to the liberalised foreign exchange market, to meet a demand that could not be met in their countries with over-valued currencies.

Regional Integration and Private Capital Flows

Private capital flows, particularly foreign direct investment and portfolio equity, into the developing world grew remarkably after the mid-1980s. Their share in total private flows moved to an average 35% and 13.5% respectively in the period 1990-1996, up from 12% and 1.2% a decade earlier. The growth is generally attributed to the growing integration of markets and financial institutions, increased economic liberalisation and rapid innovation in financial instruments and technologies, particularly in the areas of computing and telecommunications. For SSA, however, most of these growing flows were hardly observed as they were directed at Asia and Latin America. China alone accounted for 86% of total FDI flows in 1995. Even though Nigeria is the second largest recipient of FDI, this is not diversified and mainly restricted to the extractive sector of the economy as is the case in Ghana.

Thus, SSA currently attracts only 4% of the emerging markets portfolio, which is itself only a small proportion of global capital flows. Despite this low magnitude, it is considered that SSA has a significant chance of becoming a major drawer of capital and investments for a number of reasons (Senbet, 1997). The reasons include the fact that in the last couple of years, the number of operating capital markets in Africa has grown considerably reaching 16 at the beginning of this year, up from less than five a decade ago. Moreover, African markets have in the last few years begun to attract international attention. Thus over a dozen African investment funds have been established since 1993, trading in Europe and New York. These African funds had a total investment of $1 billion at the beginning of 1997, up from zero in 1992.

Based on these achievements of the last few years, SSA is increasingly viewed as being capable of attracting more private capital, if only it will put its house in order (Senbet, 1997). With increasing and more effective financial sector reforms, the way should be paved for increased flows as global investors look for new frontier markets. Since emerging markets are under-represented in the global market, it is expected that they will increase their share. With improved infrastructure and policies, SSA

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should enhance its ability to become an important player, as international investors seek out the last frontier.

Senbet (1997) has proposed a number of developments that should take place in SSA economies in order for them to be considered as serious players. These include: the development of public confidence and informational efficiency; the promotion of financial market integration through regionalisation; the development of human resources and infrastructure; the promotion of capital market development through privatisation; the globalisation of SSA financial markets; the fostering of financial innovation and the use of informal sector signals; the design of efficient regulatory systems; and a solution to the negative perceptions on risk in SSA.

Quite a number of the financial sector reforms that SSA saw in the last decade are attempting to tackle many of these issues What still remains untouched by the reforms is the issue of globalisation and regionalisation of the market and the regulatory issues associated with this. With the stock markets generally considered to be thin, the pooling of resources as well as the harmonisation of the securities and investment laws should enhance competition among countries in the region and enhance public confidence in the markets. The likely effect of this will be a considerable growth in cross-listing of securities. There is only very little of that happening now, as in the case of Namibia and Zimbabwe and also for Ashanti Goldfields in Ghana and Zimbabwe.

The development of a regional stock exchange which is centred around the exchange in Abidjan is currently under serious consideration by the francophone West African countries. The stock exchange operators of Ghana are also considering ways of cooperating with such a regional exchange. There are also a number of proposals for developing stronger linkages between the Johannesburg exchange and the smaller exchanges of Botswana, Namibia, Swaziland and Zimbabwe for Southern Africa (Jefferis, *et al.*, 1997). One of the burning issues that has to be tackled is the issue of regulation of a regional stock exchange.

In the absence of regional stock exchanges and their regulatory bodies, a lot of financial transactions inevitably must be handled by central banks and the rest of the banking system. Hence, the integration of financial markets across country borders is seen as the major key to the dilemma (Folkerts-Landau and Van Greuning, 1997). A number of SSA countries with more internationally-oriented emerging financial markets have become interested in strengthening monetary cooperation and financial market infrastructure. The Franc zone allows countries to share a common currency with a common central bank. They are moving steadily towards modernising bank regulation, liberalising markets, improving supervision and moving towards indirect monetary instruments at the regional level.

They are continuing to develop regional bond and equity markets as well as regional pension and insurance regulations.

The argument for integrating financial market infrastructure in SSA is based on the notion that "prudent cross-border lending and investment can diversify financial institutions' asset risks away from the small number of economic sectors that dominate so many national economies and that are prone to frequent shocks" (Folkerts-Landau and Van Greuning, 1997: 1) In Southern Africa, for example, it is argued that the concentration of economic activity in a small number of natural resources, e.g. tobacco in Malawi, cattle and diamonds in Botswana, copper in Zambia, ensures that banks are often largely exposed to only a few industries and crops. They can diversify their asset portfolios by investing abroad, a step which helps them to reduce their exposure to risk while increasing the volume of inflation-adjusted lending.

Further arguments for regionalisation of banking is that the new legislation and regulations from an outside body act as an agency of restraint on national authorities when banking regulations have been harmonised. This allows for coordinated supervision. Further benefits come from the possibility of averaging country resources to mitigate small country concerns and the possibility of a coordinated response to financial crisis as happened with the problems created by the Meridien Bank failure.[4] Folkerts-Landau and Van Greuning (1997) provide many other reasons why such integration would improve the service delivery and efficiency of financial institutions in SSA.

The main approach recommended for integration is the institution of a regional supervising authority, which might be either private or public, charged with responsibility for off-site analysis of adherence to prudential rules and regulations on a regional basis. Such off-site supervision which will entail processing returns and manipulating data will lead to evaluating and interpreting individual banks risk management processes as well as their performance. The supervisory authority will need to be well-equipped with appropriate standards and regulations, as well as human capacity in order to establish its credibility.

4 Meridien BIAO was an international banking group with the umbrella bank based in Luxembourg and its treasury based in the Bahamas. It started operations in a number of African countries in the mid-1980s as countries began reforms. The parent bank in Luxembourg held 75% of total shares of the group, while the Bahamas often held up to 55% of the shares of Meridien BIAO in various countries. Meridien BIAO became exposed (deposit-wise) to the Bahamas in a significant way. When the Bahamas, being the treasury of the group, suffered severe over-exposure on its assets, this triggered a chain of financial distress within the group, affecting the banks in Ghana, Nigeria, Swaziland and Zambia.

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Cooperation in Infrastructure Development

A major obstacle to the implementation of the Economic Commission for Africa's sub-regional plan for Africa's industrialisation were the deficiencies in physical (transport and communications) and institutional (commodity exchanges, clearing houses, etc.) infrastructure. Cooperation in the provision of regional economic infrastructure is bound to facilitate market integration and reduce transaction costs, facilitating greater trade integration, as well as encouraging more regional investment. Even though some arrangements exist with current sub-regional arrangements for the purpose of developing regional infrastructure, these have had very little impact. For example, the ECOWAS Fund for Cooperation, Compensation and Development was established and located in Lomé in 1977 with the objective of promoting economic development and integration through the financing of industrial and infrastructure projects of common interest to ECOWAS states.

Robinson (1996) noted that "despite its 'win-win' characteristics, the level of regional cooperation in infrastructure and natural resources in the past has been disappointingly low." In the area of energy supply, there are very few intra-regional supply arrangements, even though the potential for intra-regional grid connections exist at non-prohibitive costs. The potential exists to cooperate in the areas of water and transport with benefits for all parties involved. Sarfoh (1993) has indicated that the gross potential hydro-electricity that can be generated by SSA's large water resources has been estimated at 300 gigawatts, out of which only 4% has been exploited.

The potential gains from regional cooperation in infrastructure and natural resource development are reflected in the way they contribute to economic growth. The first channel is the direct cost reductions that can be achieved for both capital and operating costs, via economies of scale. Another channel is the reduced opportunity costs for unserved demand. Robinson (1996) argues that "in situations where, for example, investment is inhibited by lack of access to electricity, water, transport or telecommunications facilities, the opportunity cost associated with unmet demand can be very high" (p. 71). It is also argued that supply can be enhanced through the operation of conjunctive systems. An example of this is the cooperation in the supply of energy between Ghana and Côte d'Ivoire which allows each country to complement the other's supply in times of shortage.

Other gains expected from joint infrastructural development are a positive impact on trade as well as the likely savings when investments are lumpy. Robinson (1996) also expects some dynamic gains to be achieved. "Dynamic gains are also likely to accrue from regional cooperation in infrastructure. In infrastructural systems which operate more efficiently as

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a result of regional cooperation, technological and managerial skills are acquired by the nationals of the countries involved, and these will spread into other activities in the same sector, or into other sectors contributing to progressive efficiency gains. Foreign investors participating in regional projects are also more likely to participate in member countries when they have acquired some experience and familiarity with the region" (p.75).

One way in which SSA can effectively achieve an integrated provision of infrastructure is to negotiate together a change in the composition of aid from the industrialised world. I have argued that 70 percent of multilateral project assistance should be directed at developing regional infrastructure, focusing on transport and communications, energy and water development (Aryeetey and Oduro, 1996). This would be adequate for starting the process of building a sound infrastructure base.

Industrial Policy

Most SSA countries have a small manufacturing base with little or no inter-industry linkages. Several years after the creation of SSA regional units, they remain unable to generate substantial increases in intra-African trade in manufactures. Mistry (1996) has suggested that the emphasis on trade integration within the current integration arrangements of SSA without a regional policy for the production base may explain why the benefits of regional integration efforts have been limited. The small manufacturing base in SSA requires that trade integration should be accompanied by production integration to develop that manufacturing base.

There is often a tendency, particularly under proposals for general trade liberalisation, to let trade policy subsume industrial policy. The response of the industrial sector under any liberalisation scheme cannot be taken for granted since that response is also dependent on other factors aside from trade policy including the macroeconomic conditions. The problems that arise from these must be addressed with an appropriate set of regional industrial policies.

Industrial policy should, however not be seen as a simple collection of policies for intervening in the functioning of markets, as was the case in the early post-independence period. Industrial policy should be conceived as a tool for assisting markets to function more efficiently. This point is made considering the fact that under reforms, the principles of trade liberalisation and 'getting prices right' were relied on to ensure that industry and other sectors could produce in an assumed efficient way, in order to pave the way for an almost self-operating or automated process of development. Inadequate attention was paid to the second-best consideration that trade and market liberalisation may not increase efficiency when some markets (such as insurance and credit markets) cannot be made to function perfectly (in practice this is never possible), either as a consequence of more conventional types of market failure or for reasons related to the cost of transactions and lack of perfect information. Also, little importance was attached to the fact that even if static efficiency gains were realised by moving the economy onto the production frontier, this in no way implied that the frontier would subsequently shift outwards in a dynamic way.

Hence harmonised industrial policies would encompass any set of policies that remove structural and institutional bottlenecks to the development of industry, particularly across national frontiers, without the state's direct involvement. This is when the private sector's role in fashioning integration becomes most desirable.[5] Industrial policies complement the development of suitable infrastructure and ensure that institutions work.

Effective Compensatory Mechanism

A major obstacle to galvanising the political will to lower import tariffs is the likely loss of revenue. Compensatory schemes that have been established for the purpose of minimising this problem have had little impact. McCarthy (1996) has suggested that the issue of compensation and the failure of the compensation mechanism to address those concerns was important in explaining the collapse of the East African Community. For ECOWAS, the Trade Liberalisation Scheme Compensation Fund which was set up in 1990 to compensate member states for losses in revenue arising from the introduction of trade liberalisation measures, is observed to have had little impact in allaying the fears of member states (Aryeetey and Oduro, 1996).

But the experience of Ghana, for example, shows that there can be reduced dependence on trade taxes as a source of revenue (without total revenues declining) within the context of unilateral trade liberalisation supported by compensating exchange rate adjustments and tax reform measures which tap the potential tax base more effectively. It may be deduced from this that regional trade liberalisation need not necessarily result in a decline in total revenues. What is essential for the AEC to do in that case, is to ensure that the overall level of trade protection is reduced so that the revenue losses of countries are minimised following unilateral trade liberalisation by members.

5 The absence of active involvement of the private sector in the formulation of decisions, protocols, etc. on regional integration is largely because at the time the agreements were ratified, most of the regimes were statist in outlook. Domestic economic policy did not actively encourage private enterprise.

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Cooperation in International Negotiations

Formation of a regional unit can increase the bargaining strength of the member countries. This requires an ability to adopt a unified regional position on the relevant issues. This is particularly important for negotiating trade and international commodity agreements with third parties. A prerequisite for this, however, is the coordination of national agricultural and industrial policies. It may be possible to obtain more trade concessions *en bloc* as opposed to individually. In this case, SSA countries may be more willing to drop the principle of non-reciprocity in their trade negotiations since they will be negotiating from a stronger position.

A clear test of the willingness of SSA countries to jointly negotiate for concessions will be when the Uruguay Round comes up for re-negotiation. Sorsa (1997) shows that SSA did not use the Uruguay Round to support domestic efforts at trade policy reform. They did not seek to place on the table for discussion such pertinent issues as agricultural taxation whereas the agricultural subsidies of concern to the industrialised nations were a major item on the agenda. When the Uruguay Round created opportunities for binding tariffs to newly liberalised rates, most SSA countries did not take advantage of the opportunity. The round would have provided them with an opportunity to lock their unilateral trade policy reforms into an international framework that would provide the needed credibility for foreign investment by making policy easily predictable and stable. Coordinated negotiation would allow the countries to force on the agenda the issues of relevance to the region, and the AEC must take this up.

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The SADC Trade Protocol and the Enabling Clause: A View from South Africa

Rosalind H. Thomas[1]

I Introduction

At the Maseru Summit in August 1996, member states of the Southern African Development Community (SADC) adopted a Trade and Development Protocol which is an "interim arrangement" leading to the establishment of a free-trade area (FTA) within 8 years. This Protocol conforms to a symmetrical GATT Article XXIV free-trade agreement – and herein lies the problem. By its very symmetrical design, the Protocol treats all SADC states as 'equal', and requires them to uniformly follow through on obligations to *inter alia*, reduce tariffs, harmonise on standards and policies and phase out subsidies and non-tariff barriers to trade. While such uniform application of contractual liability is legally and politically correct since they are sovereign member states entering into treaty obligations, it creates an absurdity when analysed from an economic perspective. What the Protocol should have done was to introduce the concept of differentiation by building in temporary compensating asymmetries in order to account for the diversity in the size and strength of the various economies of SADC countries.

To their credit, member states have recognised that the Protocol is a framework agreement, and have accepted that some flexibility is needed in negotiating the necessary commitments. The written agreement, however, makes no provision for such flexibility, and therefore everything rests on the negotiators in the Trade Negotiating Forum who must move the process forward in a way that has real meaning for each country. This paper analyses the SADC Trade Protocol from a South African perspective. It

1 Legal Advisor, Policy Business Unit, the Development Bank of Southern Africa (DBSA). This paper was prepared for the Friederich Ebert Stiftung (FES), Johannesburg, South Africa, April 1997, and is reproduced with permission from FES for the purposes of the FONDAD Conference, 18-19 November 1997. The views expressed herein are the author's, and do not purport to reflect the thinking of either FES or the DBSA. The author is grateful for comments received from Percy S. Mistry. All errors and omissions remain the author's responsibility.

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examines its importance for South Africa and includes current thinking on how the protocol should evolve and how it should relate to the WTO Regime. In this context, the paper will also touch on South Africa's classification at the WTO as a 'developed' economy.

II Historical Background

The first draft Protocol tabled in 1994, suggested that the FTA would be established immediately upon its entry into force. This draft took a neo-classical approach to trade liberalisation. At no stage did it mention development or industrialisation. Indeed, proponents of the earlier draft did not see the importance of the link between trade and industrial policies.

After South Africa's accession to the SADC Treaty in August 1994, it expressed concern about the appropriateness of the draft Protocol for the region, especially the desire to move immediately to an FTA without considering the diversity between SADC member states. In June 1995, South Africa supported its arguments with the results of a preliminary study carried out by the South African Industrial Development Corporation which showed that an FTA would have immediate economic benefits only for South Africa and would result in de-industrialisation in the rest of the region. It was already evident that some countries in the region (Zambia, Tanzania, Malawi and Zimbabwe in particular) were experiencing stagnation in industrial output and exports, very little diversification and a significant amount of dislocation and de-industrialisation, i.e these economies had largely become 'sellers' markets'. Under structural adjustment programmes (SAPs) and within the confines of the Cross-Border Initiative (CBI), these states had already liberalised unilaterally (globally or within the Common Market for Eastern and Southern Africa – COMESA). Because of its more open economy, Zambian trade with South Africa was ballooning, exacerbating its trade deficit and causing de-industrialisation.[2]

South Africa called for a joint SADC study to analyse the impact of a free trade regime on Southern Africa. South Africa was willing to consider an arrangement of asymmetrical trade in SADC which disadvantaged South Africa in favour of the others. It would lower its tariff regime for imports from its SADC partners at a faster rate than they would be required to do for South Africa.

2 Several economists had commented upon the IMF/WBGs SAPs, alerting policymakers to the inherent dangers if the specificities of the individual countries and the sequencing of events were not considered. See, e.g. M. Shafaeddin (1995); Ajit Singh (1994); and G.K. Helleiner (1986).

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In January 1996, the SITC (Standard International Trade Classification) delegates met with SADC delegates during the Annual Consultative Conference in Johannesburg. With bilateral trade tensions having reached unprecedentedly high levels,[3] they decided to create a Trade Negotiating Forum (TNF) to deal with both regional and bilateral negotiations. The TNF is now adopted in the Protocol as the main institutional framework within which trade negotiations will take place. In May 1996, the TNF met for the first time in Dar-es-Salaam to consider both its own terms of reference and the new revised draft agreement. Facing a tight schedule and unfinished business, they met once again in June 1996 in Pretoria. It was evident at the June meeting that considerable differences still existed on the revised Protocol. A further meeting took place in Dar-es-Salaam in August 1996. The parties reached agreement on an 8-year time frame for the FTA, the domestic content in the Rules of Origin (35 percent *ad valorem*, to apply cumulatively),[4] and a one-year time limit to arrive at proposals on sensitive items, especially textiles and agricultural products. Described as a "framework agreement", the Protocol was adopted by heads of state in Maseru in August, 1996.

III Political Sovereignty versus Economic Reality

The Trade Protocol manifests the type of contradictions that are emerging in the 1990s with regard to statehood, international law and interdependency, i.e. a contradiction between the accepted, universally applied doctrine of the 'sovereign equality of States' found in general public international law and the continuous dilution of the same doctrine in the field of international economic law. Writing on this subject, Thomas M. Franck has opined, "Sovereignty has historically been a factor greatly overrated in

3 Both Zambia and Zimbabwe were challenging South Africa over bilateral trade negotiations. Zimbabwe was unhappy about the unilateral termination of their bilateral agreement by the former South African government in 1992. They expressed disappointment and frustration that the South Africa was not urgently addressing the issue since their textiles industry was in crisis. Zambia also felt that it was being dealt with unfairly, and was desperate to conclude a bilateral agreement. Both countries accused South Africa of all kinds of chicanery, including 'dumping' of 'subsidised' goods. While much of this was political rhetoric, the Zimbabweans, in particular, had a genuine grievance requiring attention. As a result, there is enormous distrust of South African motives within the region which are used by the EC in their bilateral negotiations with South Africa. To some extent, South Africa's delay in adequately dealing with these concerns has contributed to such perceptions.

4 Cumulation would be applied on the same principles as it applies within the Lomé relationship with the EU, in the sense that inputs originating from within the SADC region would be calculated as comprising part of the 35 percent domestic content. The Malawi delegation has, however, reserved its position.

international relations... Never, however, have notions of sovereignty demanded as much cautious rethinking as now" (1995: 3).

In classical international law, the equal treatment of states is fundamentally correct. Hence the United Nations Charter which deals with issues affecting countries equally recognises this 'sovereign equality' and gives each state represented in the General Assembly an equal vote for decision-making purposes regardless of its size, population or wealth. International lawyers have long upheld this concept, however, the 'sovereign equality' of states becomes meaningless when looked at through the cold lens of international economic relations. It is here that this concept of equality departs from the reality. From the perspective of international economic relations, where global *interdependence* and not independence is the key concern, 'equality' of states becomes illusory. This is demonstrated very clearly in the Southern African region.

IV An Unequal Region

The SADC region is comprised of twelve countries demonstrating varying levels of development.[5] At one end of the spectrum is South Africa whose economy is four times larger than the other eleven SADC countries combined.[6] At the other end are Angola, Lesotho, Malawi, Mozambique, Tanzania and Zambia, as least-developed countries (LLDCs).[7] In the middle range of SADC countries are Zimbabwe, Mauritius, Namibia and Swaziland. Because of the extremely weak and vulnerable nature of LLDC economies, they are entitled to a substantial number of derogations under the WTO regime, and have been accorded as a right, "differential and more favourable treatment" in recognition of their special development needs. This is an acknowledgement that WTO member states are not considered 'equal', and therefore differences in the levels of their development must be accepted in multilateral trade commitments. This latter position was reached after a long struggle to obtain recognition of this fact (starting with the Dillon Round through to the Uruguay Round of negoti-

5 Two more states were admitted to membership of the organisation in September 1997, namely the Democratic Republic of Congo and Seychelles. Since these countries have not yet formalised their membership, they are not considered in this discussion.

6 Within the WTO, South Africa is considered a 'developed' country, but this classification is a misnomer. Since classification in the WTO is by self-selection, South Africa may choose what category it falls under. By the OECD's Development Assistance Committee classification, South Africa is considered 'developing'. Certainly it cannot match Singapore or Israel in per capita GNP, and the latter two are classified in WTO as 'developing countries'.

7 Botswana graduated out of LLDC status in December 1994.

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ations), and it was lobbied for extensively by developing countries themselves.

South African industry may be inefficient in global terms, but it is considered sufficiently competitive in the sub-regional and continental context to have an overwhelming competitive advantage in an SADC FTA. The South African government believes that if tariffs are dropped uniformly and on an equal basis over the next eight years, the results could be devastating for the neighbouring economies. At any rate, South Africa believes that the Protocol places far too much emphasis on the elimination of tariffs and the role of tariff policy while tariffs *per se* are not the issue for two important reasons. First, intra-SADC trade is characterised by unprocessed primary commodities going into South Africa and Zimbabwe, and manufactured goods and semi-processed intermediate products going to the other SADC countries. Given the lack of complementarity of individual SADC countries, and the fact that only South Africa and Zimbabwe have a diversified industrial capacity, this trend is hardly surprising (Ndlela, 1987).[8] It is absurd that the Protocol should emphasise tariff policy for achieving regional goals when only a limited range of tariffs will be in use at any one time by the majority of countries. South Africa will be the only country requiring an elaborate range of tariff lines. Second, for all the reasons stated in the AfDB Study (1993: 23-24 and 36), non-tariff barriers still remain the single most important constraint to intra-regional trade in the SADC region. Thus, the focus of the Protocol on tariffs is totally misplaced.

A more important concern is that while trade with Southern Africa constitutes a small percentage of South Africa's global trade, this trade is growing at a phenomenal pace and has become exceedingly important for the nature of the merchandise being exported. South Africa primarily exports capital equipment and manufactured goods to the region. Excluding Botswana, Lesotho, Namibia and Swaziland, exports to Zimbabwe, Zambia, Malawi and Mozambique account for 64% of South African exports to the African continent as a whole (South African Communication Service, 1996: 187). South Africa has a surplus in excess of 8:1 with the region, which is unsustainable for the other SADC member states. This large and entrenched trade imbalance is unhealthy and could result in impoverishing SADC states. The negative spill-over effects for South Africa would include increased clandestine migration into South Africa of economic refugees and a degree of destabilisation in the region which would dramatically increase its own political and social costs.

8 See also African Development Bank (1993); M.J. Mayer and R.H. Thomas (1997).

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Thus what the Protocol should have addressed is how to counter the huge trade imbalances between South Africa and the rest of SADC. Here, the nature of the two-way exchange between South Africa and SADC becomes critical. The Protocol should have investigated the possibility of increasing trade in non-traditional tradables such as, for example, water and energy from the region. Given the abundant endowments of these resources in the region, and South Africa's diminishing domestic resources accompanied by rising demand, trade in energy and water are areas where intra-regional trade may be improved and the trade imbalance redressed.[9] Further, regional cooperation in the implementation of infrastructure projects is critical,[10] as well as cooperation on finance and investment.

For these and other reasons, the manner in which the Trade Protocol develops and that strategies that are used to offset regional inequities becomes absolutely critical from a geopolitical viewpoint and from the perspective of more firmly anchoring regional economic stability. Thus, even the South African Reconstruction and Development Programme policy document has argued that the South African government must develop policies in consultation with its neighbours to ensure more balanced trade. The Government is attempting to do this through the SADC Trade Protocol.

V Article XXIV, the Enabling Clause and MFN

This suggests that whatever relationship is developed under the SADC Trade Protocol, it would certainly need to be flexible in order to accommodate very real divergences between the various parties to the Protocol. Within this context, an important issue for the member states to consider is what would be the most appropriate WTO instrument under which to register the Protocol? Bearing in mind the economic diversity in the region and the required flexibility in approach, should the member states proceed with the more restrictive Article XXIV or should they use the Enabling Clause?

Because of its lack of flexibility on a number of criteria, Article XXIV is a difficult instrument with which to proceed, especially when exploring alternative strategies to maximise the development impact of trade arrangements. SADC member states should instead explore the use of the

9 See, for example, Mayer and Thomas, 1997, p. 39.

10 See Aryeety's paper in this volume; see also the South African Department of Trade and Industry's initiative entitled the *Regional Industrial Location Strategy* which explores the concept of development corridors and clustering in the SADC region.

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more flexible 'Enabling Clause', as the region begins to consider how best to develop the 'framework agreement' it adopted at Maseru.

Article I of GATT contains the most-favoured-nation (MFN) clause, which establishes the fundamental principle guiding trade relations globally and is essential to any understanding of regionalism today. It implies non-discrimination among WTO members who are forbidden to selectively grant special trade preferences or privileges to specific other members. The MFN principle is subject to several important exceptions, including Article XXIV and the Enabling Clause. Through these two provisions, customs unions (CUs) and FTAs are tolerated and even encouraged as exceptions to the MFN clause.

Article XXIV envisages four types of arrangements, namely CUs, FTAs and 'interim arrangements' leading to either a CU or an FTA, the objective of which must be "... to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories" (Article XXIV: 4). Amongst the many agreements which make up GATT 1994,[11] is the Understanding on Article XXIV which requires that all notified agreements be examined by a Working Party and must include a plan and a schedule. The plan and schedule need not be detailed nor contain clear obligations, but the parties must not put any interim agreement into force if they are not prepared to alter it to conform with recommendations made. GATT requires that an interim agreement for a CU or an FTA be established within a "reasonable length of time" (Article XXIV: 7(b)) which the Understanding now places at ten years. Only in extremely exceptional cases may this period be exceeded, and here a period of two years is indicated.

In 1979, during the Tokyo Round, GATT Contracting Parties adopted the agreement *Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries* containing the provisions which make up the 'Enabling Clause'. This created a permanent legal basis for preferences in favour of LDCs or among them, notwithstanding the provisions of Article I. The 'Enabling Clause' was specifically designed to facilitate the economic development of LDCs and LLDCs. For that reason, it is more flexible in its application than Article XXIV. Olivier Long, a former Director-General of GATT, has argued, "Following the entry into force of the so-called 'enabling clause' at the conclusion of the Tokyo Round on 28 November 1979, the preferential agreement between developing countries, and similarly the preferences in their favour granted by developed

11 The Final Act concluded at Marrakesh contains several agreements and 'understandings' on the interpretation of the GATT 1947 provisions, and I refer to this agreement as GATT 1994.

countries, now have a permanent legal basis in the GATT" (Long, 1987: 30). Article XXIV exists for the FTAs of developing country members, and the more advanced LDCs (such as Israel, Singapore and Korea), for which trade liberalisation is the main objective.

Implicit in the heading *Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries* is the notion that LDCs would, with the continued and successful development of their economies and their graduation to a more developed status, be able to "participate more fully in the framework of rights and obligations" under the GATT. This notion of 'fuller participation' by LDCs is the complement of 'differential and more favourable treatment' and provides the basis for a potential reversal of the entitlement. As their situation improves, steps towards progressive 'equality' of treatment should become the rule. Thus, differential treatment should not be prolonged or made immutable, but be time-bound with a provision which underscores the principle that it is not an end in itself, but a vehicle to encourage more rapid economic development.

The WTO Secretariat has reaffirmed the GATT practice in regard to regional arrangements (WTO, 1996) and has acknowledged that a flexible regime for LDCs' trade blocs exists as a continuum from the previous GATT regime. In this context, LDCs have the ability to create an arrangement *sui generis* of Article XXIV provided that it does not prevent the reduction and elimination of customs duties or other trade restrictions on an MFN basis.

While Article XXIV sets out criteria considered by many to be inadequate for both CUs and FTAs, the rules under the Enabling Clause are even less tangible. Indeed, with regard to CUs and FTAs, it has been said that, "in the international system there is no standard model for a trade bloc. There are no standard models for customs unions, or free trade agreements ... Analysis must borrow and synthesise from the practice of existing trade blocs"(Qureshi, 1996: 151-152).

The Enabling Clause permits the actualisation of the principle, 'differential and more favourable treatment' for LDCs. In support of this proposition, Sir Leon Brittan has stated,

> "... the EU encourages developing countries to use regional integration as part of their economic development process. Many of the agreements which result are notified under the 'enabling clause', agreed as part of the Tokyo Round in 1979 to enable special and differential treatment (and more lenient application of GATT rules) to be applied to developing countries. This objective remains important for the EU. Ideally it should be possible to provide for clearer, stronger rules in respect of FTAs and other regional integration agreements

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> affecting developed and more advanced 'developing' countries (many of whom have a per capita GDP equivalent to EU member states), while at the same time providing for a genuine more relaxed regime applicable to developing countries." (Brittan, 1997)

The phrase 'differential and more favourable treatment' and the principle it espouses is unique in its application to the GATT. It has been a part of GATT language since the early 1970s. The phrase was given more tangible definition to mean *inter alia*, non-reciprocity, or exemption from the MFN requirement in trade relations with developing countries. With the adoption of GATT 1994, 'differential and more favourable treatment', has become codified as a rule of law which is time-bound in its application to LDCs. In respect of LLDCs (with a few exceptions), the rule has indefinite application. Thus the GATT 1994 Agreements have divided LDCs into two groups: LLDCs, and the rest.[12]

The fact that the principle is available *indefinitely* for LLDCs does not mean that it is intended to apply in perpetuity. Rather, its indeterminate nature is a recognition of the extreme uncertainties and difficulties which these countries confront in their efforts to develop, and which makes it nearly impossible to specify in advance how long it will take them to 'graduate' from LLDC to LDC status. But, there is an unspoken assumption that, given the admittedly slow and susceptible nature of attempts at development in LLDCs, the latter will eventually graduate from their unfortunate status. When that happens, the rule falls into disuse and becomes redundant as they will then adopt reciprocal MFN in respect of their trade relations with other WTO member states, and be integrated into the global economy.

The reality of the Enabling Clause, taken with the new WTO rules-based approach to trade relations, indicates that WTO members will not be so tolerant of LDC arrangements registered under Article XXIV that do not comply strictly with the latter provision. The fluidity of the economic conditions of LDCs, and the pregnant expectation that they will advance and move away from a state of underdevelopment, are important factors in the evolution of thought and practice in this area. The Enabling Clause provides inducement for this conceptual evolution with the underlying notion of the 'fuller participation' of advanced LDCs in the implementation of the GATT.

12 This division is, however, not helpful since it groups countries like Swaziland, Botswana and Zimbabwe together with Brazil, Singapore and Israel, and treats them all equally.

VI Conclusion: Trade and Investment as the Driving Forces

If we accept that the aim of integration among LDCs is not simply the efficient use of existing capacity as portrayed in classical CU theory (since this capacity is in any event less developed than is desirable), but that its primary objective is to encourage development and the transformation of production structures through industrial diversification and market expansion (Ostergaard, 1993: 29-34), then we can argue that the Enabling Clause allows member states the flexibility to design an agreement better suited to their circumstances and needs.

SADC member states should therefore notify the Trade Protocol under Paragraph 4 (a) of the Enabling Clause, especially if they want the flexibility to design an agreement more appropriate for their needs, and for safeguarding their economic interests. The effect of registering an agreement under the Enabling Clause would also indirectly indicate that South Africa considers itself as a developing country within the WTO framework. While this would need to be determined when the Committee on Regional Trade Agreements examines the arrangement, it is highly unlikely that the WTO Committee would have any difficulty arriving at the same conclusion as the OECD's Development Assistance Committee which classifies South Africa as an LDC.

How then should the Trade Protocol be framed? First, the primary point of departure should be the need to address investment, especially countervailing investment – and principally, trade-related investment – from South Africa into the other economies of the region. This should preferably occur in amounts which would substantially offset the massive trade surpluses in favour of South Africa from intra-regional trade. The reality is that the size of South Africa's trade surplus vis-à-vis the rest of the region is so large as to be unsustainable and unfinanceable. With most SADC economies being highly dependent on foreign aid, it would be unrealistic to expect donors to keep providing exceptional levels of balance of payments support to these countries simply to finance imports from South Africa.

A second and more important reason why the Protocol should focus more heavily on investment measures is that in the absence of inductive capital flows from South Africa, it is extremely unlikely that private capital flows from the rest of the world will materialise if primary flows from South Africa do not lead.[13] For this reason, SADC needs to conclude a

13 The region's investment-risk profile is still too high to encourage normal FDI. The only type of investment that seems to be materialising lately is in mining, where the risk profile is not as important a consideration. Southern Africa needs to attract more investment in productive capacity, but this is not happening.

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complementary Protocol on regional investment policy, to supplement the Trade Protocol, as soon as possible. The former would need to target or facilitate cross-border movements of capital in the short term and the issue of the clearing of payments. More particularly, it should not be detailed and complicated, but should be designed to meet the needs of countries at various levels of development. Certainly, there will be need for very close collaboration between the Trade and Industry and Finance and Investment sectors.

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Regional Economic Interaction in the Middle East and North Africa

Mohamed A. El-Erian[1]

I Introduction

Regional economic interaction in the Middle East and North Africa (MENA) is relatively low: trade flows are limited in size and concentrated in composition; labour movements, while significantly more important, are skewed and have been subjected to a range of non-economic disruptions; tourism flows are segmented within the region; and residents' capital holdings have been often invested outside the region rather than in other countries within the region.[2]

The reasons for the limited amount of regional economic interaction are mainly economic and security related. Until recently, the economic policy stance of several countries has tended to limit integration with the international trade and financial systems, let alone within the region. On the security front, the region has had its host of problems, particularly in the context of the prolonged Arab-Israeli conflict.

While economic interaction has been limited, there has been no lack of recognition among governments of the region of the potential benefits of deeper integration in the region and/or among subgroups of countries in the region.[3]

Indeed, the region's history is full of attempts at greater integration –

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1 The author is grateful for the comments provided by Ernest Aryeetey and other participants in FONDAD's July 1997 workshop on "Regionalism and the Global Economy" and the follow-up November conference. The author is also grateful to Peter Kunzel for his research assistance. The views expressed in this paper are those of the author and do not necessarily reflect those of the IMF.

2 For the purposes of this paper, MENA is defined to cover the members of the Arab League, the Islamic Republic of Iran, and Israel (see box). The paper builds on the analysis contained in El-Erian and Fischer (1996) and El-Erian and El-Naggar (1996).

3 Interest in regional integration is not unique to MENA. Indeed, interest in regionalism, or what is often labeled as "new regionalism," has become quite broad, with some analysts seeing it as the second most powerful force currently reshaping the world economy – the first being globalisation. See, for example, de Melo and Panagariya (1993), Hine (1992), Keating and Loughlin (1997), Mistry (1996), OECD (1993), and Teunissen (1995 and 1996). Borrman and Koopmann (1994) noted that regional trade under formal integration arrangements covered 45% of total trade due, primarily, to developments in the European Union.

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MENA at a Glance

Coverage. The MENA region is defined to encompass the economies of the Arab League (Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, the Syrian Arab Republic, Tunisia, the United Arab Emirates, and the Republic of Yemen), as well as the Islamic Republic of Iran and Israel. The region possesses abundant natural resources and, on average, enjoys a reasonable standard of living. However, individual countries exhibit a broad diversity of characteristics. They vary substantially in natural resources, economic and geographical size, population, and standards of living.

Size. The MENA region covers an area of more than 15 million square kilometers and contains more than 300 million people, roughly 6 percent of the world's population. The population of individual countries varies considerably – the smallest among them have a population of about half a million (Bahrain, Djibouti, and Qatar) and the largest have populations of some 60 million (Egypt and the Islamic Republic of Iran). The nominal GDP of the region amounted to over $600 billion in 1996, roughly 2 percent of world GDP and about 11 percent of developing countries' GDP.

Population growth. Many MENA countries are experiencing rapid population growth and have a high proportion of young dependents among their population. The average increase in population in recent years has been about 3 percent, although a group of countries (Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) have registered a higher rate of growth of 3.5 percent. Bahrain, Egypt, Lebanon, Morocco, and Tunisia have recorded relatively low rates of population growth (of about 2 percent) compared with the average for developing countries as a group.

Per capita income. The region includes some of the poorest countries in the world, with per capita incomes around $200 (Somalia and Sudan), as well as countries among the high-income groups, with per capita incomes ranging between $14,000 and $18,000 (Israel, Kuwait, Qatar, and the United Arab Emirates).

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Regional subgroupings. Many subgroupings have been used in the literature. The most common include:

- *Oil economies.* Ten MENA countries are classified as oil exporting countries. They are Algeria, Bahrain, the Islamic Republic of Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Although other countries (such as Egypt, the Syrian Arab Republic, Tunisia, and the Republic of Yemen) also export oil, the role of this sector in their economies is relatively limited.
- *Cooperation Council for the Arab States of the Gulf (GCC).* Member countries of the GCC are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.
- *The Arab Maghreb Union (AMU).* The members are Algeria, Libya, Mauritania, Morocco, and Tunisia.
- *Mashreq.* This group consists of Egypt, Israel, Jordan, Lebanon, the Syrian Arab Republic, and West Bank and Gaza Strip.

Source: International Monetary Fund, Building on progress: reform and growth in the Middle East and North Africa, IMF, Middle Eastern Department, Washington, D.C., 1996.

mainly through bilateral trade agreements among Arab countries. In the design of these agreements, governments have rightly sought to exploit opportunities for welfare-enhancing economic interactions, strengthen the collective political bargaining power vis-à-vis other countries, and achieve other non-economic national goals (namely, greater national security). Their effectiveness, however, has tended to be quite limited. This history of bilateral agreements led one observer to note that in certain regions of the world one finds regional trade, in MENA one just finds regional trade agreements!

In the last five years, the MENA region has witnessed three major initiatives aimed at enhancing regional interactions. First, efforts launched after the Oslo agreements and Madrid meeting (both relating to Arab-Israeli relations); second, the pursuit of regional integration through the indirect route of linkages with another region (e.g. through "Association Agreements" between certain countries of the region and the European Union (EU)); and third, and most recently, efforts toward creating an "Arab Common Market" (ACM) starting with a subgroup of countries, if necessary.

The purpose of this paper is twofold: first, to provide insights into the reason for the limited regional interaction to date; and second, to identify

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the main factors that will influence the effectiveness of future interaction, including various integration initiatives. To this end, Section II, documents and explains why, despite various official initiatives and favourable initial conditions, regional interaction has been limited overall and very skewed in terms of activities. Recognition of the resulting adverse economic welfare effects, as well as non-economic factors, is behind the current resurgence in interest in regional integration. As discussed in Section III, the prospects for regional interaction (both regionalism and regionalisation) will be determined by two sets of competing forces. On the one hand, the favourable recent developments in individual countries' enabling economic environments (the "economic fundamentals") and, to a lesser extent, the catalyst of the Association Agreements with the EU will encourage regional interaction, as well as progress on the creation of the ACM. On the other hand, the uncertain political dimension will act as a damper for *region-wide* integration. Accordingly, the paper concludes that what is likely to emerge over the next few years is greater interaction among *subgroups* of countries in the region (the Arab ones) – particularly in the form of regionalism – with positive welfare effects.

II The Extent of Regional Economic Interaction in MENA

Regional economic integration is a broad concept. It can cover not only strict economic relationships among goods and factors of production in a region (also known as "market integration"), but also legal and institutional relationships ("institutional integration").[4]

The instruments of regional integration are also quite broad, ranging from informal and non-directed mechanisms to institutionalised ones such as custom unions and free trade arrangements.[5]

In reviewing the extent of regional economic interaction, this section looks at four factors which impact both elements of economic integration: trade in goods, labour movements, other market integration channels, and policy coordination mechanisms. It is argued that, in MENA, these ingredients of integration have been extremely limited at the level of the region *as a whole* – both in absolute levels and relative to other regional groupings (formal and informal). Moreover, the most important ingredient of regionalism in the MENA region – *viz.*, that based on labour flows – has been subject to significant non-economic disruptions. At the sub-regional level, there have been more pronounced cases of effective integration.

4 See Cooper (1974).
5 The latter differentiate regionalisation from regionalism.

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Trade in Goods

Trade among countries in the MENA region is relatively limited. In the 1990s, such trade averaged around 7.25% of the region's total trade (see Table 1 at end of paper).[6] The share has been a relatively stable one, fluctuating for the most part in the 6-8% range (Chart 1). By contrast, trade with countries in the European Union has averaged some 43% in the 1990s, with a higher share of imports from the EU (48%) than exports to the EU (38%).

The extent of regional trade is limited not only at the aggregate level, but also at the country and product levels. Thus, for no country in the region does regional trade account for more than 25% of total trade.[7] On the product side, there is no category for which MENA trade is very important, with the exception of mineral fuels.[8]

Table 2 (at end of paper) compares regional trade in MENA to some other country groupings based on the same methodology and source of statistics. In the 1990s, MENA had the lowest incidence of regional trade. While regional trade in Africa is only somewhat higher, it is significantly larger in other industrial and developing country regions – ranging from almost 20% in Mercosur to over 60% in APEC and the EU.

A cursory look at the composition of MENA's trade suggests that the limited intra-regional trade is not really an issue of product composition. While exports of primary products (mainly oil) are important, the region also has a solid base of exports of manufacturing goods and foodstuffs. This is particularly so for the non-oil exporting countries where manufacturing products have accounted for 54% of their total exports in the 1990s. On the import side, the structure is dominated by manufacturing goods (67%), followed by commodities (15%) and foodstuffs (12%). The recent work by Havrylyshyn and Kunzel points to the potential for complementary trade for the group of Arab countries.[9]

Labour Movements

In contrast to trade in goods, labour movements have been an important

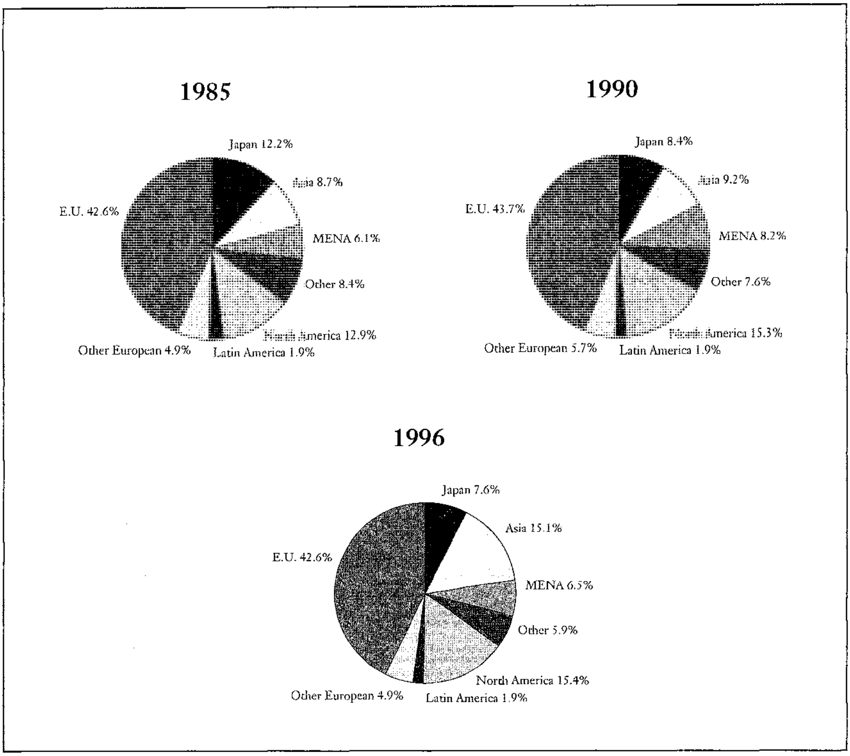
6 The unweighted country average is also under 10%. The measure does not include informal border and suitcase trade. While such trade exists, its magnitude is not thought to alter significantly the argumentation in this paper.

7 The countries with the highest share of regional trade in the first half of the 1990s were Bahrain (23%), Oman (14%), Jordan and Syria (both 14%); those with the lowest were Israel (0.1%), Algeria (3%), and Kuwait (4%).

8 See Fischer (1993).

9 Havrylyshyn and Kunzel (1997).

Chart 1 MENA: Direction of Trade, 1985, 1990, and 1996



element of interactions among countries in the MENA region. Thus, it has been argued that trade in labour services has been the most successful element of regional integration.[10] This is seen to have given rise to a curious phenomenon whereby labour movements were the first rather than the final and most controversial aspect of regional integration, as is normally the case.

Labour migration has reflected the large differences in factor endowments between the relatively populous non-oil economies in the region, and the oil economies with small populations (essentially members of the Gulf Cooperation Council (GCC) and Libya).[11] While significant in number, labour flow patterns have been subject to significant disruptions. This

10 See Shafik (1992).

11 The six GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

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is illustrated in considering the two types of flows that have dominated regional labour movements over the last 25 years: (i) flows from non-oil Arab economies to the Arab oil economies; and (ii) Palestinian workers employed in Israel.

In the case of the first type of flows, it is estimated that about two-thirds of the eight million migrant workers in the six members of the GCC in 1985 were from other Arab countries.[12] While comprehensive numbers are hard to come by, it is believed that this number has declined. There has also been a change in composition in some countries. In Kuwait, for example, a significant proportion of the Jordanian, Palestinian, and Sudanese labour flows before the 1990-91 regional crisis has been replaced by Eastern Asian workers and higher inflows of other Arab nationalities (especially Egyptian).[13]

In the case of the second type of flows, the variability has also been significant, if not considerably higher. Indeed, since 1992, Palestinian labour employed in Israel has fluctuated from levels well in excess of 100,000 (over 25% of total Palestinian employment) to virtually zero. As regards annual averages, these have ranged from 116,000 in 1992 to 25,000 in 1996. The movements have not only been large in size but also subject to dramatic sudden changes, with considerable direct and indirect effects on private incomes, the government budget, and neighbouring economies.[14]

The fluctuation in labour movements has been associated with an important institutional/legal aspect. MENA workers have not enjoyed the type of structure that is found in the EU for example, where citizens of one country enjoy the legal right to work in other countries within the region.

Other Flows

Data on other flows are more limited. *Tourism and non-factor service flows* have appeared quite segmented, with significant regional flows limited essentially to Egypt, Jordan, Lebanon, Morocco, and Tunisia. *Capital flows* have also been limited, with the exception of the very large official flows from the oil-exporting Arab countries to other Arab countries, particularly following the 1973-1974 and 1979-1980 international oil price increases, and the continued activities of Arab regional institutions (particularly the Arab Fund for Economic and Social Development and the Arab Monetary Fund).[15]

12 See Klinov (1991).
13 See Chalk, El-Erian, Fennell, Kireyev, and Wilson (1997).
14 See Zavadjil, Calika, Kanaan, and Chua (1997).
15 Van den Boogaerde (1991) provides information on official capital flows.

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Regional Policy Coordination

There have been no effective mechanisms for regional policy coordination for the region *as a whole*. Mechanisms for resolving economic disputes have been virtually non-existent and regional channels for exchanging macroeconomic information have been extremely limited.

The closest countries in the region have got to *region-wide* economic dialogues has been through the series of "economic summits" launched in 1994 in Casablanca. However, while including Israel, they were not attended by certain Arab countries and the Islamic Republic of Iran. Also, they have not taken the nature of coordination summits with the exception of some projects in tourism and cooperation by chambers of commerce. With the deterioration in Israeli-Palestinian relations since 1996 and related setbacks to the peace process, the "summits" have been downgraded to the concept of a regional economic "conference". Indeed,Van den Boogaerde (1991) provides information on official capital flows. the November 1997 conference held in Qatar was poorly attended by countries in the region as several Arab governments expressed frustration at the hardening of the Israeli positions in the peace process.

There has been better policy coordination at the sub-regional level, with some notable successes. The fora for such coordination include: (i) the GCC (the closest the region gets to regionalisation); (ii) through the mechanism of OPEC and OAPEC; and (iii) in the context of the activities of the Arab financial institutions and the Arab League. Other attempts, such as the Arab Maghreb Union, have been of very limited success.[16]

III Why Has Regional Interaction Been So Limited?

The above-cited indicators of limited regional economic interaction contrast strongly with the repeated efforts by governments to implement cooperation agreements among groups of Arab countries in the region. They also contrast with the economic, geographical and cultural characteristics of the region that point to gains from increased regionalism.

As in other regions, there were three reasons behind most attempts at regional integration: (i) economic welfare gains; (ii) enhanced collective political bargaining power in extra-regional affairs; and (iii) non-economic national goals (especially, security-related ones).[17]

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16 Members of the AMU are Algeria, Libya, Mauritania, Morocco, and Tunisia. For a discussion of the AMU, see Finaish and Bell (1994).

17 For a survey of regional integration issues, see OECD (1993). Reviews of the operation of regional trade arrangements may be found in Brown (1994), de la Torre and Kelly (1992), de Melo and Panagariya (1993), and IDB (1997).

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On paper, these reasons should be facilitated by economic, geographical and cultural conditions that are conducive to regional integration in MENA.

- On the *economic* side, the region has a diverse natural, human, and financial endowment that is spread among countries in the region. The regional market offers considerable purchasing power and there are indicators of trade-creating gains.

- On the *geographical* front, the region covers a large contiguous land mass which is rich and diverse in natural resources (oil, gas, non-fuel minerals, agriculture pockets, etc.). Regional trade routes are, on paper, relatively accessible.

- On the *cultural* front, the extent of language and religious coherence compares favourably with other regions such as the EU and ASEAN.

These factors suggest that the level of regional economic interaction should be larger than what currently exists. Or, to use the traditional terms, it would appear that there are good reasons for trade-creating (as opposed to trade-diverting) forces under an integration arrangement, given what appears to be unexploited "natural trading" opportunities.[18] This trade-creating element is related to cost-reducing economies of scale associated with the factors cited above. There would also be an impact on the pattern of foreign direct investment and portfolio flows, including that originating from outside the region. Finally, for several economies in the region, efficient regional cooperation can help overcome the disadvantage of their relatively small size in the world economy.

As indicated in El-Erian and Fischer (1996), it is important to stress that what is being argued here is not necessarily that economic factors point to an *a priori* scope for regional economic interaction that is overwhelmingly large; nor is it argued that increased regional interaction need necessarily be pursued through formal discriminatory arrangements. Rather, the arguments in this paper call for countries in the region to continue to interact mostly with non-regional partners while enhancing the level of regional interaction which, at this point, is well below what would be attained if economic relations among countries in the region were subject to fewer economic and political constraints.[19]

18 This argumentation is developed by, for example, Langhammer (1992) and Borrman and Koopman (1994).

This argumentation is closely related to the importance of viewing regional integration initiatives as consistent with multilateral liberalisation rather than as an obstacle or a substitute for it. In this regard, and as discussed further below, the complementarity of regionalism and multilateralism depends essentially on three factors: first, ensuring that the regionalism is "open" – i.e. accompanied with liberalisation versus other regions; second, avoiding that work on regional issues detract from preoccupation with multilateral issues; and, finally, avoiding that vested interests' opposition to regionalism compound unduly so that they effectively oppose multilateralism.

What, then, are the most important constraints? Two stand out in importance: the enabling economic environment (at both the individual country level and structural rigidities at the regional level); and the political dimension.

The Enabling Economic Environment

It is critical that the economic environment in the countries in the region is such as to enhance trade. Until recently, the Arab region's external trade and investment relations have been undermined by the legacy of the inward-oriented public sector-led development strategies pursued by most non-oil countries in the region. It is, therefore, no surprise that the limited intra-regional economic activity had been accompanied, until recently, with limited interaction with the rapidly globalising international economy.[20] Thus, at a time when developing countries' share of the booming international trade grew (from 23% in 1985 to 29% in 1995), that of the Arab economies declined (from 5% to 3%); moreover, trade (as well as foreign direct investment) remained concentrated in the energy sector. At the same time, these countries attracted less that 1% of the flow of portfolio capital to developing countries.[21]

Appropriate economic policies are a prerequisite for the deepening of efficient international economic links – be it within a region or with partners outside the region. Among the factors stressed by recent studies are: (i) macroeconomic stability; (ii) openness of trade and payments regimes;

19 A good illustration of this is the Maghreb sub-region. Because of some similarity in resource endowments and the greater proximity of the Maghreb countries to Europe as compared to the MENA Mashreq countries, the Maghreb will continue to trade mostly with non-regional partner countries in Europe. Nevertheless, there are gains to be attained from deeper economic interaction within Maghreb, including through the attraction of foreign direct investment to supply a considerably larger market.

20 See El-Erian (1997).

21 Additional information is contained in El-Erian and Sheybani (1997).

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(iii) government intervention in the economy in support of (rather than substitute for) private sector activity; (iv) financial sector deepening; (v) sound human resource development policies; and (vi) strengthened institutions, governance, and information flow. Recent studies also stress that there is no single policy that is sufficient to ensure a favourable outcome. Rather, economies need at least a moderate degree of success on several policies.[22]

The recent economic history of the region is well documented.[23] Studies tend to stress not only the region's limited integration through trade and capital flow but, importantly, its limited ability to generate sustained high growth. Thus, thc rcgion's per capita income level in 1995 was somewhat lower than a decade earlier – this at a time when developing countries as a group saw their per capita income rise by over 40% while that of the Asian economies increased by over 80%. Not surprisingly, investment and saving rates remain well below the averages for developing countries, let alone the fast growing ones.

There are several inter-related reasons behind the disappointing growth performance and several MENA's countries' relatively limited interaction at a regional level and with the world economy. Since this paper does not provide an appropriate forum to delve into this topic, we will limit ourselves to two observations. At the most basic level, there is now widespread agreement that the domestic policy stance in most MENA countries was not strong enough to offset the deterioration in the external economic environment (particularly the weakening international terms of trade). The following economic factors have tended to attract attention in recent studies on the particular aspects of the region (especially for the non-oil economies)[24] – factors that are now being addressed in several countries by comprehensive adjustment and reform policies:

- Investment activity that was overly directed by the public sector, low in efficiency, involving limited growth in total factor productivity, and dependent overall on outside (and volatile) sources;

- Financial intermediation processes that were insufficiently market-based for the mobilisation and allocation of loanable funds, thereby placing excessive emphasis on selective credit allocation mechanisms and involv-

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22 See for example the study of 110 developing countries contained in Aziz and Wescott (1997).

23 For recent analyses see World Bank (1995) and IMF (1996).

24 These include Alonso-Gamo, Fedelino, and Paris-Horovitz (1997), Bisat, El-Erian, and Helbling (1997), Chabrier and Kanaan (1997), and Moalla-Fetini and Waterbury (1997).

ing an inherent bias against domestic savings mobilisation; they did little to impose discipline on the enterprise sector;

- An external trade regime that tended to undermine export activity and overly limited the degree of competition faced by domestic producers, as well as limiting consumer choice; and

- A public/private sector balance in which the public sector often ended up substituting (rather than complementing) private sector activity; at the same time, some of the existing private sector activities tend to depend on rents and on the largess of the public sector, preferring to be shielded from external competition.

These factors inhibit trade and investment interaction at the regional and international levels. They were compounded by structural rigidities. These include divergences in regulatory frameworks, including customs nomenclatures which impact directly on trade. Moreover, regional road and rail transportation facilities have remained limited, and regional infrastructural projects have been constrained by a host of restrictions. Also, the region *as a whole* has not benefited from a strong institutional setup that provides a forum for discussion of regional issues and harmonises policies where needed. Indeed, it is this recognition that has led to efforts to establish the Middle East Development Bank.

The Political Dimension

MENA has had more than its share of political conflicts. These conflicts have impacted economic relations at both the country and regional level. The Arab-Israeli conflict has been, by far, the most protracted conflict in MENA. With the largest range of direct and indirect economic and financial repercussions,[25] it has resulted in four regional armed conflicts in the past 50 years, a series of border clashes and incursions, and spillover effects in other regions. It has fostered for years a high degree of deep mistrust and hostility.

Regional economic activities have also been undermined by other political differences, including those triggered by Iraq's invasion of Kuwait in 1990 and developments in North Africa which have inhibited cooperation among members of the Arab Maghreb Union (AMU). The diversity of political systems and governance may also have played a role in limiting regional economic activities. The argument here is that the less similar the

25 See, for example, papers in Fischer, Rodrik, and Tuma (1993).
26 This is the line taken in OECD (1993) for example.

political institutions and systems of governance among countries in a region are, the more difficult and less effective the process of regional integration becomes.[26]

With the various conflicts and political differences, it is perhaps not surprising that there has not been a broad commitment at the national level to regional economic goals. After all, such commitment implies yielding a certain amount of economic and financial sovereignty from the country to the regional level – a process that raises all sorts of issues as demonstrated, most recently, by developments in the EU. In the case of MENA, such political and governance issues have repeatedly led to national considerations undermining regional efforts, including in the context of translating regional aspiration into an effective and independent institutional foundation.[27]

IV Prospects for Regional Integration

The previous section's review of the main factors that have determined the pace of regional economic interaction in MENA forms the basis for evaluating the prospects. Thus, it is clear from above that the prospects for regional economic interaction depends on improving the enabling economic environment and overcoming the considerable political hurdles. It is in this context that the more focused efforts bear fruit.

There is now increased attention being devoted to integration efforts in MENA, be it through informal channels in the form of linkages to Europe, a new Arab Common Market or region-wide arrangements. The analysis detailed below comes out with four main findings of relevance to these efforts.

1. For an increasing number of countries in the region, the economic preconditions for integration (regionalism and regionalisation) have become more favourable.

2. The political aspects, however, and especially those linked to the resolution of the Arab-Israeli conflict, remain difficult.

3. Successful integration efforts are more likely to happen among subsets of countries in the region than at the level of the region *as a whole.*

4. These efforts may well be given a boost by the ongoing process of nego-

27 See Ghantus (1982).

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tiations of "Association Agreements" between the EU and countries of the southern and eastern Mediterranean, as well as the renewed political emphasis on an Arab Common Market.

A Changing Economic Landscape

In reaction to both the disappointing growth performance discussed above and policymakers' increasing recognition of the dangers of marginalisation in the rapidly globalising world economy, several MENA countries have stepped up their process of economic adjustment and reforms. Responding to the strengthening of policies and favourable external terms of trade developments, the region's growth rate doubled in 1996 (to almost 5%), while inflation, the current account deficit, external debt indicators, and foreign exchange reserves were at their most favourable level this decade (Chart 2). Macroeconomic conditions remained favourable in 1997 as reflected in a second year of per capita income growth, and further reductions in domestic and external financial imbalances.[28]

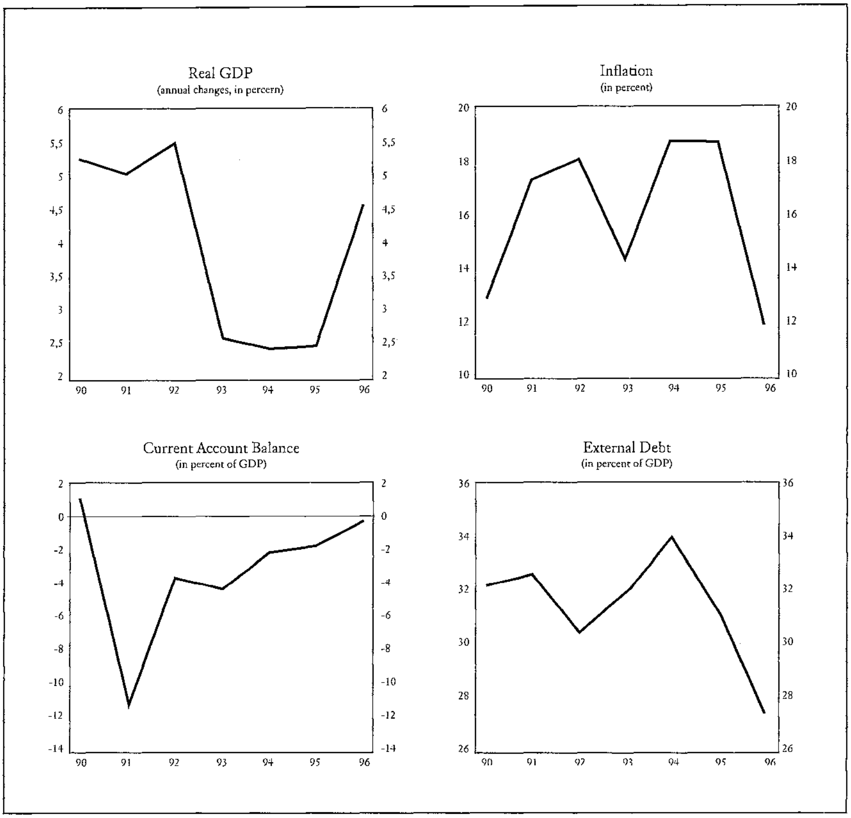
MENA's economic and financial improvements have been noted by the international markets. Larger amounts of capital have been channelled to the region. Several public and private sector entities are now able to directly tap the international capital markets, assisted by the favourable credit ratings obtained by several countries in the region. Institutional linkages with international firms are increasing. While the disruptions in Southeast Asia are expected to result in a decline in overall private flows to developing countries, the share of MENA is expected to increase and, also perhaps, the absolute amounts.

These favourable changes in the region's macroeconomic indicators and linkages with the international system are to be welcomed. Equally important, if not more, are the underlying changes in the economic structure of the non-oil MENA economies. Thus, several countries have taken important steps to reduce the level of tariff and non-tariff protection, deregulate domestic activities, and improve the intermediation of funds mobilised domestically and abroad. This is part of the large move away from a public sector led import-substitution strategy to one where the private sector takes the lead with public sector support rather than substitution.

Trade liberalisation. The non-oil MENA economies have some of the highest rates of tariff protection in the world.[29] This has inhibited their export activities without a pronounced return in terms of establishing a

28 See El-Erian and Fennell (1997).
29 For details see Alonso-Gamo, Fennell, and Sakr (1996).

Chart 2 MENA: Selected Economic Indicators, 1990-1996



solid domestic production base; it has also undermined consumer welfare. Not surprisingly, therefore, tariff reductions have been an important part of reform programmes in the region. For example, Egypt has reduced its maximum tariff rate from 70% in August 1996 to 50% in June 1997, and Jordan has reduced its rate from 70% in December 1996 to 40% in June 1997. While the non-oil economies still have higher tariff rates than most other developing countries, these recent moves will facilitate their faster integration in the world economy.

Domestic deregulation. Concurrent with the reduction in tariff rates, several countries have taken steps to deregulate domestic activities (e.g. Egypt, Jordan, Morocco, and Tunisia). Measures have focused on privatisation and opening up sectors previously reserved for the public sector (e.g. airport, ports, roads, and power generation). Indeed, several countries, including in the GCC, are exploring ways for greater involvement of the private sector in large infrastructure projects. Steps have also been taken to reform investment regulation, especially as applicable to foreign direct investment.

Financial reform. In an attempt to improve the process of mobilising and allocating loanable funds, several MENA countries are promoting the role of market forces in the mobilisation, pricing, and allocation of financial resources while, concurrently, strengthening prudential supervision and regulation.[30]

Institutional linkages. With the improvement of the enabling economic conditions, we are witnessing increased institutional linkages within the MENA region. Recent advances have included the linking up of the Cairo, Beirut, and Kuwait stock markets. Progress, albeit slow, is also being made in establishing the MENA Bank. The Bank is to provide a wide range of assistance to the region's private sector and help finance regional projects. It can also provide an important forum for countries to discuss regional economic issues. All in all, the MENA Bank offers a cost-effective option for supporting the development of economies in the region while minimising the duplication of the activities of existing institutions.

The Catalyst of Europe

The last two years have seen intensive negotiations between the EU and southern and eastern Mediterranean countries in the context of the EU's "Mediterranean Basin Initiative." As of October 1997, Israel, Morocco, and Tunisia had finalised "Association Agreements" with the EU; Jordan and the Palestinian Authority had initialled agreements; and Algeria, Egypt, Lebanon, and Syria were in the process of negotiation.

These agreements have an important trade component which is of relevance to this paper's discussion. Specifically, they entail the creation over 12 years of a free trade area for most products between the EU and countries of the southern and eastern Mediterranean. The dismantling of tariff and non-tariff barriers in the latter group of countries is to be facilitated by the provision of EU assistance of some ECU4.7 billion, with a corresponding amount from the European Investment Bank.

On paper, the Association Agreements with the EU offer the prospects of benefits in the form of increased bilateral trade and, potentially more

30 These efforts are discussed in Chalk, Jbili, Treichel, and Wilson (1996).

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important, from higher foreign direct investment. Given the favourable access that MENA countries already enjoy to the industrial product markets in MENA and the absence of aggressive liberalisation of EU agriculture, the static trade gains appear limited.[31] The large potential gains result much more from dynamic factors such as the associated changes in productivity levels and the advantages of being anchored to Europe, including beneficial effects on investor perceptions. Indeed, most studies of regional integration efforts – covering both successes and failures – emphasise the impact on investor expectations of economic policy convergence and harmonisation of regulatory and supervisory regimes.

Putting aside discussions on the components (actual and potential) of the current Association Agreements, it is generally recognised that, if well managed, the Association Agreements with the EU can not only enhance the economic environment in several MENA countries, but also provide a catalyst for regional MENA integration as a stepping stone to multilateral liberalisation. A thorough discussion of this issue is contained in Havrylyshyn's recent works, as well as in the volume edited by Galal and Hoekman. For the purposes of our discussion, there are two important elements to note: (i) the cumulative rule-of-origin principle applicable to the MENA partners; and (ii) the incentive for MENA partners to reduce the risk of foreign investment taking the "hub-and-spoke" form whereby the incremental direct investment locates in Europe to access the new southern and eastern Mediterranean markets. In both circumstances, the benefits are maximised and the risks reduced if MENA countries integrate more with each other.

This argument has important implications for the renewed emphasis on Arab economic integration. Simply put, by opening up to each other, Arab countries will increase the welfare benefits of their other economic liberalisation efforts, particularly vis-à-vis the European Union.[32]

An Uncertain Political Dimension

The factors cited above have the potential to facilitate greater regional interaction in the context of a faster integration with the world economy. The improvement in the enabling economic environment, in particular,

31 There is a concern here that the process is not comprehensive across sectors (let alone covering labour) and does not involve reciprocity on the part of all trading partners. Thus, the current exclusion of agriculture from the EU's liberalisation process will entail welfare losses for the countries of the southern and eastern Mediterranean.

32 For example, initial general equilibrium model work on Egypt by Hoekman, Markus and Konan suggest that the welfare gains of free trade agreements with both the EU and the US increase dramatically if accompanied by an Arab free trade agreement.

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may be thought of as a necessary, but not sufficient, condition. Indeed, region-wide interaction will continue to be constrained by the unsettled Arab-Israeli political conflict.

Already in 1996 and 1997, several Arab countries have slowed down their process of economic normalisation with Israel in response to the deteriorating Israeli-Palestinian relations and other setbacks to the eventual establishment of a comprehensive, just, and durable peace. Moreover, participation in the 1997 MENA Economic Conference was limited. Accordingly, the resumption of region-wide integration efforts will depend on attempts to restore confidence in the peace process. It should also be noted that even with progress in the peace process, it will take time to overcome the suspicion and hostility associated with what has been a prolonged and costly Arab-Israeli conflict.

Putting it Together

In sum, the region faces two conflicting forces with respect to greater regional economic interaction. On the one hand, favourable developments in the enabling economic environment and the catalyst of the EU Association Agreements will encourage regional interaction. On the other hand, the uncertain political dimension will act as a damper. Accordingly, what is likely to emerge is greater economic interactions among subgroups of countries – in the form of further integration of the six members of the Gulf Cooperation Council and greater interaction among other subgroups of Arab economies. Such interactions will benefit from reduction in tariff and non-tariff barriers (including simplifications in and harmonisation of administrative and regulatory regimes). Unlike past attempts, this one will need to be driven operationally by the private sector rather than by agreements among public sector entities.

In pursuing such interaction, Arab economies will need to be mindful of the implications for multilateralism. In particular, the interactions should be seen, and therefore designed, as consistent with the much needed multilateral liberalisation rather than a substitute for them.[33] Otherwise, there will be significant welfare losses as a result of traditional trade diversion effects. Moreover, a "closed regionalism" is unlikely to prove attractive to sustained high foreign direct investment.

For regional integration to prove consistent with, if not conducive to, multilateral liberalisation, it needs to be accompanied as soon as possible

33 The risks are put starkly by Borrman and Koopman (1994) who note that regional integration could well be viewed as "an institutionalised beggar-thy-neighbour policy." See also discussion in Bhagwati (1993), Krugman (1993), and other papers in de Melo and Panagariya (1993).

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by liberalisation vis-à-vis the rest of the world and pre-emption of the blocking power of vested interests. It is such considerations that have led people like Bhagwati to propose the early specification of specific measures to move from regionalism to multilateralism.[34]

V Concluding Remarks

The MENA region remains strikingly unintegrated in economic terms when compared to Europe, Asia/Pacific, and Latin America. Trade in goods is limited; labour flows, while significantly more important, are skewed and subject to frequent disruptions; residents have tended to invest funds outside the region rather than within; and the region-wide institutional base remains partial. The limited amount of regional interaction has had direct adverse economic welfare effects, as well as weakening the region's position in extra-regional economic negotiations.

It is therefore not surprising that renewed emphasis is being placed on greater regional integration involving groups of Arab economies and through the indirect route of Association Agreements with the EU. The prospects for such integration efforts are being boosted by the improvements in the enabling economic environment. However, political conditions, particularly the Arab-Israeli dimension, are likely to limit a more general progress in regionalism at this stage. Accordingly, what is likely to materialise is closer integration between subsets of countries in the region, particularly Arab ones, with potentially important welfare gains (direct and indirect) provided the discriminatory aspects are minimised.

The policy changes that are required for successful economic integration are the same as those needed if the countries of the region are to benefit from the more general process of globalisation and integration in the world economy. This point is best illustrated by the dynamic Asian economies where outward-oriented development strategies have been associated with intensified regional economic interactions without the implementation of significant discriminatory measures.

Progress in regionalism is therefore primarily dependent on policy changes at the country level. Specifically, continued progress in reducing financial imbalances needs to be supported by the widening and deepening of structural reforms aimed at promoting private sector-led growth and investment and a greater outward orientation of the economy.

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34 Wei and Frankel (1995) show both theoretically and empirically that in a world of "simultaneous continental trade blocs" relatively modest liberalisation with the rest of the world produces Pareto improvements. See also discussion on East Asia contained in Lloyd (1996) and De Rosa (1997).

These general policy changes hold the key to enhancing regional interaction in the context of a region that is growing economically, providing jobs for its increasing population, and better integrating regionally as well as internationally. The process of regional integration will also be assisted by steps targeted specifically at greater regional interaction including reducing divergences in regulatory frameworks, improving transportation and transportation networks, realising certain regional projects, and ensuring a strong institutional structure.

Table 1 Direction of Trade, 1970-1996[1]
(percentage of total trade)

	1970	1975	1980	1985	1990	1991	1992	1993	1994	1995	1996
Trade of MENA with:											
MENA	5.4	4.7	3.7	6.1	8.1	7.2	7.2	7.5	7.7	7.0	6.5
Asia	5.1	5.9	8.1	8.7	9.2	11.1	12.0	12.1	11.9	14.2	15.1
Japan	5.7	10.5	11.8	12.2	8.4	8.9	9.3	8.7	8.2	7.6	7.6
European Union	53.4	47.0	44.6	43.5	43.7	43.4	42.8	43.3	43.0	42.0	42.6
Other European	8.9	4.9	2.9	5.9	5.7	5.0	4.1	4.0	4.2	5.1	4.9
Latin America	2.0	5.4	2.6	2.3	1.9	1.9	1.9	2.2	2.1	1.9	1.9
North America	7.7	11.3	19.5	12.9	15.3	15.9	16.0	15.6	16.0	15.2	15.4
Of which:											
United States	7.1	10.5	18.2	11.9	14.4	15.0	15.1	14.7	15.0	14.2	14.3
Oil Exporting MENA											
MENA	4.5	4.4	2.9	4.6	9.2	7.0	6.8	7.6	8.2	7.5	6.9
Asia	4.7	6.8	9.1	11.0	11.3	13.8	15.2	16.0	16.0	19.8	21.1
Japan	8.1	13.9	14.0	16.7	11.6	12.3	12.7	12.2	11.9	11.4	11.3
European Union	65.5	48.8	44.0	43.5	40.9	40.3	39.1	39.2	38.2	36.4	36.2
Other European	3.3	1.9	1.9	4.6	4.2	3.7	3.3	3.0	3.1	3.8	3.4
Latin America	3.1	6.8	2.8	2.7	2.1	2.1	2.1	2.5	2.2	2.0	2.0
North America	4.8	11.2	21.4	12.5	16.8	17.4	17.5	16.1	16.9	15.1	15.7
Of which:											
United States	4.7	10.2	20.0	11.5	15.9	16.5	16.6	15.0	15.6	13.9	14.3
Non-oil exporting MENA											
MENA	6.3	5.4	6.7	9.0	6.5	7.5	7.7	7.4	7.0	6.5	6.2
Asia	5.5	3.9	4.0	3.9	6.1	6.8	7.1	7.2	7.5	8.2	8.8
Japan	3.2	2.7	2.6	3.1	3.5	3.6	4.2	4.2	4.1	3.5	3.7
European Union	41.2	43.0	47.0	43.7	47.8	48.1	48.3	48.6	48.1	48.1	49.3
Other European	14.6	11.6	7.0	8.3	7.8	6.9	5.2	5.3	5.4	6.4	6.5
Latin America	1.0	2.2	1.7	1.5	1.6	1.7	1.7	1.8	2.0	1.9	1.9
North America	10.6	11.6	11.8	13.9	13.2	13.6	13.7	14.9	15.0	15.3	15.1
Of which:											
United States	9.5	11.0	10.9	12.6	12.3	12.6	12.9	14.2	14.3	14.5	14.4

Table 1 (continued)
(percentage of total trade)

	1970	1975	1980	1985	1990	1991	1992	1993	1994	1995	1996
Gulf Cooperation Council											
MENA	8.9	6.2	3.9	7.1	12.3	8.3	7.8	9.0	9.5	8.4	7.5
Asia	10.4	9.9	12.5	17.2	16.4	18.9	19.8	20.9	21.3	26.5	27.6
Japan	19.2	19.6	18.4	25.7	16.7	16.7	16.9	16.3	16.1	15.1	14.8
European Union	41.4	41.1	40.2	29.6	24.0	25.9	26.1	26.2	25.2	23.3	24.7
Other European	0.7	0.2	0.6	1.4	2.3	2.9	2.5	2.9	2.7	2.5	2.2
Latin America	2.9	7.7	2.7	2.9	2.5	2.3	2.2	2.6	2.4	2.1	2.0
North America	4.9	7.0	17.6	10.4	20.7	21.0	21.0	18.3	19.2	17.3	17.4
Of which:											
United States	4.5	5.8	16.1	10.2	19.9	20.1	20.2	17.4	18.2	16.5	16.5
Arab Maghreb Union											
MENA	2.2	1.7	1.8	2.9	5.3	6.0	6.7	6.4	6.9	6.6	6.3
Asia	1.7	1.7	1.1	2.2	2.3	2.9	3.6	3.7	3.4	3.2	3.0
Japan	1.2	3.1	2.8	2.9	1.9	2.0	2.0	2.1	2.0	1.8	1.7
European Union	77.3	62.8	55.6	63.5	68.5	69.9	69.6	70.1	69.1	68.9	70.2
Other European	6.0	6.3	5.4	8.9	7.2	5.6	5.2	3.4	4.0	6.4	5.7
Latin America	2.7	4.8	2.9	2.3	1.5	1.7	1.8	2.3	2.1	1.9	2.1
North America	5.9	15.9	26.6	13.9	7.9	7.5	7.0	9.2	9.2	7.8	8.1
Of which:											
United States	5.7	15.3	25.7	11.7	6.7	6.3	6.0	7.9	7.7	6.0	6.0

1 Data for countries where information was available throughout sample period.

Source: IMF, *Direction of Trade and Statistics.*

Table 2 Intra-Regional Trade, 1970-1996
(percentage of total trade)

	1970	1975	1980	1985	1990	1991	1992	1993	1994	1995	1996
MENA	5.4	4.7	3.7	6.1	8.1	7.2	7.2	7.5	7.7	7.0	6.5
European Union	57.9	56.5	57.3	58.5	64.6	64.8	65.2	60.6	60.9	61.4	60.6
Mercosur	9.6	6.6	9.9	7.0	11.0	12.9	16.1	18.9	19.5	19.5	19.8
APEC	...	...	51.0	62.3	61.3	60.7	60.9	62.8	64.7	64.9	64.7
NAFTA	36.0	34.3	33.4	44.9	41.8	42.4	43.6	45.8	48.0	46.9	48.3
Africa	8.2	5.4	5.2	5.2	7.6	7.5	8.0	8.2	9.1	10.3	8.6
Eastern and Central Europe	33.2	36.9	41.2	35.5	25.1	21.6	22.3	25.3	32.6	34.7	36.6

1 Data for countries where information was available throughout sample period.

Source: IMF, *Direction of Trade and Statistics.*

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Floor Discussion of "Regional Integration in Africa and the Middle East"

'Natural' Integration and Sub-Regions

Several participants wondered about the 'natural' composition of regions in the Middle East and Africa. For instance, Björn Hettne asked whether it would not be more helpful to view Africa as well as the Middle East in terms of sub-regions, and Zdeněk Drábek asked, "Should we view the 21 Arab countries as a natural integration region? I understand that the language and religion issues are powerful, but are there other powerful forces that would help pull these countries together?"

Mohamed El-Erian replied, "By its nature, the definition of the region is arbitrary. The issue of which countries to include in a Middle East regional arrangement is controversial. Do you include Israel? Iran? What about Turkey? Not even the World Bank and the IMF can agree on what constitutes the Middle East. The reason I included the 21 Arab countries in my definition is because the countries themselves have indicated the desire to be treated as a region: they are all members of the Arab League, the Arab Monetary Fund, and the Arab Fund for Economic Development.

There are currently four models of regional integration in the Middle East under discussion. There is the ad hoc model which I have proposed. The second is the Gang of Four which would start with Egypt, Israel, Palestine and Jordan and then expand. The third is the EU-driven model based on the association agreements with Morocco, Tunisia, Israel, Egypt, Jordan and Syria which can be expanded to other countries. The last model is the Big Bang approach of the United States. So far, there is no inclusion problem, it is more a matter of who wants to join rather than who is allowed to join. While there is no agreement on the models, there is agreement on the principle that integration should be driven by the private sector and not based on government agreements which have negative and positive lists because that has not worked in the past.

We are optimistic. For the last two years, this region has achieved 4-5 percent economic growth, inflation is down to 10 percent and fiscal deficits are 2 percent of GDP. The macro conditions are more enabling now that a number of countries have growth rates which are higher than their inflation rates. The structural reform conditions are improving with trade liberalisation, privatisation, deregulation, and the role of the private sector is

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increasing in terms of feeding into the policy formulation process."

Ernest Aryeety answered Björn Hettne's question about sub-groupings in Africa. "To a large extent, the existing sub-regional groupings have been operating with their own institutional structures. There are various countries which have naturally become centre-pieces around which other countries revolve. In Southern Africa, for example, South Africa's immense role cannot be denied. In West Africa, there is a bit of a problem. Everyone sees Nigeria as a leading country, but it cannot play that role very efficiently until it gets its act together."

The Politics of Regional Integration in Africa

Bertil Oden had two comments on trade integration in Sub-Saharan Africa (SSA). "As Ernest Aryeety pointed out in his paper, trade integration in SSA has always been perceived as an industrialisation strategy, but in many cases it has failed. This is due in part to the import-substitution strategy used during the 1970s, but it is also due to the fact that the assumed prerequisites of the trade integration model are met only modestly or not at all in many SSA countries. I would argue that while it is still part of an industrialisation strategy, the international context is different. Elsewhere, the primary focus is on attracting FDI by increasing the market and locking-in liberalisation efforts at the national level. In Africa, however, traditional trade integration is emphasised, and other activities are viewed basically as instruments for improving its efficiency. This is an unfortunate position because it is based on a short-term, win-lose perspective. Given the production structure and trade patterns in Africa, more attention should be given to supply-side efforts. This does not exclude trade integration, but it requires achieving a balance between investment and regional trade. In the debate about whether investment creates regional trade in the African context or regional trade creates investment and growth, I would argue that both theory and empirical evidence support the former."

With regard to specific integration arrangements in Africa, Gavin Maasdorp expressed scepticism about the establishment of an African Economic Community given the problems that a significant number of African countries face. "Countries such as the Congo, Angola and even Mozambique have to get back on some type of economic growth track. The real challenge is to put together regional arrangements like SADC based on sectoral cooperation in Africa. If your transport systems do not work, all of the trade agreements in the world will not result in significant trade integration. Malawi is already experiencing this in the context of SADC. Operators must agree on transport, telecommunication and so forth before business can be done across borders. At the same time, there is scope within the SADC region for fast-tracking – we already have it with the Southern African Customs Union and the Cross Border Initiative. In fact, when we talk about the negotiations for SADC free trade, we are talking about negotiations between two free trade areas and how to dismantle the barriers between them. An interesting point about the SADC free trade agreement is that very few of the countries have devoted any time to analysing the costs and benefits. Malawi and Mauritius are only now analysing the benefits of going into SADC free trade."

Rosalind Thomas believed that Zimbabwe and South Africa are the only two economies which are diversified enough to take advantage of any kind of industrial or manufacturing trade. "The problem in Southern Africa is development. We must seriously tackle marginalisation and the issue of integration into the global economy. When South Africa came onto the trade integration agenda of SADC in late 1994, it was confronted with a trade protocol calling for an immediate free trade agreement among all member states. Instead, South Africa advocated a phased, nuanced approach to regional integration which recognised the fact that member states in the negotiations were least-developed countries with preferences and access to differential treatment conceded to them in the WTO. It was not necessary for them to move straight to liberalisation. Furthermore, many of these SADC countries were undergoing structural adjustment programmes which made them incapable of offering a coherent regional preference among themselves. This was not open regionalism but confused regionalism.

The issue of policy credibility is closely related to this. At the September 1997 meeting, the SADC agreed to allow the Democratic Republic of Congo and Seychelles to accede. This has damaged their credibility in the region because the criteria for membership adopted in early 1995 were not used in the case of the Congo and Seychelles. South Africa opposed their accession by stating that integration was not sufficiently deep in the region to permit extra members. But in this situation, political motives were deemed more important than the policy credibility."

Samuel Wangwe stressed the link between political change and economic cooperation. "It is important to examine the influence of political change and political liberalisation on the prospects for economic cooperation in the region. South Africa's role in the region and the changes we see in the Congo are the consequences of political developments. The unfortunate developments in Burundi and the region's attempt to isolate Burundi has important implications. Not only can regional economic cooperation contribute to peace, but also the other way around, sanctions can have negative effects for economic cooperation."

Barriers and Incentives to Regional Integration

Salvatore Zecchini pointed to trade discrimination as a barrier to regional integration by comparing the Middle East with former Yugoslavia. "You would get many different answers if you asked why there is not enough competition in former Yugoslavia, but the real reason is that each individual republic views trade with the other republics as foreign trade. There is a great deal of trade discrimination which is not based on prices and market forces, but just on internal rules of origin which are not explicitly stated. I wonder whether any move toward regional integration in the Middle East would face the same kind of non-market constraints that producers face in former Yugoslavia."

Zecchini continued with an observation about the role of oil as a limiting factor in the Middle Eastern integration. "Oil has not proved to be an integrating factor in the Middle East. On the contrary, it has led to some erosion of cohesiveness in the area. In economic terms, we might say that since many of these countries had the same trade specialisation, i.e. oil, it made little sense to integrate these economies. Is this argument still valid as discouraging any move toward integration or the reduction of tariff and non-tariff barriers?"

Mohamed El-Erian replied that while oil is certainly important, it should not be overemphasised. "We have done a lot of studies on the Middle East which reveal tremendous diversity in production patterns and factor endowments, and there is scope for both inter- and intra-industry trade within the region. Certainly, we are not talking about 60 percent of regional trade as in the EU. But we are talking more along the lines of 20 percent." He went on to agree with Zecchini's comparison to former Yugoslavia. "Even if tariffs were reduced, regional trade would be inhibited by non-tariff barriers. Borders are opened and closed at the whims of politicians. And even at the open borders such as Jordan and Israel, freight has be transferred to a different truck before crossing the border."

Fred van der Kraaij suggested the importance of including informal trade in the analysis of integration in Africa. "We know that there is a lot of informal trade in Africa, both in imported products and locally produced goods. We may not know the magnitude of this trade, but I think it is an important phenomenon which should not be excluded from our analysis."

Ernest Aryeety acknowledged the importance of including informal trade in the analysis and added, "The question here is the cost at which informal trade takes place. All over Africa, you find large groups of women who travel from country to country with various goods for sale. You also find them travelling to import goods into their own country. It is even thc

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dominant form of trade across borders in West Africa and now also in Central Africa, but it is not likely to grow much more than we have seen in the last two decades because of the significant costs involved. It can only grow as much as the economies grow and that is not significant now. Until some of the non-tariff barriers are removed, it will continue to exist, but it will become less prevalent than it has been."

Mohamed El-Erian confirmed that the situation in the Middle East was similar to Africa. "There is a lot of trade that escapes measurement, such as the suitcase trade like in the case of Africa and there is also border trade, but few experts think it is massive."

Jan Willem van der Kaaij wondered whether there might be other factors which have inhibited integration in the Middle East. "Mohamed El-Erian explained that the share of Middle East trade in world trade is declining, and even within that declining framework, the portion of intra-regional trade has declined. This can be the result of political tensions in the region, but those tensions have been around for a long time. Maybe there are other factors in play such as a lack of economic diversification or poor regional infrastructure. If it is the latter, perhaps it will partially be alleviated by the MENA Bank since one of its explicit missions is to facilitate and finance transborder infrastructural projects. What is the progress on its establishment?"

Mohamed El-Erian stressed the importance of institutions such as the MENA Bank in regional economic development. "The MENA bank would help overcome impediments to financing regional projects such as electricity grids, and it would also provide an important forum for the countries. It has now been established beyond doubt that this is a cost-effective use of resources – it is not a duplication of the World Bank. There is a transition team in Cairo working on it. The US will be providing 21 percent of the capital, but if the US Congress does not appropriate the funds, other countries will be much more hesitant to move. Of course, an additional problem is the Israel-Palestinian conflict."

Ernest Aryeety observed that improvement of infrastructure is also crucial in Africa. He stressed that the African Development Bank (AfDB) should be playing a much larger role. "I strongly believe that the AfDB should focus more intensively on infrastructure in Africa than it has in the past. The AfDB is fond of jumping onto international bandwagons. Today for example, micro finance is receiving attention from the World Bank and the UN, so the AfDB is investigating it as well. But the trans-West Africa highway has been on the agenda for the past 20 years, and everybody agrees that we need it. The problem with the highway is funding, and I think that this is the type of activity the AfDB should be funding."

Rosalind Thomas tied the infrastructure issue to the SADC trade proto-

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col. "Infrastructure is an important aspect of our approach to regional integration. The DBSA's (Development Bank of Southern Africa) mandate is that it has a regional role to play in SADC. We see the need for a much more holistic approach to integration rather than just trade, and infrastructure is one of these."

Samuel Wangwe added that foreign investment would be another important ingredient for African integration. "In recent years, South Africa has increased investments in neighbouring countries and it would be interesting to examine the implications of this development for regional integration in Southern Africa, particularly in light of the broadening of DBSA's mandate to include more countries of the region."

Bertil Oden warned about the volatility of short-term capital inflows. "Africa is the last non-exploited market for capital, which means that mutual funds will sooner or later go into Africa as emerging markets. This brings the issue of instability to the surface because in Africa – also in South Africa as we have seen recently – there is enormous sensitivity to the withdrawal of short-term capital."

Stephany Griffith-Jones elaborated on Oden's observation by distinguishing between different types of capital flows. "I sense that SSA countries are keen on attracting all kinds of flows because they have been starved of flows in the past, but I think there should be more emphasis on attracting long-term flows and especially foreign direct investment (FDI) which is accompanied by valuable technology transfer and know-how. Recent research reveals that the long-term macroeconomic record within Africa determines the amount of long-term flows countries attract. An additional point is that Africa faces a negative bias. This may be due to prejudice or a bad image, but it is also caused by the large number of small countries. In this internationalised world, it is expensive to collect information on every country's economy, so this is another argument for integration because it will help attract more private flows."

Ernest Aryeety pointed out that African countries are seeking considerable growth in FDI, but that macroeconomic stability has not proven to be the entire solution. "There are a significant number of African countries that have worked very hard over the last decade to achieve the kind of environment that was supposed to attract FDI. Ghana has had a stable macroeconomic regime for seven years but the investment has not yet materialised. Perceptions about African markets still have to change."

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