THE NEW INITIATIVE OF THE EAST AFRICAN COOPERATION: OPPORTUNITIES, CHALLENGES AND PROSPECTS

THESIS

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by

PETER NJAU KIMEMIA

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DECLARATION

Except for references specifically indicated in the text, and such help as I have acknowledged, this thesis is wholly my own work and has not been submitted for degree purposes at any other University.

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P.N. KIMEMIA

Grahamstown
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ABSTRACT

The landmark inauguration of the East African Cooperation (EAC) on 14 March 1996 brought to the fore some key issues regarding regional economic integration in East Africa, particularly since it signalled the second attempt by Kenya, Uganda and Tanzania to form a regional economic bloc. The EAC's predecessor, the East African Community, had collapsed in 1977 in acrimonious circumstances. Prominent among the issues that led to the collapse of the East African Community was the perception of unequal gains from the integration scheme, with Uganda and Tanzania considering that disproportionate benefits were accruing to Kenya at their expense.

With the new initiative, the question emerges as to whether the problems that caused the collapse of the Community will not beset the EAC and subject it to a similar fate. In an attempt to address this question, this study considers some of the theoretical issues relating to regional economic integration among countries at different levels of development, and attempts to provide an analysis of the new initiative of the EAC in the light of this theory and the history of the East African Community. The study also critically examines the objectives of the EAC and the integration strategy adopted by the three countries, and offers suggestions on the way forward.

Among the arguments made in this thesis are that, contrary to the suggestions of orthodox static analysis, if the dynamic effects of integration are considered, then there may be important gains which may accrue to integrating states in the developing country context. It is also argued that different levels of development among integrating states need not necessarily be an impediment to economic integration. The study finds that, in spite of the enormous challenges facing the EAC, member states may be better off within the integration scheme than if they acted as individual units in a rapidly globalizing international system.

CONTENTS

LIST OF TABLES

Page

LIST OF FIGURES

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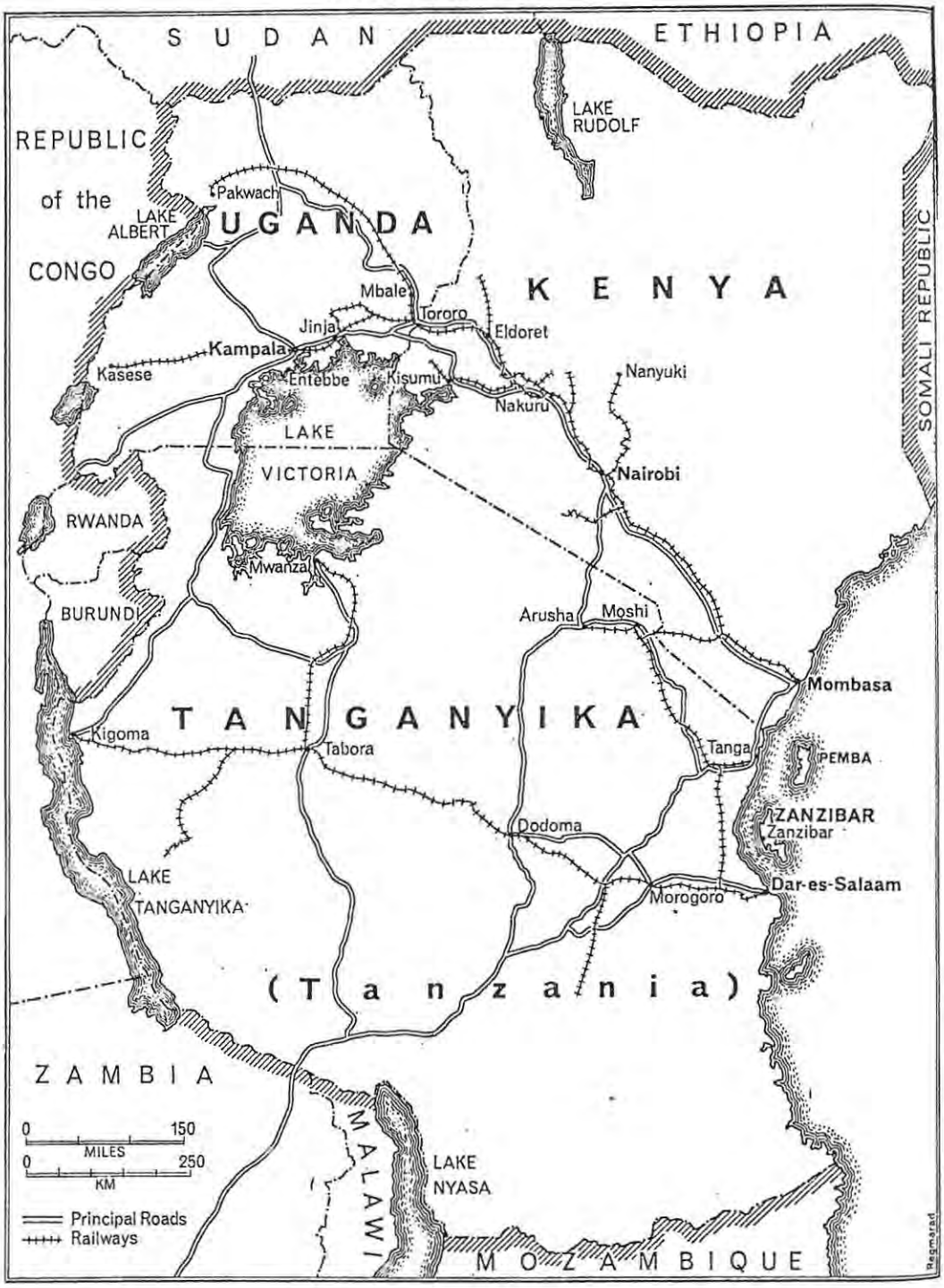
EAST AFRICA



Source: Hazlewood, 1967:70.

CHAPTER 1: INTRODUCTION

1.1 Historical background

Economic integration in East Africa began in 1900 when Uganda made her first formal customs arrangements with Mombasa (Kenya) as the customs collection centre. The building of the Kenya-Uganda railway contributed to a rapid shift of trade from Tanganyikan ports to Mombasa. Kenya and Uganda were under British rule at the time while Tanganyika, then under German rule, was not part of initiatives towards economic cooperation. In 1905, the East African Currency Board was established to issue currency in the two countries, and a Postal Union was also set up.

The amalgamation of the customs authorities of the two countries in 1917 created a customs union, initially with a common external tariff (CET), and later with the free inter-territorial exchange of goods. At the end of the First World War, Tanganyika became a mandate territory within the British Empire under the League of Nations. It consequently adopted the CET in 1922 and acceded to the free exchange of locally produced goods in 1923 (EAC/ds,1997:1). In 1933, Tanganyika joined the Postal Union. The formation of a loose form of common market for the three countries later allowed for the free exchange of imported goods. A joint East African Income Tax Board was set up in 1940 and the Joint Economic Council was established in the same year, enabling the territories to start acting as a single economic and trade unit.

In 1948, two crucial institutions were established: the East African High Commission (EAHC), comprising the governors of the three territories, and the East African Legislative Council (LEGCO). They both provided the necessary legal basis and international outlook for regional cooperation. The EAHC had four executive officers: the Administrator, the Commissioner of Transport, the Finance Member, and the Post Master General. Rules made by the EAHC had the force of law in the three territories, and this facilitated the establishment of inter-territorial departments responsible for services in areas of common interest such as transport, communications, taxation, and the East African Railways and Harbours service.

With the independence of Tanganyika in 1961, the East African Common Services Organization (EACSO) was set up to inherit the operations of common services from the EAHC. In the early days of EACSO, the region remained a free trade area and the similarities in the external tariff regimes were such that a customs union (CU) situation effectively prevailed. The Nairobi Declaration of 1963 issued by the three countries failed to usher in a political federation due to disagreements arising during subsequent negotiations. In June 1967, the Treaty of the East African Community was signed by the three member countries, establishing what was primarily an economic cooperation arrangement. Under the East African Community, the East African Common Market (EACM) was institutionalized (EAC/ds,1997:3). However, the Community collapsed in 1977 for reasons discussed in some detail in Chapter 4 of this study.

On 14 May 1984, the three former member states of the defunct East African Community signed the East African Community mediation agreement for the division of the organisation's assets and liabilities. A provision was, however, made in the mediation agreement whereby the three states agreed to explore areas of future co-operation and work out concrete arrangements for such cooperation. Consequently, during a meeting of the Heads of State of Tanzania, Kenya and Uganda in Nairobi in 1986, it was agreed to establish a mechanism to reactivate the spirit of cooperation among the three countries (EAC/ds,1997:3).

In 1991, the three East African Heads of State met again in Nairobi where they committed themselves to reactivate the East African Cooperation (EAC). Subsequently, at the Arusha summit on 30 November 1993, they set up a Permanent Tripartite Commission (PTC) comprising the three ministers responsible for regional cooperation. The ministers instructed their officials to work out modalities for the establishment of the PTC Secretariat and the implementation of priority areas of cooperation, including the removal of non-tariff barriers to trade, the easing of immigration formalities, transport and communications and the strengthening of the surviving institutions of the former East African Community. Subsequent meetings in Nairobi and Kampala enabled the experts to consider these areas of cooperation and make recommendations that were adopted on 14 March 1996 during the official inauguration of the EAC at Arusha, Tanzania.

The primary objective of the reactivation of the EAC is to enhance closer social and economic

relations among East African countries with the aim of promoting faster economic development in the region. This study aims to examine this new initiative of the EAC, especially with regard to the opportunities and challenges it offers, and its prospects for success.

1.2 Theoretical framework

The study is carried out within the theoretical framework of regional economic integration. Economic integration entails a state of affairs designed to abolish discriminatory trading practices between economic units belonging to different nation-states. Robson (1987:2) notes that all arrangements for international economic integration are characterized by three features: (i) the suppression, in certain matters, of discrimination among the members, (ii) the maintenance of discrimination against the rest of the world in various respects, and (iii) the conclusion of agreements among the members, intended to have a lasting character, that limit the unilateral use of certain instruments of economic policy.

An adequate theory of economic integration must, however, go beyond customs union theory in three important respects: it should take account of intra-union factor movements, it must address the implications of the integration or harmonisation of instruments of national economic policy other than commercial ones, and, finally, it should evaluate integration with reference to criteria that go beyond that of efficiency in resource allocation (Robson,1987:3). Such a theory must embody a broader set of criteria or goals than that of allocative efficiency, which is all that is considered in the orthodox trade or customs union theory, because integration in the areas of fiscal and monetary policies, for instance, can affect commodity and factor inflows, and thus the allocation of resources within and between member countries, as well as having other impacts (Robson,1987:3).

Regional integration has long been advocated as a way of helping the development of the smaller countries of the Third World (Hazlewood, 1975). At the time of its collapse in 1977, the East African Community of Kenya, Tanzania and Uganda constituted one of the longest established and most far-reaching examples of economic integration among developing countries. Many of the causes of the collapse of the East African Community relate to the particular problems of

regional integration among countries at unequal levels of development. This will be discussed further in Chapter 4.

1.3 Goals of the research

Economic integration is a widely researched subject and continues to generate a lot of interest, especially in the contemporary international system, due to globalisation. In their analysis of the 'new regionalism', de Melo and Panagariya (1993:17) argue that the literature on regional arrangements has shifted emphasis from the effects of adopting preferential tariff concessions to coordination at the institutional level with the growing recognition that regional integration goes beyond trade in goods, services and factors. They further point out that, though not concretised, new initiatives are on the table in every region of the world. Not even East Asia has been spared from the "second wave" of regional integration. The region was largely uninvolved in first wave in the 1950s and 1960s because it was mostly preoccupied with political and security issues (de Melo and Panagariya, 1993:19).

In East Africa, economic integration can generally be viewed as a policy response to developmental problems. Pre-1980 integration efforts in the region have been analysed by Hazlewood (1967, 1977,1979), Robson (1968) and Ojo *et al* (1985). However, little has been done on the new initiative of the EAC. Owing to its potential importance to the region, research on the new initiative appears to be warranted, and would help to ascertain whether there is a difference in approach towards regional integration from that which applied in the defunct community. One important point emphasized by the EAC Secretariat at its inauguration was the fact that the new initiative would be based on the establishment of a single investment area through coordination of policies, as opposed to the joint ownership of assets which was partly blamed for the collapse of the East African Community. Moreover, the new initiative is set to be more private sector-driven as opposed to overly involving the respective governments as in the community era.

Research is necessary in order to assess these new tenets upon which the integration scheme is being reactivated. This study seeks, either directly or indirectly, to provide an insight into these

issues. Its purpose is primarily to identify the challenges to the EAC and to make recommendations on how such challenges may be met in order to strengthen co-operation, make it sustainable and avoid the pitfalls of the past. To this end, the study seeks solutions to the following questions:

1) To what extent have the economic and political reforms undertaken between 1985 and 1995 enhanced economic cooperation in East Africa?
2) What are the opportunities offered by the reactivation of the EAC?
3) What are the main challenges to the stated objectives of the EAC?
4) How can the challenges in (3) above be met in order to strengthen the EAC?

1.4 Plan of the thesis

The rationale for economic integration in Africa is briefly discussed in Chapter 2. The study considers some of the reasons why economic integration is deemed necessary among African countries. In spite of the many false starts that have more often than not culminated in the failure of a number of African economic blocs, it is emphasized that economic integration remains a much sought after goal as a response to developmental problems. Integration is viewed as one of the major vehicles for concerted economic development in Africa, especially in the face of globalization.

Chapter 2 also discusses the distinction between economic cooperation and integration, as well as that between positive and negative integration. To enhance an understanding of international economic integration, the chapter considers the origins of thought on integration. To this end, the underlying approaches to international integration are discussed, including the pluralist, federalist and functionalist approaches.

Chapter 3 provides a detailed analysis of various theories of economic integration. It begins with orthodox customs unions theory, and considers its applicability in a developing country context. This is followed by a discussion of a proposed theoretical framework for analysing customs unions among developing countries, in which Cooper and Massell (1965b) consider economic

integration as a tool of industrialization. An examination is then made of possible benefits from economies of scale (EOS) within a CU. The chapter further discusses other alternative theories of economic integration, analyzing both their merits and weaknesses in relation to developing country circumstances, and concludes with a brief look at the viability of economic integration among countries at unequal levels of development in the light of the theory.

The following two chapters provide essential background to the discussion of the new EAC initiative. Pre-1980 integration efforts in East Africa are considered at length in Chapter 4. Most of the discussion revolves around the defunct East African Community. However, a chronological account of its origins is provided, in an attempt to demonstrate the changes and continuities that enabled the integration scheme to grow to the remarkable level it had reached by the time of its collapse in 1977. The causes of the collapse of the East African Community are also briefly examined. The performance of the integration scheme is considered with regard to the benefits that accrued to the three member states during its existence. This chapter also helps to bridge the gap between the defunct integration scheme and the new initiative of the EAC, and shows how the pre-1980 scheme was structured. This becomes important when comparing the structures of the old arrangement and the new one in order to ascertain the differences in the approaches adopted.

Chapter 5 provides an overview of the East African economies since 1985. It examines differences in per capita income, economic size, growth performance and sectoral structure between the three countries, as well as their trade relations. The aim is to provide an understanding of the economic background against which the new initiative of the EAC is operating, and also to demonstrate the skewed levels of development in the region. The latter is particularly important because of the implications of such unequal levels of development on the distribution of the benefits of integration. A brief analysis of trade relations in East Africa is offered in order to demonstrate recent trends in intra-regional trade.

Chapter 6 introduces a more substantive analysis of the new initiative of the EAC. It begins with the background against which the reactivation of the EAC was built. It enumerates the economic and political changes that occurred both within the region and further afield, the ramifications

of which were felt across the region. The changes in the political ideology of Tanzania in 1985 are noted, as are the dramatic changes in the political scenario of Uganda after President Museveni took power in 1987. In addition, developments in Kenya in the post 1985 period are also discussed. All of these are considered in relation to their role in hastening the need for the reactivation of economic cooperation in the region. The chapter then highlights some of the enormous challenges facing the EAC and the need to address them in order to enhance economic integration in the region. The future prospects of the EAC are also examined in the light of the collapse of the East African Community, as well as the theoretical analysis in Chapter 3. Furthermore, the approach and guiding principles of the EAC are discussed to ascertain how they compare to those of the defunct Community.

Chapter 7 concludes the study by considering a proposed way forward for the EAC. It provides some recommendations in the light of the discussion in preceding chapters with regard to, *inter alia,* policy harmonisation, privatisation, regional payments mechanisms, the role of donors and democratization. The concluding section revisits the discussion on the importance of regional economic cooperation and integration in East Africa and offers suggestions for dealing with the problem of economic integration among countries at unequal levels of development.

CHAPTER 2: ECONOMIC INTEGRATION IN AFRICA

2.1 Introduction

As noted in Chapter 1, one of the most prominent features of the contemporary international system is the heightened tendency for some state units to gravitate towards some degree of regional integration (Asante,1996:1). The United Nations Economic Commission for Africa (ECA) views economic cooperation and integration as "the political will or the will to develop, as a qualitative attribute of immense significance which cuts across the development scenarios under discussion" (Asante,1996:1). It has even been suggested by some scholars that its absence or ineffectiveness is an inherent part of the development problem that faces Africa.

The move towards economic integration has become such a worldwide phenomenon that the post World War Two period could, to a certain extent, be termed the era of regional integration. This is so much the case that it is likely that nowhere in the world today do policy makers and economists tackle any problem of economic development without taking into consideration theories of and trends in economic integration both at home and abroad. Indeed, for economists and social scientists today, economic integration is an essential aspect of the dynamics of modern society in its continuous process of transformation. Moreover, it is acknowledged as an important aspect of economic development in developing countries and contributor to more rapid growth in industrialized ones (Asante,1996:2).

In some economic literature, the term integration or common market has tended to be associated with rapid economic growth, acceleration of economic development or 'big push'. Asante (1996:2) argues that, regardless of the terminology used, "there can be no doubt that the process of regional integration is now inextricably linked to that of economic development". It is against a background of similar reasoning, coupled with postwar progress towards integration in Europe culminating in the establishment the European Economic Community (now the European Union, EU), that the idea of economic integration became attractive to the political and economic leaders of Third World countries during the 1950s and early 1960s. The potential power of the EU triggered a desire for emulation both to reap the perceived benefits of integration and to seek

protection against the EU's capacity to export and import goods. Hence, over the past three decades, more than a dozen customs and monetary unions, common markets, free trade zones and other regional cooperative arrangements have been proposed or established in Latin America, Africa and Asia.

The purpose of this chapter is to consider the rationale for and moves towards economic integration in Africa, and also to provide definitions of terms in the literature which are to be used in the course of this study. The chapter also gives an overview of the origins of thought on international economic integration by discussing some of the underlying approaches to the subject. The aim is to provide a useful base for an understanding of subsequent chapters.

2.2 The rationale for economic integration in Africa

Ostergaard (1993:27) points out that, in Africa, the subject of economic integration is like a myth that will not die. Despite three decades of disappointing progress, African leaders continue to propagate the view that economic integration is an important device for fostering development. Indeed, the case for regional economic integration and intra-African economic cooperation has long been advocated. With the movement towards independence in the late 1950s and early 1960s there was recognition that, while independence had been the primary goal, African countries were largely artificial by-products of the colonial scramble that occurred during the 1884-85 Berlin Conference. The present fragmentation and small African markets emanate from the specific political and economic conditions in which the continent found itself at independence. Most African states have small populations, with only about five having more than 30 million people. The latter include Ethiopia, Egypt, Nigeria, Zaire (the Democratic Republic of Congo) and South Africa. Generally, the typical developing African nation has a sparse population, small internal market, limited infrastructure, fragile borders, and economies vulnerable to fluctuating world prices (Asante,1996:5). Indeed, the balkanization of Africa appears to be one of the most enduring colonial legacies.

Given this background, it is not surprising that economic integration has been viewed as a means of helping to overcome the disadvantages of small size, low per capita incomes, small

populations and narrow resource bases, and of making possible a greater rate of economic growth and development (Asante,1996:6). It has also been seen as a means of consolidating the political independence of African countries and thereby strengthening their overall position vis-à-vis developed countries, especially the former colonial powers. Indeed, it has been argued that economic integration or cooperation in general is not only desirable, but necessary, if Africa is to industrialize, develop intra-African trade, develop the capacity to participate effectively in evolving global linkages and interdependencies, reduce her vulnerable and fluctuating overseas markets, mobilize and maximize scarce resources of capital and skills, and, finally, forge the way to effective African unity, both political and economic (Asante,1996:6).

African countries fully accept that they cannot make real progress with economic integration without close coordination and harmonization of their sectoral plans and national development policies, and they continue to adopt resolutions and declarations to that effect. These are reflected in the 1980 Lagos Plan of Action (LPA) and the Final Act of Lagos, as well as in Africa's Declaration on Economic Cooperation and Development (1973), the Monrovia Strategy (1979), Africa's Priority Programme for Economic Recovery (APPER) (1985), Africa's submission to the special session of the United Nations General Assembly on Africa's Economic and Social Crisis (1986), the UN Programme of Action for African Economic Recovery and Development 1986-1990 (UN-PAAERD), the UN New Agenda for the Development of Africa in the 1990s (UN-NADAF) adopted in 1991, and the Cairo Agenda for Africa (1995). All contain fresh proposals and undertakings about more effective approaches to achieving the goals of economic integration.

By 1990, forty-nine African states with a total population of 465 million had already regrouped themselves in broader subregional economic communities with the result that, apart from Egypt, all African countries were then, involved in the process of economic integration (Asante,1996: 6). Egypt has since become a member of Comesa, into which it gained admission in May 1999. In West Africa, the French-speaking West African Economic Community (CEAO) was established in 1973, the Mano River Union in 1974 and, the most ambitious of all, the Economic Community of West African States (ECOWAS) in 1975 (Asante,1996:7). In 1994, the French-speaking West African states established an economic and monetary union, known in its French

acronym as UEMOA, to replace CEAO. In North Africa, the Arab Maghreb Union (UMA) was established in 1989; in Central Africa, the Customs and Economic Union of Central Africa (UDEAC) in 1964, the Economic Community of the Great Lakes Countries (CEPGL) in 1976, the Economic Community of Central African States (ECCAS) in 1983 and, in 1994, the economic and monetary union CEMAC was created to replace UDEAC.

In Eastern and Southern Africa there exist the Southern African Customs Union (SACU), first established in 1910, the Southern African Development Coordination Conference (SADCC), formed in 1980 and transformed into the Southern African Development Community (SADC) in 1992, and the Preferential Trade Area (PTA), established in 1981 and transformed into the Common Market for Eastern and Southern Africa (COMESA) in 1993. Recently, the East African Cooperation (EAC) was reactivated by the three member countries: Kenya, Uganda and Tanzania. Generally, all these groupings point to the fact that, in spite of the apparent failure of economic integration efforts in Africa in the past, many still believe that, in the contemporary world, it is the deliberate integration of African economies that provides the best means by which to attain growth and development. This study will focus on one of the most unique regional economic groupings in Africa, the new initiative of the EAC.

2.3 Economic cooperation and integration

At this point it would be useful to define two concepts that are often used interchangeably in the literature, although they have slightly different implications: economic cooperation and economic integration. Economic cooperation is a flexible form of association between two or more countries, aimed at deriving mutual benefits for all participants. It usually precedes integration, and does not threaten participants with any significant loss of sovereignty with regard to policy-making. Cooperation usually involves the sharing of resources and the undertaking of joint ventures in sectors of the economy such as transport and communications, energy, water and health.

On the other hand, the term economic integration relates specifically to a process whereby the economies of two or more countries are partially or wholly merged into a larger entity. At higher

levels of integration not only are barriers between members dismantled, but a collective policy is also adopted towards non-member states. Models of economic integration are based on customs union theory, which emphasizes the gains that are likely to result from the creation of regional markets. More recently, this body of theory has also begun to highlight the gains which may be derived from economies of scale in a regional setting (see Chapter 3) (Ostergaard, 1993:27). Thus economic integration is essentially a process in which tariff and non-tariff barriers to trade are progressively removed, and in which the external trade and ultimately fiscal and monetary policies of cooperating partners are harmonized.

It is noteworthy that, despite the distinction between economic cooperation and economic integration noted above, the two concepts nevertheless continue to overlap when real life integration schemes are considered. For example, the African Development Bank study on regional integration in Southern Africa (ADB,1993) argues that economic cooperation embraces any or all of the following three levels. At the lowest level is coordination, which implies the voluntary alignment of specific national private or public investment in various sectors of the economy such as power generation, transport and communications. At a higher level is harmonization, wherein common legislation is adopted on how countries may use particular policies or instruments such as tariff and non-tariff barriers, indirect taxation and monetary management, which are regionally agreed upon but nationally controlled and applied. The third level is integration, which entails the ceding of some national sovereignty with regard to regional policies and particular economic functions, policies and instruments to a union or regional authority or institution which exercises its power at the regional level (ADB,1993:10).

It is therefore not surprising that an arrangement defined simply as one of "cooperation" may actually involve more far-reaching activities which would by the above definition pass for integration. This could also indicate a pressing desire on the part of the participating states to see greater cohesion and policy harmonization with its accompanying benefits. A case in point is the East African Cooperation (EAC) which, as the name suggests, would appear to have been formed to enable member states to reap the benefits of a flexible but loose arrangement. However, a closer look at the prevailing activities of the Secretariat reveals that cooperation and integration processes are going on almost simultaneously (see Chapter 6).

2.4 Positive and negative integration

Lundahl and Petersson (1991:152) make a further distinction between what they refer to as negative and positive international economic integration. The terms were first used by Tinbergen (1954). The former refers to the possibility of unhampered trade and the elimination of restrictions to regional trade liberalization. The latter refers to the planning of production branches that cannot be developed to an optimum size within national boundaries. In the second case, regional integration can be used by countries with scarce human and material resources as an instrument for enlarging their production capacity and their markets for the benefit of producers.

In the case of positive integration, the harmonization of development policies thus becomes more important than the removal of customs barriers (Lundahl and Petersson, 1991:152). Such a situation not only implies the creation of a large market (and static gains via the reallocation and specialization of production), but also involves a dynamic aspect, where regional integration of production constitutes a possible source of faster economic growth. The term positive integration may thus be seen as the modification of existing instruments and institutions and, more importantly, the creation of new ones, to enable the market not only to function efficiently but also to promote other policy objectives in the union.

2.5 Underlying approaches to international integration

The final section of this chapter briefly considers three general underlying approaches to international integration, with the aim of enhancing our understanding of the origins of thought on international integration, and how such early ideas may have influenced present day integration efforts. It will also help us to appreciate the dynamism of the international system which makes it seem necessary for nation states to realign themselves in order to deal with emerging issues effectively and secure their respective national interests in the international arena.

It is arguable that one of the most important impetuses to international integration has been the

desire to create an interdependence that will militate against the tendency to spark off international conflicts. This would effectively contribute to international peace globally and thus minimize the misery that would otherwise be occasioned by war. It is against such a background of an intense and genuine quest for international peace that various approaches towards integration have been advocated.

2.5.1 The pluralist approach

In this approach, integration is seen essentially as the formation of a community of states defined by a high and self-sustaining level of diplomatic, economic, social and cultural exchange between its members. The states are engaged in a continuous process of adjustment to each others actions, supported usually (although not necessarily) by the socio-political behaviour and attitudes of their populations. There is, however, no suggestion that those common institutions which might emerge to facilitate international cooperation and communication represent the embryo of a supranational state or are able to act independently of the will of the constituent states (Pentland, 1973:29).

International organizations are rather assigned the kind of role described by Claude (1971) as follows: in the short term, easing the management of power by states in a system of more or less stable equilibrium; in the longer term, perhaps helping to limit the abusive aspects of state behavior which balance of power operations may otherwise entail, and building the economic and social basis for new forms of international order (Claude,1971, cited in Pentland,1973:29).

Among the major theorists of integration, Deutsch (1954) perhaps best articulates this approach. He concerns himself with the problem of developing peaceful relations among states. He writes that "since our study deals with the problem of ensuring peace, we shall say that any political community, be it amalgamated or pluralistic, was eventually successful if it became a security community that is, if it achieved integration, and that it was unsuccessful if it ended eventually in secession or civil war" (Deutch,1954, cited in Pentland,1973:31). By implication, what is essential for integration, then, is not a particular kind of formal institutional change, but the attainment of peace and security in the international system.

Deutsch's (1968) concept of the security community would appear to refer to a type of international system whose members are highly interdependent, but do not contemplate resolving their conflicts of interest through violence. To Deutsch (1968), integration has to do with the ultimate task of converting the world into a pluralistic society marked by a reasonable flexibility potential and by the existence of component parts which are susceptible to regulation in their relationships with each other and with the whole, through the process of political accommodation (Claude,1962:284).

In the pluralist approach, *economic* integration is given minimal attention. In fact, it is judged to be effective only in so far as it has a favorable influence on communications flows and hence on mutual points of view. Pluralists would appear to adhere to political realism which emphasizes the primacy of security and high politics, the irreducibility of the nation-state and the importance of traditional diplomatic goals and methods. This approach may therefore not effectively serve a study of regional economic integration. Indeed, for those like functionalists and neofunctionalists to whom integration means more than the preservation of peace among nations, the pluralists minimal definition will seem quite inadequate.

2.5.2 The federalist approach

As observed above, prior to the Nineteenth Century, the prospects for international integration were discussed almost exclusively within what might be called the literature of pacifism. The pluralist approach stressed the desirability of moral, political and economic change within states, and the need for improved techniques of interaction between them to ensure that they would resolve their conflicts peacefully, and coexist in a stable, harmonious system of sovereign entities.

The second approach to integration called for the formation of a supranational authority to regulate the behavior of states and assume many of their sovereign rights, duties and powers. This federalist approach has often been identified with formal legalistic attempts to draw up peace plans or constitutions for the international system. The essence of the integrative process, according to this view, is the formation among a group of previously sovereign powers of a

common supranational state. The international identities of the constituent states are merged in this new legal and political entity. Internally, jurisdiction is divided so that the states and the federal government possess complementary but independent powers.

Federalists follow Albert Einstein's conviction that "there is no salvation for civilization, or even the human race, other than the creation of a world government" (Kegley and Wittkopf, 1993:525). They recommend building a political union at the regional and global level. If people value survival more highly than relative national advantage, so federalists reason, they will transfer their loyalty to a supranational authority to dismantle the multi-state system that produces war and threatens to annihilate the human race.

Ardent nationalists have vociferously attacked the revolutionary federalist "top-down" peace plan since it was advocated. Because the plan seeks to subvert the nation-state system, it threatens many entrenched interests. More abstractly, other critics reject the world federalist's proposition that governments are bad, but people are good, wise and enlightened (Claude, 1971:41). Likewise, they challenge the assumption that necessity will lead to global institutional innovation, as the need for something will not automatically bring it into existence. Although still actively advocated by United World Federalists, aversion to war and raised consciousness of its dangers have not mobilized widespread grassroots enthusiasm for a world government. Other approaches to reforming the world system have attracted more adherents (Kegley and Wittkopf, 1993:526).

2.5.3 The functionalist approach

Classical functionalism is a rival but a complementary reform movement, also in the spirit of neoliberal institutionalism. In contrast to federalism, however, functionalism is directed not to the creation of a world federal structure with all its constitutional paraphernalia but, rather, to building "peace by pieces" through transnational organizations that emphasize the "sharing of sovereignty" instead of its surrender. Functionalism advocates a bottom-up evolutionary strategy for building cooperative ties among states (Kegley and Wittkopf, 1993:527). The functionalists see technical experts, not professional diplomats, as the best agents for building collaborative ties

bridging national boundaries, because the latter are overly protective of national interests at the expense of collective human interests.

Rather than addressing the immediate sources of national insecurity, the functionalist peace plan calls for transnational cooperation in technical (primarily social and economic) areas, as a first step. Habits of cooperation learned in one technical area, such as physics and medicine, will, they assume, spill over into others, especially if the experience is mutually beneficial and demonstrates the potential advantages of cooperative ventures in other related functional areas such as transportation and communication (Kegley and Wittkopf, 1993:527). To enhance the probability that cooperative endeavours will prove rewarding rather than frustrating, the functionalist plan recommends that less difficult tasks be tackled first. It assumes that the successful mastering of one problem will then encourage collaborative tackling of other problems.

If such a process continues unabated, the bonds among nations will multiply, for no government would oppose the web of functional organizations that provides such clear cut benefits to their citizens. Hence, " the mission of functionalism is to make peace possible by organizing particular layers of human social life in accordance with their requirements, breaking down the artificialities of the zoning arrangements associated with the principle of sovereignty" (Claude, 1971:347).

The functionalist approach to peace was found persuasive because, as its intellectual father Mitrany (1966) argued, it was based on self interest. "Functionalism proposes not to squelch but to utilize national selfishness; it asks governments not to give up sovereignty which belongs to their peoples but to acquire benefits for their peoples which were hitherto unavailable, not to reduce their power to defend their citizens but to expand their competence to serve them. It intimates that the basic requirement for peace is that states have the will to cooperate in pursuit of national interests that coincide with those of other states rather than the will to compromise national interests that conflict with those of others" (Mitrany,1966, cited in Claude,1971:386).

Functionalism as originally formulated did not pertain to multinational corporations (MNCs), but

it is tempting to speculate that MNCs may facilitate the transformation of world politics in a manner consistent with functionalist logic. Individuals who manage global corporations often think and speak of themselves as a revolutionary class possessing a holistic, cosmopolitan vision of the earth that challenges traditional nationalism (Barnet and Müller, 1974). This ideology, and the corresponding slogan "down with borders", are based on the assumptions that the world can be managed as an integrated unit, that global corporations can serve as agents of social change, that governments interfere unnecessarily with the free flow of capital and technology, and that MNCs can promote compromise between different states.

However, the functionalist approach is not without flaws. Functionalism assumes that political differences will be dissolved by the habits of cooperation learned by experts organized transnationally to cope with technical problems. The reality is that technical cooperation is often more strongly influenced by politics than the other way round. The United States withdrawal from the International Labour Organization (ILO) and the United Nations Educational, Scientific and Cultural Organization (UNESCO) because of their politicized nature demonstrates the primacy of politics (Kegley and Wittkopf,1993:527).

In addition, functionalists sometimes argue naively that technical (functional) undertakings and political affairs can be separated, but they cannot. If technical cooperation becomes as important to state welfare as the functionalists argue it will, states will not step aside. Welfare and power cannot be separated, because the solution of economic and social problems cannot be divorced from political considerations. Whether the authority and competence of transnational institutions can readily be expanded at the expense of national governments is therefore unlikely.

2.6 Conclusion

Among the approaches discussed above, it appears that only the functionalist approach may be of substantial relevance when it comes to the issue of regional economic integration. However, as demonstrated in the following chapter, it will need to be qualified further by the ideas brought forth by neofunctionalists. The focus of the discussion will now move from the general ideas of international integration to theories that are specific to economic integration.

CHAPTER 3: THEORIES OF ECONOMIC INTEGRATION

3.1 Introduction

In this chapter, an attempt will be made to review the theory of economic integration from orthodox customs union (CU) theory to the more recent literature which considers economies of scale and intra-industry trade. The implications of this theory for the viability of economic integration among countries at unequal levels of development will then be considered. The latter is of particular relevance to economic integration in East Africa, and will be explored further in this context in subsequent chapters.

The theory of economic integration considers the impact of the removal of trade impediments between participating nations in an integration scheme. It is also concerned with the establishment of certain elements of coordination between member countries in order to meet national and supranational objectives.

Economic integration can take several forms representing different levels of interaction (El-Agraa, 1989:1-2). A free trade area (FTA) entails the elimination of trade impediments between partners, although members retain the freedom to determine their policies vis-à-vis non-participants. A customs union (CU) is a FTA in which the member countries have a common external tariff (CET) in their trade with non-member countries. A common market has all the elements of the CU but, in addition, permits capital, labor and entrepreneurship to move among member countries. An economic union is a common market in which members coordinate their national economic policies to some degree. A complete economic union would involve the total unification of monetary, fiscal and social policies. A supranational authority is established whose decisions are binding on member states. Finally, with complete political integration, the participants literally become one nation; the central authority not only controls economic policy but is also responsible to a central parliament (El-Agraa, 1989:1-2). Each level of integration entails a different degree of sacrifice of national sovereignty and has different implications for the international redistribution of income. However,

in spite of a seemingly linear progression of the levels of integration, it is important to note that the activities in actual integration schemes may overlap between these categories.

3.2 Orthodox customs union theory

The origins of orthodox CU theory date back to Viner's (1950) pioneering work. His central argument was that the formation of a CU would result in free trade between members and protectionism vis-à-vis the rest of the world (El-Agraa, 1989:19). Initially, each country has its own set of tariffs. As a consequence of the integration of commodity markets and the establishment of a CET, trade and the prices of goods in the domestic markets of the member countries will change. Orthodox theory analyses these changes in terms of Viner's distinction between trade creation and trade diversion (Lundahl and Petersson, 1991:161). This is a comparative static analysis concerned with the reorganization of production with given resources.

Trade creation refers to increased trade among the members of the CU due to the removal of trade barriers between them. It implies a shift from relatively high-cost domestic production to lower-cost production in partner countries, and thus a reallocation of resources according to comparative advantage. Trade diversion, on the other hand, results when trade is shifted from lower-cost outside to higher-cost partner sources. This shift occurs through the extension of the protected home market to the entire CU area. For the importing country, in the Viner setting, trade diversion implies rising costs (import prices) for the goods previously imported from the rest of the world, and a loss in welfare (Lundahl and Petersson, 1991:161). Trade creation is regarded as welfare-improving and trade diversion as welfare-worsening. The relative strength of these two forces would therefore determine whether or not a CU is beneficial (El-Agraa, 1989:19).

Orthodox CU theory is based on the following simplifying assumptions: perfect competition in factor and commodity markets; perfect mobility of factors of production within countries but perfect immobility across borders; full employment of resources; the state of technology, tastes and forms of economic organisation are all assumed to be given. The analysis is carried out in a three-nation

framework comprising the home country (H), partner country (P) and the rest of the world (W) (El-Agraa, 1989:19). The following diagram illustrates the concepts of trade creation and trade diversion.

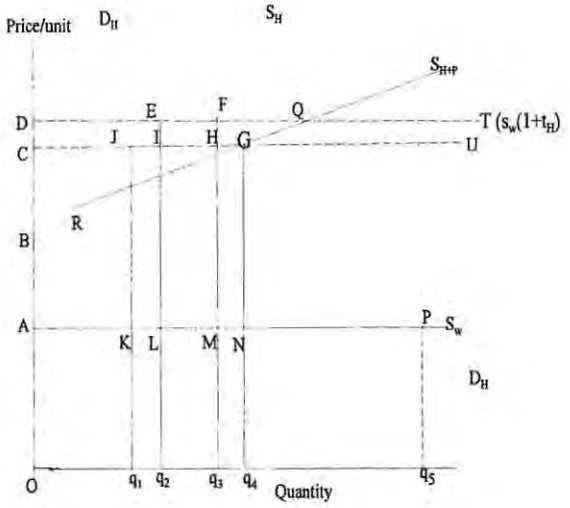


Figure 3.1: Trade creation and trade diversion

Source: El-Agraa (1989:20)

In the diagram above, S_W is W's perfectly elastic tariff-free supply curve for this commodity; S_H is H's supply curve while S_{H+P} is the joint tariff-free supply curve for the good originating in the CU. With a nondiscriminatory tariff of AD (t_H) imposed by H, the effective supply curve facing H is BREFQT. The domestic price is therefore OD which gives domestic production of Oq_2, domestic consumption of Oq_3 and imports of q_2q_3 from the lowest cost supplier, W. The home country (H) pays q_2LMq_3 for these imports while the domestic consumer pays q_2EFq_3 with the difference (LEFM) being tariff revenue accruing to the government of H. This revenue can be seen as a transfer from consumers to the government with the implication that when the government spends it, the marginal valuation of the expenditure should be exactly equal to its marginal valuation by private consumers so that no distortions occur (El-Agraa,1989:20).

The formation of a CU by H and W would restore the free trade position such that Oq_5 is imported

to be consumed in H, implying that free trade is the best situation. However, formation of a CU by H and P means the tariff still applies to W (assuming a CET set at AD) while it is removed for P, and the effective supply curve in this case is BRGQT. Domestic production falls to Oq_1, consumption rises to Oq_4 and imports rise to q_1q_4 and are now from P. The concepts of consumer and producer surplus best illustrate the welfare implications of these changes. Due to the fall in the domestic price, consumer surplus rises by CDFG, of which CDEJ is a transfer from producer surplus and IEFH is a portion of the tariff revenue now transferred to the consumer (El-Agraa,1989:20). The triangles JEI and HFG are the trade creation gains from the formation of a CU.

To determine whether these triangles represent net gains, the overall effects must be critically evaluated. The decline in domestic production from Oq_2 to Oq_1 leads to increased imports of q_1q_2 costing q_1JIq_2 to import from P and q_1JEq_2 to produce domestically, saving JEI. The rise in consumption from Oq_3 to Oq_4 leads to new imports of q_3q_4, costing q_3HGq_4 to be imported from P. These provide welfare to the consumer of q_3FGq_4, increasing satisfaction by HFG. However, the initial imports of q_2q_3 originally cost the country q_2LMq_3, but now come from P, costing q_2IHq_3. These imports therefore cause a trade diversion loss equal to a fall in government revenue of LIHM. It follows that the trade creation gains (JEI+HFG) have to be compared with the loss in tariff revenue (LIHM) before a definite conclusion can be reached on whether CU formation results in a net gain or loss (El-Agraa, 1989:21). Note that if the initial price is taken to be at the intersection of D_H and S_H (due to a higher tariff), the CU results in pure trade creation since the tariff would have been prohibitive. Conversely, if the initial price is OC due to a lower tariff rate, CU formation causes pure trade diversion.

It is therefore important to note that a fall in the domestic price is a necessary condition for a trade creation gain in this framework. This implies that the partner country must be able to displace imports from the rest of the world completely in order for trade creation to occur (Cattaneo,1998:93). This can be illustrated with reference to Figure 3.1. The situation in which the partner is unable to displace imports from the rest of the world completely would occur if S_{H+P} cuts the tariff-inclusive world supply curve $S_W(1+t_H)$ in between points E and F, rather than to the right of point F. In such

a case, the domestic price would remain OD, domestic production and consumption would also remain the same, and there would be no trade creation gains on integration. There would, however, be a trade diversion loss reflecting the loss of customs revenue on that portion of imports from the rest of the world that has been displaced (Cattaneo,1998:93).

3.3 Weaknesses of the model

Customs union theory, also referred to as market integration theory, faces criticism due to its rather simplistic assumptions which, besides being unrealistic, are said to be particularly inapplicable to Third World situations. Ostergaard (1993:30), for example, points out that the model is criticised both with regard to the inner logic of the theory itself and, in particular, with regard to its relevance for regional integration schemes in the Third World. It relies heavily on the neoclassical assumptions of full employment, perfect competition, constant returns to scale, perfect internal mobility of factors of production and the equality of private and social costs, and its analysis is mainly confined to static effects (Jaber,1970:267). It has frequently been argued that the dynamic effects of economic integration are more important than static effects, and that the static gains from economic integration among less developed countries (LDCs) tend to be insignificant. The latter can be explained by the relatively small percentage of intra-regional trade in a typical LDC bloc, inflexibility or delay in the responsiveness of the economic structure to necessary adjustments, and the greater degree of imperfection in LDC markets (Jaber,1970:267).

Viner (1950) confined his analysis to the static production effects of integration only, assuming demand curves of zero elasticity and supply curves of infinite elasticity (Jaber,1970:255). Gehrels (1956), Lipsey (1960) and others incorporated the consumption effects of a CU, that is, the response of consumers to the drop in import prices caused by tariff removal. However, the traditional theory failed to consider most of the other effects of economic integration, namely increased competition, economies of scale, changes in the volume and location of investment, and terms of trade effects. Furthermore, the theory dealt almost exclusively with CUs among industrial economies, whose problem "is not primarily one of economic development but of relatively marginal adjustments in

production and consumption patterns" (Jaber,1970:267). Many writers have argued that economic integration in the developing country context should be treated as an approach to economic development rather than as a tariff issue. Consequently, the emphasis should be on dynamic rather than static effects in evaluating the desirability of economic integration among LDCs.

Some limitations have also been identified in the orthodox analysis with regard to production effects. Although trade diversion is traditionally viewed as a negative production effect leading to a loss of welfare, Jaber (1970:256) argues that such trade diversion would basically be happening at the individual country level in LDCs through import-substituting industrialisation. Therefore, if a pattern of industrialisation based on greater specialisation within the region is adopted, then trade diversion may not lead to a loss of welfare if the positive effects of faster industrialisation are considered. This argument is explored further in Section 3.4.

Most of the conditions that Viner's analysis appears to have considered are not necessarily prevalent in LDCs. The assumption that all resources are fully employed is hardly accurate. In many LDCs, there is low labor productivity and a high rate of unemployment. Thus, if trade diversion moves labor from low productivity to more productive activities, it should bring about a gain in welfare. This reinforces the proposition that the evaluation of economic integration among LDCs should not be confined to production and consumption effects alone. Income and employment effects ought to be considered as well (Jaber,1970:256).

LDC imports from developed countries largely comprise capital goods. In a static situation, no trade diversion or creation is likely to occur in LDC imports of such goods. However, in a dynamic situation, Jaber (1970:257) notes that a higher rate of growth would require larger investment and, since most of this investment requires the use of capital goods, the level of LDC imports from the rest of the world might actually increase, which could increase world trade and overall welfare. Furthermore, trade diversion in consumer goods would release the much needed foreign exchange to the import sector to be used for the purchase of capital goods from the rest of the world. Moreover, trade diversion from developed countries may result in a larger market for manufactures

in the partner states which could lead to economies of scale. All these arguments run counter to the view that trade diversion will necessarily result in a loss of welfare.

Jaber (1970: 257) also questions the relevance of the orthodox conditions for a beneficial CU in the LDC context. Viner (1950) suggested that the more competitive the partners are in the sense of producing similar products, the more favorable economic integration would be. Since most LDCs specialize in primary products, it follows from Viner's suggestion that such countries would be competitive. But, there is a limiting factor in that LDCs mostly trade with developed countries and, therefore, it is likely that economic integration would not result in sizeable intra-regional trade. This tends to limit the welfare gain from economic integration among LDCs. "Indeed, the criterion of competitiveness and complementarity is not relevant at all to LDCs unless it is given a different sense" (Jaber,1970:261).

The criterion alluded to above presumes a developed economic structure which when integrated would readjust through what Jaber (1970:261) refers to as a 'creative destruction' process that ends up with the survival of the most efficient producer. Such structures are essentially not existent in LDCs. Since the welfare gains or losses in LDCs from these effects is relevant to manufactured goods and processed foodstuffs rather than to traditional exports of primary products, these countries should develop complementarity because this would minimise the costs of adjustment. Competitiveness is likely to be achieved as industrialisation progresses.

The traditional theory further suggests that a CU is more likely to raise welfare the lower is the total volume of foreign trade as a percentage of the GNP of member countries. Consequently, economic integration is viewed to be of little benefit to LDCs whose foreign trade constitutes a large percentage of GNP.

On the basis of these weaknesses, Jaber (1970:262) concludes that the generalisations of traditional theory have limited applicability for evaluating the desirability of economic integration among LDCs. This has resulted in some writers suggesting an approach which accepts industrialization as a legitimate policy goal, and considers how membership in a CU may enable a less developed country

to achieve more economically the ends served by protection (Jaber,1970:262).

Furthermore, Cooper and Massell (1965a) argue that since the gains from trade creation in the orthodox model are simply due to the reduction in tariffs which takes place between partner countries, such gains could be obtained through unilateral tariff reduction, without any accompanying loss due to trade diversion. According to Cooper and Massell (1965a:746-747), the traditional framework does not explicitly demonstrate why a customs union is to be preferred to unilateral tariff reduction and also why a customs union may more efficiently serve the ends previously served by non-preferential protection. Their analysis demonstrates the need to recognize "a prior rational argument for the existence of protection, which orthodox customs union theory fails to provide" (Cattaneo,1998:105).

Similarly, Robson (1968:37) concludes that "the basic arguments do not provide a rationale for the formation of regional customs unions..... arguments for regional economic groupings must therefore rest on a framework of analysis which either provides a rationale for protection as an aim of policy, or accepts it". Indeed, Robson's ideas lead to a discussion of the development integration model, considered in Section 3.8 below. Ostergaard (1993:31) notes that a substantial part of the debate on the merits of integration takes place between proponents of global free trade as an immediate objective and those who see CUs as a step towards this. The latter argue that intra-union free trade would result in increased dynamism within the union, ultimately leading to greater trade with the rest of the world and a reduction in common external trade barriers. They point out that the starting point in most cases has been a situation of widespread protectionism among participating states. A CU therefore starts the process towards free trade by reducing protection among member states.

Robson (1968) further argues that orthodox theory needs qualification because it takes no account of the way in which the potential benefits of integration may be distributed. Although it is implied that members will gain on the basis of comparative advantage, experience shows that this may not occur under market integration. Indeed, Ostergaard (1993:31) concurs with Myrdal (1957) that where disparities exist among members of an integration scheme, the spread effects of increased economic activity will be less important to the poorer areas than the backwash effect of the attraction of

resources from the poorer to the richer areas. The possible polarization effects of integration are considered further in Section 3.11.

Each member state in an integration scheme assesses its participation in terms of the benefits which accrue to it. Factors such as nationalism, the nature of leadership, and the role of interest groups will directly affect the cooperation of governments on a regional level. These factors are overlooked in traditional customs union theory. The relationship between the objectives agreed upon at the regional level, and the commitment and capability to implement such decisions at the national level represents, in Ostergaard's (1993:32) view, the most crucial variable in any integration scheme.

Ravenhill (1980:46) makes a central observation with regard to the relevance of CU theory in the Third World, arguing that benefits from the creation of free trade areas arise only when tariffs have been a major impediment to inter-territorial trade. Among many LDCs, and in Africa in particular, this is rarely the case. The problem is not so much a matter of tariff barriers but of the inability of states to produce the goods which satisfy the import demand of their neighbors. This argument implies that the market integration model has limited relevance in the LDC context.

The above analysis suggests that orthodox customs union theory has little applicability to LDCs. This necessitates the development of more relevant approaches that can cater for the unique conditions that prevail in the Third World.

3.4 Economic integration as a tool of industrialisation

Cooper and Massell's (1965b) work on the potential benefits of CUs among developing countries was a response to the inability of orthodox theory to provide a rationale for CU formation. They argue that the potential gain from a CU will be larger if there is a steeply rising marginal cost of protection in the two countries, the two countries are complementary in the nature of production and they have a strong preference for industry (El-Agraa, 1989:23). Furthermore, the impact of a CU will depend on the precise rules under which it is formed, the rules governing the location of industries, intra-

union trade and compensation. Cooper and Massell (1965b:461) make the following assumptions:

(i) there is a social preference for industrial activity and planners in the economy are willing to accept a reduction in national income in favour of increased industrial production;
(ii) planners are not only indifferent to a choice between any two industries, but diversification within the industrial sector is not an objective; planners satisfy their demand for industrial production by selecting the lowest cost industries;
(iii) there is full employment, constant costs, competitive bidding and a constant terms of trade.

A notable implication of the collective preference for industrial production assumption is that members are willing to expand industrial production (and industrial employment) beyond what it would normally be under free trade. To finance this policy, mainly tariffs are used; protection is carried out to the point where the value of marginal utility derived from the collective consumption of domestic and industrial activity equals the marginal private cost of protected industrial production.

Since industrial production is preferred in a country, any evaluation of the impact of a CU must take into consideration changes in both the country's national income and size of the industrial sector. Gains in any one sector, if offset by considerably large losses in the other sector, will necessarily render the economy worse off. Protection is rationalised on several grounds, political as well as economic. It can be used to alter a country's terms of trade, increase domestic employment, raise revenue or foster local industry (Cooper and Massell, 1965b:462).

The optimal level of industrial production is determined by the intersection of demand and supply curves and corresponds to the level of efficient tariffs. Efficient tariffs are those which provide any specified level of industrial production in the CU irrespective of the composition and distribution of this production, at the lowest cost in combined income foregone by the two countries (Cooper and Massell,1965b:462). The welfare implications of this analysis are best illustrated by the following diagram.

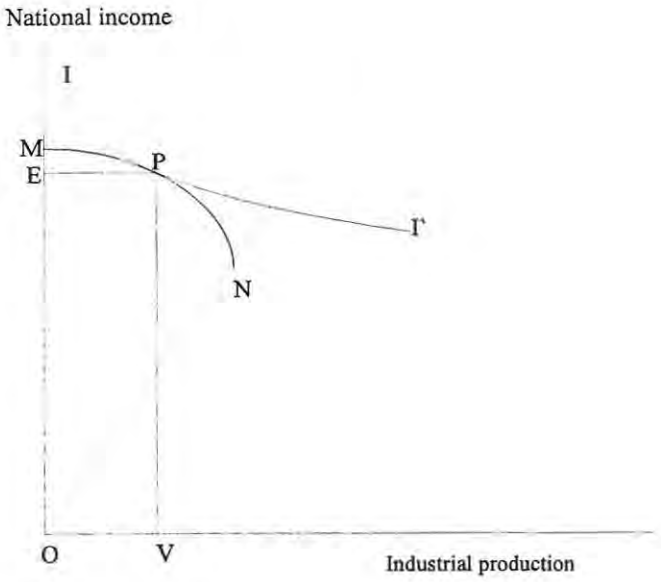


Figure 3.2:Preference for industry

Source: Cooper and Massell (1965b:465).

In the preceding diagram, MN is a production-consumption locus showing how much national income must be foregone to achieve alternative levels of industrial production, subject to the constraint that all industrial production is consumed locally. A downward movement along this curve corresponds to moving up the hierarchy of industries and increases the marginal cost of protection in discrete steps. At point N the economy produces industrial goods only, all of which are for domestic consumption, and national income equals industrial production (Cooper and Massell,1965b:464).

The indifference curve II' expresses the planners' preference for industrial production. This curve would be horizontal if the planners were indifferent between, say, corn production or industrial goods, with a corner solution at point M (and all resources devoted to corn production). The optimal point is realized at P, which is a combination of OV industrial goods, and corn output equal to OE-OV.

In this model, specialisation and efficiency can be demonstrated as follows. Assume that there are two countries, North and South, each with a development plan comprising a list of industries to be

developed during the planning period. Further assume that domestic demand is the same for each industrial product and is equal in both countries. In such a situation, formation of a CU between North and South results in a pooling of markets, and hence specialisation, so that each country produces a given level of industrial output at a lower cost in terms of income foregone. The level, composition and distribution of industrial production is determined by a CET for each item.

The choice of tariff is dependent upon the preferences of the planners; indifference on their part to the distribution of industries between the two countries means an efficient tariff is chosen. As a consequence of market pooling, income and substitution effects are realised. The former means the countries can produce the same combined industrial output originally planned and still have resources to spare. This causes an increase in industrial production and national income. A substitution effect is seen when there is a lowered marginal cost of protection resulting in increased industrial production at the expense of national income. Both effects combine to increase industrial production; national income will increase as well if the income effect outweighs the substitution effect (Cooper and Massell,1965b:464).

Relaxing the assumption of indifference by planners to the distribution of gains between countries, and presuming that planners are interested only in gains to their countries, the national level of social welfare is determined by the country's level of industrial production and national income, and is specified by a CET together with a rule for distributing income between the countries. When planners act rationally, and jointly choose the tariff and distribution of income, their decision results in a Pareto optimal situation. However, it is worth noting that an efficient tariff may be non-Pareto optimal for any distributive rule. Genuine Pareto optimality requires that each country take into account external diseconomies generated by its industrial production. This can be achieved by making each country pay full income compensation for the relatively high cost industrial goods sold in the partner's market (Cooper and Massell,1965b:466).

The curve (ML) shown below is an adjusted production-consumption locus, each point showing the income and industrial production available to South after deducting the increased cost imposed on

North. South pays no compensation if it has no industrial production, hence the adjusted locus begins at M.

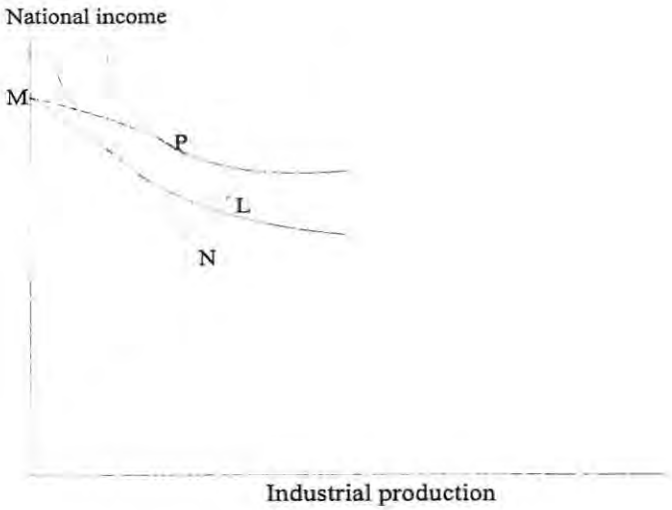


Figure 3.3: The adjusted production-consumption locus.

Source: Cooper and Massell, 1965b:473

But with South expanding output, the required compensation increases, so that the divergence between the adjusted and unadjusted loci widens. South can choose any point on the adjusted locus without affecting North. Point P represents a tangency solution, where South can do no better and North is indifferent between this and any other point.

It is also possible to form a partial customs union. This is an arrangement whereby two or more countries have a CET but not internal free trade (Cooper and Massell,1965b:472). This type of protection within a CU may allow for increased gains by members. In our two nation example, if South establishes all the industries on its list even though some of these industries are more economic in North, and assuming also that North chooses not to produce similar goods because they rank low on its list, if South sells the said goods in the combined CU market at compensatory prices, South is clearly no worse off. North gains since the total cost of producing a given amount of industry in the North is less than before the CU was formed. "These arrangements ensure that each country's

adjusted production-consumption locus lies outside the pre-CU locus" (Cooper and Massell, 1965b:472).

In considering whether or not there exist any tariffs that will make both countries better off relative to individually optimal policies of non-preferential tariffs, it is important to distinguish the following types. As noted earlier, an efficient tariff is that which provides any specified combined level of industrial production in the CU irrespective of the composition and distribution of this production, at the lowest cost in terms of combined national income foregone by the two countries. Quasi-Pareto optimal tariffs are those which, given the level of industrial production in each country, maximize the joint national income of both countries; these are designed to permit each country to produce any specified level of industrial production in the cheapest way. Pareto optimal tariffs, on the other hand, are a set of common external tariff rates which result in levels of industrial production in each country such that neither country's welfare can be raised without a reduction in the other country's welfare (Cooper and Massell,1965b:468). It follows that efficient tariffs are necessarily quasi-Pareto optimal, but not all quasi-Pareto tariffs are efficient, and genuine Pareto optimality requires choosing a quasi-Pareto optimal tariff. However, if left to market forces, each country will equate the marginal gain from industrial production to the marginal private cost, and thus a Pareto optimal tariff will not be chosen.

Cooper and Massell (1965b:464) argue that in this framework trade creation or trade diversion can either be good or bad. In the case of trade diversion, each economy expands its industrial production to supply the other's market. Trade diversion may thus be preferred to trade creation since it does not entail the loss of domestic industrial production. While national income may be decreased, without knowledge of actual indifference curves it cannot be said whether welfare is raised or lowered. They conclude that the potential gain from a CU would be larger if neither country dominated the other in industrial production. Case studies abound in the Third World where one member in the integration scheme has dominated the others. A good example is the now defunct East African Community, considered in Chapter 4. In such case studies, the backwash effect mentioned earlier concentrated benefits in the most industrialized member countries, simultaneously creating "poles of stagnation"

in the less developed partner states.

The Cooper and Massell (1965b) analysis is important in the LDC context, as it examines how membership of a CU may enable a country to lower the costs of protection. It also sheds a different light on the implications of trade creation and trade diversion when a union is formed.

3.5 Economies of scale in customs union theory

Orthodox theory assumes that the union supply price is increasing. Corden (1972) incorporated economies of scale (EOS) into customs union theory in a static analysis which retained most of the other assumptions of the traditional theory. The introduction of EOS gives rise to a number of problems and calls for some modification of the basic concepts of orthodox theory. It is vital to look into the possible benefits from EOS when a CU is formed, especially in the case of developing countries, since the creation of a regional market to exploit EOS is often given as a rationale for integration among LDCs. This was a notable omission in Cooper and Massell's (1965b) analysis of CUs among LDCs.

Consider a homogeneous product produced in the rest of the world and sold to countries H and P at constant costs (prices), but which H and P are capable of producing at decreasing average costs. Assume prices in H and P are above world prices and, in the pre-union situation, neither exports to the other. Assume that domestic prices are determined by the cost of imports from the rest of the world plus the tariff. Normally, local producers of import-competing products will place their prices at the upper limit (Robson,1987:36).

With respect to tariffs, assume that pre-union tariff rates are fixed at levels designed to make the tariff-inclusive price just equal to average costs, including normal profit, thus avoiding excess profits to producers. In this case, if there is no domestic production there will be no tariff. This is also referred to as made-to-measure tariff making, a term borrowed from the Australian tariff system. The figure below depicts demand and cost conditions in the domestic markets of the two countries.

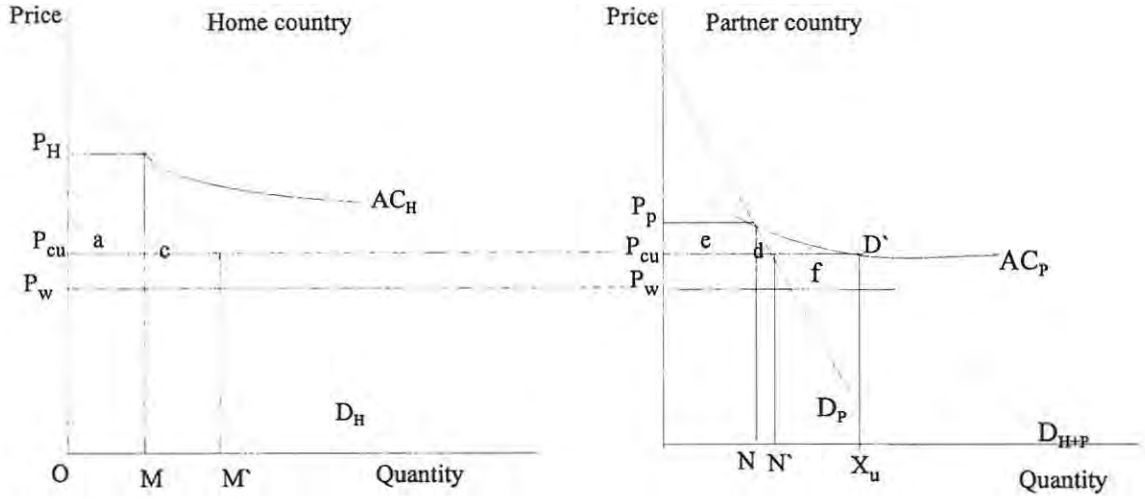


Figure 3.4: A customs union with economies of scale

Source: Robson, 1987:37

H represents the home country, P is the partner country. D_H is the home country's demand curve for the product and AC_H is the average cost curve. D_P and AC_P are the corresponding demand and cost curves in the prospective partner country. D_{H+P} represents the combined customs unions demand curve. P_w represents the constant price at which products can be imported from W (the rest of the world); terms of trade effects are thus ruled out. In the pre-union situation there are three alternative possibilities: production in both countries, in one country only or in neither.

If production is initially undertaken by both countries, H produces and consumes OM which is sold domestically at a price OP_H. A tariff of P_wP_H is required to make the industry viable. The more efficient partner country produces and consumes an amount ON at OP_P with a lower tariff P_WP_P. After formation of a CU, the more efficient producer P captures the entire market. Average costs of the producer in P when it supplies the whole market are less than the costs of the former producer in country H when it was supplying its own market, and the prevailing union price OP_{CU} will be lower than the initial domestic prices ruling in either country. The CET will thus be less than the initial tariffs, and consumers will gain from the formation of the CU (Robson,1987:36). The requirement

of the combined market, OX_u, would be produced by the partner country at price OP_{CU}, the required union tariff being P_wP_{cu}. Consumption in the home country increases to OM' and in the partner country to ON'.

It is apparent that country H's relatively expensive domestic production is replaced by a more efficient producer in country P. This amounts to an orthodox trade creation gain for country H. This trade creation gain comprises both a production effect, resulting from the replacement of dearer domestic products by cheaper imports from P, and a consumption effect resulting from increased consumption induced by the lower domestic price. The two are measured by areas a and c respectively (Robson,1987:36). There is also a cost reduction effect arising from P obtaining its own domestic supplies at a lower cost of production; this, however, is not orthodox trade creation as it arises from the cheapening of an existing source of supply. This effect can also be divided into production and consumption components, the former being the original amount of production sold domestically at a lower price (area e), while the consumption effect is the consumer surplus obtained when extra units are purchased at the lower price (area d). P also gains from its sales to country H at prices above those prevailing in the world market, represented by area f (Robson, 1987:38).

If, in the pre-union situation, there is production in one country only and that country is the more efficient of the two (country P in Figure 3.4), then it will probably capture the whole of the union market. Assuming that the pre-union tariff of country H was zero, if country P is to capture country H's market it must result from the latter imposing a tariff, that is, from the establishment of a CET, which implies an increase in the average level of protection. Therefore, the price to domestic consumers in country H will rise.

As a result of the switch from sourcing from the cheaper world market to a dearer source (P) within the CU, H experiences trade diversion. The resultant losses can be divided into production and consumption components. Less is consumed in country H, and it is obtained at a higher cost than before. There is also a loss in consumer surplus on the reduced amount of consumption induced by the higher price to consumers (Robson,1987:38). On the other hand, not only does P obtain its

product at a lower cost, realizing a cost reduction effect, but it also gains from sales to H at prices above those prevailing in the rest of the world.

In the event that initial production occurs in H, the higher cost producer, the established producer will probably be pushed out of business, causing product reversal. A trade creation gain accrues to H as it now obtains its requirements from a cheaper source (its partner); P loses out on cheap imports from W being replaced by expensive domestic production. This is because P's newly established producer is a higher cost source than W. This trade suppression effect is the result of a costlier source replacing a cheaper source, the former being a newly established domestic producer and not a source in the partner country.

Robson (1987:39) further argues that when there is initially no production in either country, formation of the CU may facilitate production in one country, say P, whose costs are still in excess of those of imports from W. Hence formation of a CU generates a trade suppression effect for P and trade diversion effect for H.

These scenarios highlight the fact that it is not possible on the basis of comparative static analysis to predict which of several alternative equilibrium positions will be attained in a CU. There is a possibility that the pattern of specialisation that results from trade liberalisation when economies of scale are present could be perverse. However, this problem need not prevent trade liberalisation from generating gains from specialisation, but might result in those gains being smaller than would be 'technically' feasible (Robson,1987:38).

In the preceding analysis, it is instructive that, in the presence of economies of scale, the orthodox concepts of trade creation and trade diversion remain relevant for an evaluation of customs unions. But the two concepts require some modification to take account of both trade suppression and cost reduction. This could be conveniently done through the extension of the two orthodox concepts to include the latter phenomena in the same way that the original Vinerian concepts were extended to include not only the production effects of CUs but also the consumption effects.

It is, however, noteworthy that the likelihood of monopolistic behavior in the presence of persistent and significant economies of scale may actually limit the gains for CU members, thus making free trade among them a necessary but not sufficient condition. Agreed specialisation involving planning and the supplementation of market forces may therefore be required to secure the gains from economies of scale in CUs. With regard to countries at unequal levels of development, Corden's (1972) analysis suggests that, in terms of the conventional criteria, both countries may gain: the small country from trade creation, the larger country from cost reduction. However, the smaller country loses its industry in this scenario, which may not be acceptable if industrialization is an objective.

Finally, it should be noted that Corden's analysis is limited in that it still considers only static effects, and still relies on the restrictive assumption of homogeneous products.

3.6 Customs unions and intra-industry trade

Robson (1987:41) argues that, irrespective of whether customs unions theory incorporates economies of scale or not, the analysis suggests that the formation of CUs will give rise to increased inter-industry or inter-sectoral specialisation among member countries. He observes that empirical studies of the trade effects of economic integration in Western Europe (Verdoorn, 1960; Balassa, 1966) did not wholly bear out these expectations. It was found that intra-bloc trade expanded markedly following the establishment of the CU in Europe, and that much of the expansion took the form of a kind of exchange until then hardly acknowledged in the literature, namely of the same or similar products, implying specialization within industries.

A later study, by Drabek and Greenaway (1984), suggests that by 1977, such intra-industry trade among the EC countries amounted to more than two-thirds of intra-EC trade. This component of trade was actually rising more rapidly than inter-industry trade (Robson,1987:41). While orthodox CU theory cannot encompass the phenomenon of intra-industry trade, as a country cannot both import and export the same product, with a relaxation of the assumption of homogeneous products to recognise product differentiation and the consumer's demand for variety (which constitute dominant

features of modern industry), a credible explanation of intra-industry trade can be offered. The existence of similar, and therefore competitive as opposed to complementary, production structures is seen as a necessary condition for intra-industry specialisation to arise (Robson,1987:43).

Krugman (1982) argues that the prospect of intra-industry specialisation and trade in differentiated goods creates the possibility for reciprocal tariff reductions to lead to increased sales within an industry by producers in a CU so that one country can expand both its imports and exports in a specific sector, which could ease the trade liberalisation process (Cattaneo,1998:132). Thus the welfare implications of such intra-industry specialisation within a CU may be worthy of consideration. The potential gains from increased intra-industry specialisation and from trade in differentiated products include (i) increased variety and EOS, and (ii) reducing the costs of adjustment to trade liberalization (Cattaneo,1998:139).

While it is generally argued that intra-industry trade is a feature of trade among industrial countries, studies such as Balassa (1979) and Willmore (1979) have found significant amounts of intra-industry trade in the intra-bloc trade of some developing countries. This would imply that intra-industry trade may therefore be a relevant issue in assessing prospects for gain in the developing country context. However, the crucial question would be whether such gains are likely to accrue in a regional union among countries like those in East Africa. This aspect is considered further in Chapter 6.

3.7 Summary

Orthodox CU theory assesses the merits of economic integration only on the basis of the balance between trade creation and trade diversion. The discussion in this section suggests, however, that there may be other considerations of importance, particularly when examining the developing country context. These may include a preference for industrial production and potential gains from economies of scale on integration. Furthermore, according to Robson (1987:198), the principal policy issues of integration among developing countries center on three factors disregarded by orthodox analysis. These include the determination in operational terms of the appropriate scope and direction of

regional trade, development and specialization, the issue of equity in the distribution of benefits, and policy towards foreign investment and multinational enterprises. These issues combine to produce a situation that dictates a different approach to integration among developing countries from what may be appropriate in advanced market economies. This suggests the need for a more positive integration strategy.

3.8 The development integration model

This model was developed in response to the shortcomings of traditional CU theory. It encompasses various ways in which economic integration may be implemented to take account of the peculiarities obtaining in the Third World, particularly differences in economic size and levels of industrialisation, and the political systems of member countries. The experience of the East African Community, considered further in Chapter 4, provided one concrete impetus for the shift of attention among scholars away from orthodox customs unions theory to development integration. An analysis of the performance of the East African Community demonstrates that, while trade diversion did occur, higher growth and development took place in the region than would otherwise have been the case (Ojo *et al*, 1985:161).

Theorists such as Nurkse, Myrdal, Prebish and Seers argued that there was a need to consider changes other than purely marginal ones within the existing structure, with the essential problem being one of fostering the structural transformation of participating economies (Robson, 1968). This view is what Robson calls the "dynamic" approach to integration, also referred to as the development integration model (Ostergaard, 1993:34).

The development integration model does not focus on maximising the efficiency of existing capacity. Instead, since most Third World countries have little productive capacity to start with, it focuses on how to stimulate the creation of such capacity. The model therefore links the theory of integration to the theory of development. One of its main characteristics is the conscious intervention by regional partners to promote cooperation and interdependence. As noted in Section 3.1, political union is the

final stage of the linear evolution of market integration. In development integration, however, political cooperation at a higher level is a prerequisite for the implementation of economic integration (Axline,1977:25). This implies a higher degree of state intervention than in the market integration model.

Moreover, it also implies a particular effort to secure an equitable distribution of the benefits of regional integration. As this involves redistributive measures of a compensatory or corrective nature, the development integration model is structurally more complex than the market integration model. It is noteworthy that some development integration schemes also address the condition of extra-regional dependence, which they perceive to be one of the principal obstacles to integration and development. Such schemes usually attempt to implement a regional policy regulating foreign investment.

At lower levels of integration, the distributional problem is addressed through compensatory measures. When certain agreements have been reached regarding a CET, a transfer tax system may be introduced to allow the less developed member countries to impose limited tariffs on imports from the relatively more developed partners. Theoretically, the transfer tax mechanism ought to lead to the expansion in less developed member countries of those industries for which the maximum permitted degree of protection would be sufficient to offset the cost advantages in more developed member states (Ostergaard, 1993:35). The resulting effect is similar to that of a partial CU, as suggested by Cooper and Massell (1965b), and considered in Section 3.4.

Budgetary transfer is another form of compensatory measure. This is calculated on the basis of the cost of trade diversion or lost customs revenue. This type of compensation has been used of Southern African Customs Union (SACU) and the Communaute Economique de l'Afrique de l'Ouest (CEAO). It has, however, been a source of disagreement within SACU between the smaller partners and South Africa. It has indeed been argued that fiscal transfers constitute the least satisfactory method of compensation in a regional arrangement (Vaitsos,1978:749).

Corrective measures are applied to cater for the distributional problem at a higher level of regional integration. These include planned regional industrial development that favours the less developed countries. Such industrial planning may allocate basic industries to each country on the basis of comparative advantage. These industries are then designed to supply the needs of the entire regional market with the aim of reaping economies of scale. Other corrective measures include funds or regional development banks that give priority to loans to the less developed countries, a longer time for less developed partners to effect tariff reductions, and the creation of common fiscal incentives to investment which would enable such countries to offer favourable terms. The development integration model, however, requires a much higher level of commitment within and among member states than in the case of market integration, making it difficult to implement in practice (Ostergaard,1993:36).

The experience of the East African Community, considered in Chapter 4, demonstrates that transfer taxes may not solve the problem of uneven gains from integration. Moreover, the transfer tax system may actually encourage uneconomic duplication of previous investments (Hazlewood, 1979:45). As noted above, budgetary transfers are considered an unsatisfactory method of compensation and have failed, for example, to address the concerns of the smaller SACU members about an unequal distribution of benefits in the grouping. Furthermore, in spite of Botswana, Lesotho, Namibia and Swaziland receiving substantial customs revenues as a result of the compensatory formula within SACU, industrial investments, both internal and external, have in the past flowed disproportionately into South Africa, the most developed member of the union. The apparent polarization of benefits creates discontent among the partner states within SACU (Ostergaard,1993:36).

The discussion above suggests that compensatory measures like transfer taxes and budgetary transfers may not rectify the problem of uneven economic development. A satisfactory long-term solution to the distributional problem may be achieved only through corrective measures, despite their own limitations. Apart from the possible positive effect that foreign investments may have on the balance of payments, the establishment of new industries generates employment and various multiplier effects like improved local skills, technology and infrastructure. This may serve to attract further investment.

These issues are considered further in Section 3.11 below.

3.9 The neofunctionalist integration model

Neofunctionalism has its roots in the functionalist theory of regional integration discussed in Chapter 2. One of the main problems of the functionalist model is its assumption of the separability of politics and economics in the functions of the state. To Mitrany (1933), one of its major proponents, political divisions could be neutralized under a spreading web of international economic and social activities. However, it is quite difficult in practice to divorce economic and social issues from political problems. Claude (1971) maintains that "states cannot be induced to join hands in functional endeavors before they have settled the outstanding political and security issues which divide them" (cited in Ostergaard,1993:39). In less developed countries it is even more difficult to separate the two fields due to weak class formation and the limited role of interest groups. Many less developed countries lack a powerful middle class with the capacity to lobby and win support for such schemes.

During the 1950s, Haas (1958:313) formulated a modified version of Mitrany's (1933) functionalism. This neofunctionalist theory differs from the functionalist model in that it does not presuppose the separation of politics from economics. It represents an ingenious combination of the method of functionalism with the ultimate objective of federalists. It borrows the postulates of actor perception and behavior held to be characteristic of pluralistically organised nation-states (Haas, 1971:19).

In the neofunctionalist integration process, rather than government being seen to play the central role, the interest groups and integrationist technocrats are the important actors. Although neofunctionalists concur with functionalists that international cooperation be initiated in the technical or basic functional areas, they nevertheless differ on the issue of the spillover of benefits from the success attained. This spillover mechanism works as follows: once sectoral cooperation has been achieved in one area, the resulting imbalance will create pressures for the initiation of integrative activities in other areas to offset the imbalance.

Integration in functional areas simultaneously results in various political spillover effects. As functional sectors merge at the regional level, a concern naturally develops over the political techniques that would be appropriate for the control of new and larger problems of integration. Ultimately, those groups which have positive long-term expectations will look to supra-nationalism to achieve their goals. Interest groups will cease to place their demands at the national level when they realize that they can be met more effectively at the regional or supranational level (Ostergaard, 1993:40).

It has been argued that neofunctionalist integration has an advantage over the market integration and development integration models because its sector-by-sector approach minimises the problem of cost and benefit distribution among member states. It also circumvents the problems inherent in the ceding of powers from the national level to supranational institutions. However, its strong Eurocentric nature limits its applicability in other parts of the world (Ostergaard, 1993:41).

The neofunctionalist model is thus embedded in the modern, pluralistically organized industrial societies of Western Europe. For this model to work, effectively working modern associational pluralism is required which includes functionally specific, universalistic achievement-oriented groups, such as interest groups and political parties. In Africa, the absence of pluralism makes the formation of voluntary groups on a regional basis very difficult. Indeed, the absence or weakness of modern associational groups makes integration more difficult by depriving regional bureaucrats of potential allies. Interest groups and political parties can in principle free government decision-makers to formulate integrative decisions by making it politically legitimate to arrive at regional rather than nationally-focused decisions. The absence of such groups further deprives governments of useful channels of information in the formation of economic policy.

Moreover, as Ravenhill (1980:48-50) points out, low levels of development also preclude the emergence of interest groups, which are arguably the major force in the neofunctional integration process. In absence of interest groups, heads of states become supreme decision-making authorities. Therefore, "regional integration in Africa often stands and falls with the maintenance of cordial

relationships between the personalities concerned" (Ravenhill,1980:50). Nowhere is it fully insulated from the instabilities of domestic politics and contentious inter-state disputes.

3.10 Which paradigm for African countries?

From the foregoing analysis, it may be contended that most of the theoretical models of economic integration are inspired by the European experience and its special circumstances, and cannot therefore be wholly transferred to the African setting. To begin with, the market integration model is too narrowly focused on the elimination of intra-regional barriers against the market mechanism, and its static assumptions are highly unrealistic, particularly in the African context. On the other hand, the development integration model depends on high level political cooperation as a prerequisite for its implementation. Political cooperation of this nature has always been elusive among many less developed countries if not altogether nonexistent.

Heads of state cannot guarantee that their governments, private sector entities and general population can act in a manner that would help fulfil the regional objectives agreed upon. African states are perhaps too weakly integrated nationally to offset the disruptive forces inherent in a regional scheme among developing countries at uneven levels of economic development. While it holds more promise in its pure European-derived form, Ostergaard (1993:46) argues that the neofunctional model relies on national and regional interest groups which are not yet prevalent in most African countries. It is integration from below that might be the only viable basis on which to foster regional integration, but the challenge remains that of building firm and effective support and participation at the grassroots.

3.11 The viability of integration among countries at unequal levels of development

As observed in Section 3.8, in a customs union or common market, uniform external tariffs can generate spread effects from more advanced centers to lagging regions and to the whole integrated area. In addition to the diffusion of technology, these effects may include factors such as an increased demand for imports generated by the growth of the more developed centers. If these effects are

sufficiently strong, all countries or regions will benefit from growth at the center. Thus dynamic external economies may constitute an argument for a common external tariff between countries at different levels of development (Lundahl and Petersson, 1991:202).

However, if they are to justify integration from the point of view of individual countries, the favorable spread effects must outweigh the unfavorable effects that may result from polarization. Because of differences between regions with respect to their attractiveness for labor, capital and entrepreneurs, the development of industrial production can be concentrated in some regions in the more advanced countries to take advantage of external economies in these areas and to have plants closer to the major markets. This concentration of industries could lead to a cumulative worsening of the relative or even absolute economic position of a member country or some regions in the integrated area. This may be referred to as the polarisation effect of integration (Robson, 1987:63).

General conditions must be conducive to industrial development in the whole CU area. There is no guarantee that all countries in a CU will be in a position to exploit the possibilities created by the enlarged market. Besides, potential investors may not be indifferent between the countries in the CU area. They may regard the domestic market as being of primary importance and they may also take into account the possibility that the CU may come to an end at a future date.

The distribution of benefits from dynamic external economies between the members of a CU depends on the location of expanding or newly established industries. Thus, in cases where a CET results in the polarisation of production in the CU area, dynamic external economies may contribute to a worsening of initial disparities over time. Through internal and external economies the more developed country may secure permanent monopolies with free trade and free factor movements.

In a CU between unequally developed partners, polarisation will also be reinforced from the demand side. Foreign goods may have an established reputation, particularly in the less developed regions of the union, so that consumers prefer imported goods even if there is no price or quality difference between domestic and foreign goods (Lundahl and Petersson, 1991:204).

When cumulative growth occurs in one area at the expense of the others, it is possible that such an area may attract skilled labor, entrepreneurs and capital from the weak regions leaving the latter with fewer resources for development and a reduced possibility of sustaining a viable regional economy. The cumulative forces are more important in unions of poor countries or countries at different levels of economic development (Lundahl and Petersson, 1991:206).

However, at a later stage of agglomeration both private and social costs are likely to increase. Further growth and increased population strains dwelling facilities and utilities in dynamic regions and towns. This may give rise to higher costs for city dwellers in general, such as more time-consuming travel and increased costs of urban flats. Social investments have to be enlarged in these regions while existing facilities in depressed areas are less fully utilized. The costs may thus outweigh the benefits of further concentration. This is likely to lead to industrial decentralisation, and it is argued that the spread of momentum from the centers of economic expansion to other regions in the end outweighs the polarisation effects (Lundahl and Petersson, 1991:206). This kind of trend may, however, be either too painfully slow or totally unacceptable to the less developed countries, hence the need to address the inequality by other means.

As noted in Section 3.8, there are various mechanisms that may be employed to offset unequal gains from integration and possible polarisation effects. Compensatory mechanisms entail taking certain measures to transfer some of the gains of integration from those countries that benefit more to those who benefit less or even suffer net losses. This may include the collection and sharing of customs revenue in accordance with a pre-negotiated formula which favors the disadvantaged or may be in the form of the transfer tax which provides revenue to the relatively less developed countries. (Ojo *et al*,161:1985). Furthermore, measures may be employed which aim at promoting industrialisation and development at the poles of stagnation, and thus correcting the underlying cause of polarisation and unequal gain.

It has been argued that the most effective corrective measure, at least in theory, is the planned regional industrial development program. Robson (1987:202) suggests that the choice of corrective

measure lies between income transfers and instruments to effect a change in the emergent patterns of resource allocation, trade and development, which income transfers cannot do. The objective of these policies is to bring about profitable specialization, subject to the requirements of balanced development. However, industrial location is seen by participants as a zero-sum condition ("a winner takes all attitude" that encourages wasteful competition) and this presents the most significant and divisive issue in the integration process. Regional industrial planning depends to a great extent on the relative strengths of the respective economies (Ndlela, 1987). Industrialists often seek to influence their governments to pursue regional policies that suit their particular interests. Even so, the more developed countries in a group are likely to pursue an "expansive" strategy aiming principally at an absolute increase in gains among member states, whereas the less developed countries are more prone to favour a " distributive" strategy which determines in advance the distribution of any gains from integration.

Vale (1982:33) argues that " the political practitioner has always to be conscious of the necessity to balance a commitment to the common (integrative) endeavor against the need to account to his constituency - local or national". This statement clearly underscores the trade-offs that have to be taken into consideration in any integration scheme. Ravenhill (1980:229) observes that "regional integration is frequently without enthusiastic domestic proponents; for politicians concerned with their national constituencies there are few rewards at the regional level, at least in the short term - the time horizon with which they must of necessity be concerned". Clearly, then, national politicians are reluctant to give up immediate national interests in favor of the regional agenda.

Even where agreements are reached on the allocation of industries within a region, rarely are they implemented. Quoting Omotunde (1991:10) on a recent survey of economic integration in Africa, Ostergaard (1993:37) points out that when national politicians cannot get what they want through industrial planning negotiations, "they are likely to ignore any integration agreement they may have signed". Mutharika (1981) also argues that the implementing institutions in member states are geared to national, not regional goals. Furthermore, large organizations function according to individual, time-tested patterns, which do not automatically change with a signature on a regional industrial

agreement. It is also noteworthy that national bureaucrats often lack an understanding of the content and scope of decisions on regional industrial programs. Red tape and inefficient administrative structures further militate against the implementation of regional agreements.

Regional planners of industrial development also tend to ignore the role of foreign transnational corporations (TNCs). These may promote regional integration of the market type if national markets are fairly small and if such firms were not involved in these countries through parallel foreign direct investment prior to regional cooperation. However, if such TNCs have subsidiaries with parallel activities in some of the national host markets, it is likely that they would oppose integration. This is because TNCs typically operate under licensing arrangements which grant them a supply monopoly of a particular commodity (Ravenhill, 1980). Such TNCs therefore tend to oppose integration and prefer to trade with the parent corporation and reap monopoly benefits in each of the protected national markets.

Robson (1987:72) adds that if transfer prices are used for such purposes as to cross-subsidize a subsidiary in order to eliminate local competitors from entering, their manipulation must be expected to affect not only trade patterns but also the character of industrial production, static and dynamic efficiency and the intra-regional distribution of benefits from integration. Generally, TNCs resist measures which hinder the operations of their subsidiaries, such as government intervention in the field of industrial planning.

However, foreign direct investment in Africa is limited, so other external actors also exert a considerable effect on integration. Through the disbursement of development aid and loans, various donors and lending institutions have had a considerable influence on some integration schemes in Africa. In the on-going structural adjustment programmes, the World Bank and the IMF may have influence in the regional integration schemes in which individual states participate. In line with SAPs, the World Bank is in favour of a type of regional integration that promotes cooperation in specific functional areas as well as the creation of a supportive environment for private capital (Ostergaard,1993:37). Among the Southern African countries, the World Bank (1991) appears to

support integration in the belief that this would facilitate multilateral trade liberalization, rather than because of the likely benefits of regional integration as such (Cattaneo,1998:67).

Besides industrial planning, there are other, less controversial corrective measures such as regional funds and development banks. In the East African Community, the East African Development Bank (EADB) was formed to promote industrial development through financial and technical assistance. The arrangement was designed to give priority to industrial development in the relatively less developed partner states and to finance projects that would make the economies of the member states increasingly complementary in the industrial field (Robson,1968). However, due to its limited scale of activities the Bank was not very effective. Furthermore, as Hazlewood (1979:45) points out, without some measure of agreement between the member states on a pattern of industrial specialization, a regional development bank alone cannot be expected to act as a catalyst for complementary industrial development. However, such banks still have potential as corrective tools, as evidence from the EU indicates (Ostergaard,1993:38).

Granting the less developed countries a longer time to abolish tariffs or even granting them outright exemptions from a possible regional investment code may not solve the problem. Factors other than protection determine whether investors decide to locate an industrial investment in a given country; business environment, government attitude and markets rank high among those considerations (Ostergaard,1993:39). Political stability also remains a major determinant.

3.12 Conclusion

The analysis of the various theories of economic integration in this chapter reveals the limited relevance of market integration in the less developed country context. Furthermore, it highlights the fact that economic integration among less developed countries is mainly a policy response to developmental problems. Therefore, rather than qualify or disqualify economic integration on the basis of static gains, the dynamic gains of integration should also be considered, as they are probably more important in arriving at an accurate assessment. The evaluation of economic integration

schemes must not be limited to the orthodox theory's analysis of the welfare implications of trade diversion and trade creation. A full evaluation must take into consideration other concomitants of economic integration, including the gains arising from economies of scale and the potential increase in intra-industry trade within a CU. Increased intra-industry specialization may generate significant welfare gains ignored in the orthodox analysis.

The alternatives to the traditional theory of economic integration, namely the development and neo-functional integration theories, have also been analyzed in terms of their merits and weaknesses. Out of this analysis emerges the special difficulty in prescribing an absolutely perfect blueprint for economic integration among less developed countries. While it is true that the two alternatives appear to offer a more relevant approach for less developed countries than market integration theory, it is also significant that much social-economic and political re-adjustment would be required before they could take effect. Both development and neo-functional integration theories appear to presume a substantial political will, a vibrant civil society well versed with and supportive of economic integration endeavors and, most of all, a high degree of organisational dynamism aimed at effectively addressing potentially disintegrative tendencies.

Indeed, if economic integration is to endure, it must not only result in a situation that improves allocative efficiency and growth, but it must also be perceived to be equitable. If the market itself cannot be relied upon to produce such an outcome, corrective policies will have to be employed to promote balanced development, and appropriate instruments will have to be devised to implement them (Robson,1987:41).

In the following chapter, the focus of the study will shift to an analysis of the defunct East African Community, and pre-1980 integration efforts in East Africa in general, drawing on some of the lessons from theory which have emerged in the present chapter. The analysis will facilitate a comparison between the now defunct East African Community and its successor, the East African Cooperation (EAC), in terms of how they differ in structure and overall outlook.

CHAPTER 4: PRE-1980 INTEGRATION EFFORTS IN EAST AFRICA

4.1 Introduction

This chapter reviews pre-1980 integration efforts in East Africa. The aim is to trace the origins of economic integration in the region and demonstrate the extent of its development up to the late 1970s. The chapter will also analyze the suggested causes of the failure of these efforts. This review is important for the purposes of comparing the approach adopted at that time with that being used for the new initiative of the EAC. This comparison will help in the identification of any changes in strategy aimed at making the new initiative more successful and sustainable than the defunct East African Community.

4.2 Historical background

East Africa, comprising the three countries of Kenya, Uganda and Tanzania, occupies an area of about 1.8 million square kilometers, stretching some 1,300 square kilometers from the Indian Ocean to the Ruwenzori Mountains and the Great Lakes in the west, and for over 1,600 kilometers southwards from the borders of Ethiopia and the Sudan to Mozambique. The region has a wide range of geographical conditions in terms of altitude, temperature and rainfall, which affect the distribution of the population and the character and location of economic activity. The coast, central and Lake Victoria regions of Kenya are densely populated, while most of the rest of the country remains sparsely settled. In Tanzania, the population is more evenly distributed while in Uganda most of the people live in the central and the southern regions around Lake Victoria.

Interactions among the people of East Africa and between them and the outside world can be traced back to long before the Europeans ventured into the interior of East Africa in the last decades of the nineteenth century. The population distribution at the time was the result of great movements of people over Eastern Africa which had occurred in the past and were continuing (Hazlewood,1975:1). There had been trade between the Africans in the interior and the Arabs travelling to the coastal region to trade in, *inter alia*, ivory, guns and slaves. However, it was not

until the arrival of the Europeans that East Africa became defined as a single entity.

The British were at first interested in Uganda, which they brought under their control in the 1890s. One possible reason for this interest was their desire to secure the source of the Nile River whose waters were, and continue to be, the life line of Egypt, then one of their colonies. To further their interests, they began the construction of the Uganda railway from Mombasa in 1896, completed in 1902. This not only facilitated development in Uganda, but also made practicable and provided an important incentive for the encouragement of European settlement in Kenya as a way of occasioning development and traffic along the railway line. With the growth of the settler community, Kenya began to acquire a dominant position in East African affairs (Hazlewood,1975:1).

Meanwhile, the Germans effectively lost control of the former Tanganyika to the British as a punishment by the League of Nations for their role in the First World War. Henceforth, until independence was attained between 1961 and 1963, the three countries were under the administration of the same colonial power. This was a fundamental factor contributing to the establishment of the common institutions and regional arrangements with which part of this chapter is concerned, and to their development on an *ad hoc* basis without a constitutional framework.

It is noteworthy that, although the three countries fell under the same colonial power, their economic development did not conform to a single pattern. The monetary economy of Uganda developed on the basis of production by African farmers, particularly of cotton and coffee. There were few settlers and few estates. In Tanganyika, estate production, particularly of sisal, African farmers' production of coffee and cotton, and European mixed farming all became important in the monetary economy. In Kenya, the structure of the monetary economy was, to a major extent, determined by the existence of relatively large numbers of European settlers. A substantial part of the economy's agricultural output was produced on European-owned farms and was for domestic consumption, whereas African monetary agriculture, which was predominant in other territories, particularly in Uganda, was largely for export (Hazlewood, 1975:2).

In Kenya, agricultural production mainly took place through wage labour rather than small farmers. In contrast to Uganda and Tanganyika, Kenya was less export-oriented to markets outside the region, and the country's deficit in external trade was largely offset by surpluses in its trade with Tanganyika and Uganda, which mostly consisted of manufactured goods. The high import bill that accrued to Kenya was mainly a consequence of the high propensity to import by Europeans and other high-income residents and the in-flow of capital to the country. Kenya also had an important entry port, and handled a larger proportion of the trade to and from Uganda and most of the northern part of Tanganyika.

While agriculture was a less important component of the monetary economy in Kenya than in its partner countries, the country's services and manufacturing were more advanced (Hazlewood, 1975:3). Administration and commerce were more highly developed than elsewhere in East Africa, and there was a well established system of agricultural marketing and processing institutions including, *inter alia*, the Kenya Dairy Board and Kenya Co-operative Creameries. All of these were directed to serve the European farmers. Asians, on the other hand, played a leading role in commerce in all three territories, but were more numerous in Kenya than elsewhere, adding to the economic impact of the European population.

These influences on the structure of the Kenyan economy contributed to the country's development as a supplier of both goods and services to the whole of East Africa. Indeed, to companies operating throughout East Africa, the capital of Kenya, Nairobi, appeared to be the natural location for their headquarters. Similarly, it appeared the natural location for most of the headquarters of the various inter-territorial services that were established (Hazlewood,1975:3). The effect was cumulative: because of the growth of Nairobi, originally a railway construction camp, as the commercial and administrative capital of East Africa, the number of Europeans and other high-income residents increased, further reinforcing its natural attractions. To date, Nairobi remains a major international centre, hosting two important United Nations agencies and numerous regional headquarters of various international organizations.

As Hazlewood (1975:3) notes, in spite of the seemingly numerous sources of aggregate national income, the higher income *per capita* in Kenya was " an arithmetical consequence of the large

number of non-Africans". Generally, African incomes in Kenya were no higher than elsewhere in East Africa, and almost certainly lower than in some parts of Uganda. In fact, labour flowed out of Kenya to the rest of East Africa, and to Uganda in particular. In all three countries, the great bulk of the population consisted of African farmers producing largely for their own subsistence, partly because of the colonial regulations that prohibited the indigenous people from engaging in cash crop farming.

The tables in **Appendix II** illustrate some of the characteristics of the East African economies considered above, both at the end of the colonial period and after ten years of independence. Notable changes occurred in this period, such as the greatly diminished importance of European agriculture in Kenya, with the transformation of many farms into African small holdings and the expansion of cash crop production in traditional African areas. A striking feature is the extent to which Kenya maintained its position in the East African economy. Kenya's GDP, at 243 million pounds in 1961, more than doubled to 576 million pounds in 1971. Uganda and Tanzania, while experiencing a remarkable growth in GDP, did not perform strongly enough to narrow the gap substantially.

During the same period, primary production as a percentage of total GDP continued to decline as manufacturing picked up rapidly in all three countries, especially in Uganda and Tanzania. In 1961, manufacturing contributed only 4 percent to the GDPs of both Uganda and Tanzania while, by 1971, it had grown to 8 and 10 percent respectively for the two countries (Hazlewood,1975:4).

With this general overview of the East African economies in the period up to 1971 as background, the focus of the discussion will now turn to the origins and development of East African integration.

4.3 The origins of the East African Community

The customs union (CU) between Kenya, Uganda and Tanganyika came into existence in stages over a considerable period of time. A CU between Kenya and Uganda was fully established in

1917, bringing about a single customs administration for the two territories. Tanganyika joined the union ten years later, but maintained a separate customs administration until the beginning of 1949 (Hazlewood, 1975:21). Originally, a huge part of Uganda's imports passed through Tanganyika (then German East Africa) and were not subject to duty as they were regarded as goods in transit. They were, however, subject to duty once they reached Uganda. On the other hand, imports into Uganda passing through the Kenyan port of Mombasa were liable for import duty which would not, however, be levied again upon arrival in Uganda. After completion of the Uganda railway, most Ugandan imports started coming through Kenya, Uganda's own customs collections declined, and it was not until 1909 when an attempt was made to transfer some of the revenue from Kenya.

Initially, the amount transferred was determined annually, but it was agreed between 1911 and 1915 that Uganda would receive 25 per cent of the revenue collected at Mombasa. This percentage was raised to 33 per cent in 1919. In 1927, the CU was further modified through a new arrangement which provided for, *inter alia,* the allocation of customs revenue between the territories on the basis of 'derivation', that is, according to the territory of ultimate destination, with the allocation based on transfer forms which were returned to the customs administration when goods were moved between the territories. Provision was further made for free trade between the three territories in products of East African origin and, from 1949, a common customs administration. There was also "free movement of capital and substantially free movement of labour" (Hazlewood,1975:23). At this early stage, then, arrangements between the three territories closely resembled those of a formal common market.

In 1948, a quasi-federation between the three countries was established with the CU and a number of common services such as the East African Railways and Harbours Administration, the East African Posts and Telecommunication Administration, and the Agricultural and Medical Research Services. Furthermore, a High Commission comprising the Governors of the three territories, with a Secretariat manned by technocrats with region-wide outlook and expertise, coordinated the common services. There was also a common legislature, although its authority over the regional institutions was limited, not only because it had no legislative competence over significant areas of regional activity like regional planning or fixing of tariffs and customs rates,

but also because of its perceived disproportionate representation to the disadvantage of the indigenous people (Hazlewood,1975:23).

The quasi-federal system was reconstituted in 1961, partly because of Tanganyika's independence that year and partly because of Ugandan and Tanganyikan resentment of the disproportionate benefits accruing to Kenya in terms of growth in GNP, foreign investment and international trade, as well as the location of the common services headquarters in Nairobi (Ojo *et al*, 1985:157). In the same year, the East African Common Services Organization (EACSO) was introduced, under which the High Commission was replaced with a Common Services Authority composed of the three elected leaders of the territories. The Authority was assisted by four ministerial committees and a revamped Central Legislature with wider legislative competence.

The problem of the perceived inequitable distribution of benefits was partially settled by setting up a distributable pool account into which a fixed percentage of customs and excise duties as well as corporate income taxes collected by each territory was paid. Fifty per cent of the proceeds were retained by the Authority to operate the common services while the balance was shared equally among the member states. Since Kenya contributed the biggest amount of the proceeds, the distributive formula clearly put the other two territories at an advantage and thus partially redressed the inequality about which they had previously complained. However, the problem of locating the EACSO headquarters in Nairobi remained a potentially disruptive issue.

The fact that EACSO was conceived as a transitional organization to be superseded by a federation when Uganda and Kenya attained independence appeared to contain the issue, at least in the short run. However, the anticipated federation failed to materialize. Negotiations for its establishment broke down in 1963, largely because Uganda opposed the high degree of centralization its partners wanted built in. This threatened the very existence of EACSO. A number of regional institutions were already beginning to break down. The East African Navy had disbanded in 1961, followed by Ugandan withdrawal from the East African Tourist Travel Association in 1963. In June 1965, the dissolution of the East African Currency Board was announced, as members opted for individual national central banks and currencies.

The perception of unequal gains was also still a major issue. Although the Tanzanian and Ugandan economies expanded at a faster rate than Kenya's, they accused the latter of getting a disproportionate share of the benefits on account of its inter-territorial trade surpluses and its industrial expansion. Ojo *et al* (1985:158) point out that an *ad hoc* arrangement drawn up after meetings at Mbale and Kampala failed to redress the situation. The agreement reached at Kampala provided that certain industries, such as tyres, bicycle parts and fertilizer manufacture, be exclusively located in Tanzania or Uganda. It further permitted the two countries, through the agency of a regional quota committee's authorization, to institute quotas on Kenyan products like beer and galvanized iron. Kenya not only failed to ratify the agreement, but went on to set up a tyre factory in its territory, causing Tanzania to impose unilateral import quotas and other restrictions on Kenya's products. A commission comprising three ministers from each state, headed by UN expert Kjeld Philip, was appointed to negotiate what was envisaged as a permanent solution. The outcome of the ensuing negotiations was the drafting of the Treaty of the East African Community whose main features are discussed below.

4.4 The Treaty of the East African Community

By 1967, just a few years after independence, the East African Community was formed by a treaty that came into force that same year. It marked what appeared to be the final stage in the efforts to foster regional cooperation in British East Africa (Ojo *et al*, 1985:157). The process had its origins in British colonial measures to promote more unified administrative control over the East African territories with the establishment of the Court of Appeal for East Africa (1902), a postal union in 1911, the customs union in 1917 and the East African Currency Board in 1920.

The Treaty was signed in June 1967 and came into force on 1 December of the same year. It placed the CU and the common services within one framework and gave the former a solid legal foundation. More importantly, it made provisions aimed at achieving an equitable distribution of cost and benefits, and created a number of Community organs to coordinate activities and provide executive direction. Each state appointed a Community minister charged with promoting the Community's interests, projects and viewpoints in his or her own Cabinet. This renewed effort by independent African states to create an economic community lasted ten years. By 1977,

the EACSO had collapsed, the Kenya-Tanzania border had unceremoniously been closed halting all official economic interactions, and Tanzania had engaged in border clashes with Uganda culminating in a full-scale war in 1978-79 which ended with the overthrow of Idi Amin's regime.

More often than not, the acrimonious collapse of the East African Community dominates most of the literature on this integration scheme, creating an erroneous impression that little was achieved besides the seemingly unending bickering. On the contrary, much was achieved in terms of economic growth and the development of the region, and at its collapse the East African Community was probably one of the most organized and integrated economic blocs among Third World countries. The value of inter-state trade in local manufactures of East African origin was 24 percent greater in 1973 than in 1967 (Hazlewood,1975:108). In 1967, it had been at the same level as in 1964. Total exports of manufactures (at constant prices) from Tanzania to Kenya were 57 million shillings greater in 1973 than in 1957. Furthermore, exports of cotton fabrics from Tanzania to Kenya were larger in 1973 than in 1967, but had been even larger in 1971, and fallen by two-thirds to the 1973 level. If they had remained at the level reached in 1971, the total increase in exports of manufactures from Tanzania to Kenya between 1967 and 1973 would have been as much as one-third greater than that actually achieved (Hazlewood, 1975:113). This increase in trade had a positive impact on job creation, skills development and welfare.

Generally, in spite of the problems that beset the East African Community, there were impressive growth achievements that were clearly a result of regional cooperation. Kenya, in particular, being the most developed of the three countries as a result of a deliberate colonial policy in favour of the white settlers, continued to develop and gain more. The common external tariff (CET) helped to protect Kenya's industries against competition from outside the Community, and guaranteed it a ready market in Uganda and Tanzania. Unfortunately, the latter countries, with fewer and less efficient industries, could not effectively compete with Kenya. They often had to buy Kenyan products at relatively higher prices than they would have had to pay had the CET not effectively shut out similar products from outside the Community (Ojo *et al*, 1985:159). Moreover, they had to forego the revenue from import duties they would have collected had they imported from the rest of the world (see Section 3.2).

In addition, foreign companies wishing to avoid the CET by establishing industries within the Community preferred to invest in Kenya, which already had a large manufacturing base and a better infrastructure. Net foreign private capital inflow into Kenya between 1969 and 1976 was $184.9 million compared with $95.9 million and $31.0 million for Uganda and Tanzania respectively (Mazzeo, 1980:103). Although Kenya's GNP was growing at about the same rate as that of Tanzania, Kenya dominated intra-regional trade, accumulated trade balances against its partners and widened the industrialization gap among them.

Kenya's share of intra-regional trade (at constant prices) climbed from 63 percent in 1968 to 77 per cent in 1974. Tanzania's share rose from 11 per cent to 17 per cent in the same period, while that of Uganda declined from 26 per cent to 6 per cent. Kenya's trade balance against Tanzania and Uganda steadily rose from 280 million shillings in 1968 to 749 million shillings in 1976 (where 1shilling=$0.14 during that period) (Ojo *et al*, 1985:161). By contrast, Tanzania ran a trade deficit against both its partners, amounting to 187 million shillings in 1969 and deteriorating to 221 million shillings in 1976. The Ugandan case was even worse, because its deficit of 59 million shillings in 1967 increased to 528 million in 1976. Significant from the point of view of the industrial gap between the partner countries was the fact that the share of manufactured goods in Kenya's intra-regional exports increased from 87 per cent in 1971 to 89.6 per cent in 1975, while the share of manufactured goods in Tanzania's intra-regional exports declined from 68.6 per cent to 61.1 percent and Uganda's slumped from 84.9 per cent to 41 per cent over the same period (Ravenhill, 1980; Mazzeo, 1980). These trends, which largely favoured Kenya, contributed to the problem of unequal gains which was to be a major factor in the eventual disintegration of the East African Community.

4.5 The causes of the collapse of the East African Community

Several factors account for the disintegration of the East African Community. While some arose out of ideological differences, others are of a fundamental nature in that they appear to afflict all integration schemes in the Third World (Ojo *et al*, 1985:158). Hazlewood (1979:40) in fact argues that it is possible to interpret the establishment of the Community not as a stride forward in cooperation but as a stage in a process of disintegration. Indeed, there had been a closer

integration of the economies of the three countries before independence and the subsequent Treaty. As discussed in Section 4.3, integration arrangements before 1967 had comprised a customs union with a common external tariff and free trade between the countries, common transport and communications services (railways, harbours, posts, telecommunications, airways) a common university, common research services and a common currency. However, by the time the Treaty was signed, the common currency had been abandoned due to a failure to find an acceptable system of East Africa-wide central banking, and the operation of the customs union was being seriously inhibited by quantitative restrictions.

As illustrated in Section 4.4, perhaps one of the most disruptive controversies that beset the East African Community was dissatisfaction about the distribution of the benefits of integration. It was firmly believed in Tanzania and Uganda that the arrangements worked overwhelmingly to the benefit of Kenya. Being the most industrially developed country of the three, and hosting the headquarters of the various common services, the employment and income-creating benefits of the services were believed to accrue mainly to Kenya.

As noted in Section 4.3, the 1961 settlement which established the East African Common Services Organization to replace the High Commission of colonial days provided for a redistribution of revenue in favour of Tanzania and Uganda. However, this proved an inadequate measure and restrictions began to be imposed on trade between the countries. Plans to establish an East African federation were stillborn as a result. Furthermore, the Kampala agreement on industrial location failed to be implemented, and by the time of signing the Treaty relations between the three countries were probably at their worst (Ojo *et al*,1985:158).

The main objective of the Treaty was to put cooperation between the partner states on a firm footing of mutual advantage. It set up a formal structure for administering Community institutions and provided measures to achieve an acceptable distribution of the benefits of cooperation between the states. Some of the main features of the Treaty were the introduction of a transfer tax to give limited protection for industries in the less developed countries against competition from those in the more developed ones, the establishment of the East African Development Bank (EADB) to allocate investments disproportionately in favour of Tanzania

and Uganda, and the relocation of the headquarters of some of the common services including the Community Secretariat (Ojo *et al*, 1985:162).

There were so many interacting influences and issues, some deriving from the Treaty and some not, that in reality led to its failure. As noted in Section 3.8, the integration of states at different levels of development often tends to concentrate further development in the most advanced countries, leading to an unequal distribution of the benefits of cooperation. This appeared to be the case in East Africa where Kenya was benefiting far more than the other partners. For an integration scheme to succeed, however, it is important for it to be perceived by participants as mutually beneficial. Measures to achieve an acceptable distribution are therefore an essential feature of such a scheme. While the Community Treaty tried to address this issue by providing for a transfer tax and the establishment of the EADB, it would appear that these mechanisms were less than adequate to persuade members to stick together (Hazlewood:1979:44). These and other factors that played an important role in the demise of the Community are considered in more detail in the subsections which follow.

4.5.1 The transfer tax

The transfer tax has been criticized for encouraging the duplication of industries, rather than avoiding duplication and enabling industries to enjoy economies of scale from access to the East African market as a whole, which was its original intention. The rationale for the transfer tax had been to protect, at least for a period of time, Tanzania's and Uganda's industries from the more established ones in Kenya. Hence, the duplication that resulted was by and large an unwelcome and unintended side effect.

Particularly in the case of large industries, such duplication would have been uneconomic. However, since formal fiscal incentives initially differed little among the three countries, it is probable that practices incompatible with the Treaty, including discriminatory purchasing by national trading corporations and quantitative restrictions on imports, were the major cause of the inefficient duplication of industries, and that the transfer tax was never given a fair trial (Hazlewood, 1979:44). A properly working transfer tax would have created a scenario similar

to that which prevails in a partial customs union (see Section 3.4).

4.5.2 The East African Development Bank (EADB)

This institution was seriously hampered by the limited scope of its activities. By the end of 1975 its total investments were not much more than twice the original contributions of the partner states, implying that little had been done. The Bank, however, achieved a remarkable success in prescribing the distribution of investments, at least until its activities were disrupted by political upheavals in Uganda. The ideal role for the EADB would have been to enhance complementary industrial development rather than to undertake a major part of industrial investment itself. The projects in which the Bank invested, such as textiles, sugar, paper, tyres and cement, do not appear particularly relevant to the aim of making the economies of the partner states more complementary, because such industries were already existent in partner states.

Indeed, failure to have an agreement on a pattern of industrial specialization and to guide the Bank's investments also made it more difficult for it to achieve the desired objectives. It is noteworthy that this kind of problem was cited by Robson (1987:205) as a shortcoming of trying to have a regional industrial policy. Quite often, even when some form of agreement is reached, problems still arise at the implementation stage.

Policy planning in general had been provided for in the Treaty, especially in the Economic Consultative and Planning Council, the Committee of Officials and the East African Committee of Planners (Hazlewood, 1979:49). However, despite discussions within the Community institutions, planning proposals never came anywhere near implementation. This in turn compromised the long-term objectives of the East African Community.

4.5.3 The common services

The relocation of the headquarters of the common services and some decentralization of operations occurred in an attempt to contain the unequal distribution of gains. Unfortunately, contrary to expectations, the greater part of the local expenditures made by the services continued

to benefit Kenya as the main activities of the services continued to be in that country. In any event, given Kenya's higher level of development, as well as geographical factors, a change in the distribution of gains could only have occurred in the longer run with relatively faster economic growth in Tanzania and Uganda.

4.5.4 The Community's top organ

The Treaty established a complicated institutional structure to administer and control the Community. There were several representative councils besides the Secretariat in which discussions were held. Ultimate control rested with the Authority composed of the presidents of the three countries. It is noteworthy that this system relied heavily on harmonious relations between the presidents; control of the Community collapsed when relations became bad and the initiative for the continuation and development of cooperation died.

Furthermore, the structure of control encouraged the pursuit of national interests and discouraged compromise, because there was always the Authority to reach an agreement in the end. A system which encouraged compromise at a lower level, ministerial rather than presidential, and among officials, would have made relations between the partner states less crisis-prone and the community machinery of cooperation run more smoothly. Moreover, the Secretary-General and the Secretariat had very limited powers, with all decisions requiring the specific agreement of the partner states (Hazlewood, 1979:47).

4.5.5 Transport and tourism

The transport and tourism sectors were another field of conflict, especially between Kenya and Tanzania. The tourism industry in Kenya benefited from access to the game parks of northern Tanzania. Fredland (1980:67-8) points out that "the typical tourist flew into Nairobi's international airport via East African Airways, lodged at a Nairobi hotel and drove or was chauffeured to Tanzania for two or three days of game viewing in a Tanzanian national park. Consequently, of perhaps US $2,200 paid by the tourist, as little as $200 was earned by Tanzania while the remainder, excluding the airfare, was earned by or at least in Kenya".

Further, Kenya's apparent preference for road transport caused additional difficulties for its partners. Kenya developed excellent road networks that competed with the Community's railway corporation and helped to make it difficult for the railways to register a profit. Different attitudes towards transport issues and other policy matters exacerbated the situation. Tanzania favoured railway transport and the development and expansion of domestic routes for the airways, while Kenya was in favour of the more lucrative international flights that would bring in foreign exchange (Hazlewood, 1979: 49).

The use of road transport while an idle capacity existed in the railway corporation ultimately led to commodity prices being forced up by rising transport costs. Although an attempt was made by one of the Community's institutions to address the issue of rail-road competition, there ought to have been a more coordinated development of surface throughout East Africa. Without this, the transport problem remained seriously disruptive of the Community's objectives.

4.5.6 Uncoordinated state trading corporations

The East African Community Treaty was implicitly written for integrated economies in which marketing decisions were based on prices while transfer taxes were meant to protect the national industries of less developed partners. The assumption was that the CET and the transfer tax would establish certain price relationships and that purchasing would be based on those prices. This, however, was rendered irrelevant when states set up trading corporations with monopoly powers to purchase for distribution. These corporations started discriminating in favour of domestic suppliers. Rules enacted to counter this were never strictly adhered to, and the result was further wasteful duplication, which largely benefitted multinationals (Hazlewood, 1979:49).

4.5.7 Ideological differences

Tanzania's inclination to socialist policies made her averse to Kenyan manufactured products that were mainly produced by multinationals. In Tanzania's view, buying Kenyan products was in effect subjecting the country to the exploitation of these imperialistic firms. For its part, Kenya largely pursued capitalistic free market policies. These polarized ideological positions made

cooperation increasingly difficult, particularly as they were used from time to time as pegs on which to hang mutual political abuse. The differences further shaped attitudes and dictated the actions of respective governments, sometimes in a manner obviously prejudicial to the objectives of the Community.[1] In addition, the anarchy that prevailed in Uganda after Amin seized power did not help the divided political terrain. Thus, in pursuit of their respective ideological positions, the partners drifted further apart and lost sight of the common goals they had set out to achieve.

4.5.8 Balance of payments problems

The Treaty appears not to have given the issue of balance of payments and foreign exchange problems adequate attention. The settlement of indebtedness arising from inter-state transactions had in effect to be in foreign exchange, with a limited provision for the extension of credit to a partner with a large deficit. Kenya benefitted greatly from this arrangement, as it relied mainly on a surplus in inter-state trade to balance a significant part of its deficit in external trade. It is thus unlikely that Kenya would have accepted a scheme which provided for balances to be in local currencies and which did not allow the country to earn foreign exchange from intra-regional trade. This is particularly the case since it had accepted the transfer tax and the investment allocations of the EADB, and given the lower free market rates of the Tanzanian and Ugandan currencies (Hazlewood, 1979:51).

The resulting huge foreign exchange costs of inter-state settlements had very serious implications. The 1973 oil shock could not have come at a worse time for the East African Community. Import prices escalated and foreign exchange reserves ran down, heightening frustrations among the member states. Tanzania and Uganda started withholding funds which should have been transferred in foreign exchange to the railway corporation headquarters. The dismissal and deportation of East African Community workers from partner countries followed

[1]Relations could turn particularly acrimonious at times. One such unfortunate incident was when the Tanzanian government referred to Kenya as a "man eat man society", to which the Kenyan authorities promptly retorted that Tanzania was a "man eat nothing society". In a further show of disdain for socialism, the then Attorney General, Charles Njonjo, remarked, " What is mine is mine and not ours. But, if you want to call yours, ours, there is no objection. We shall share it, but mine remains mine" (Africa Research Bulletin, August-September 1983: 6965).

(Ojo *et al*,1985:164).

Moreover, as Hazlewood (1979:51) argues, a possibly unforeseen effect of foreign exchange scarcity, which played an important part in the collapse of Community institutions and in souring the atmosphere in the last years of their existence, was the imposition of restrictions on the transfer of funds from the regions to the headquarters of the common services. This resulted in the slackening of the activities of the headquarters. The ensuing disruption in the financial operations of the common services led directly to their effective dissolution as common institutions, and the collapse of a major part of the structure of the community.

4.5.9 Political upheavals in Uganda

In 1971, (two years before the 1973 oil shock) a coup had occurred in Uganda, bringing arguably one of the most ruthless of dictators to power. There was very little that the East African Community Treaty could have done to legislate against such an event. Nevertheless, it is important to note that after the takeover by Idi Amin, the top organ of the Community (the Authority) no longer met. Although, after the initial disruption, the essential business was conducted by obtaining the agreement of the members individually, the ensuing atmosphere was not conducive to the smooth operation of the Community. Eventually, Uganda ceased to be an effective participant in Community discussions and the balance of the Community's tripartite structure disappeared.

4.5.10 External influences

Numerous multinational corporations and their subsidiaries capitalized on Kenya's initial advantage, extracted generous concessions on further foreign investment and then tried to service the regional market from plants located in Kenya. Kenya viewed its trade with Britain, the former West Germany and the USA as more lucrative than the regional trade based on import substitution industries. Tanzania forged similar links with the Soviet bloc, and China in particular. What followed was destructive competition for foreign markets and to attract foreign skills and technology.

This caused different conditions to be created in terms of tax incentives, patent laws, labour relations and foreign exchange privileges which "impeded the coordination and harmonisation of national development plans with respect to the external resource procurement so essential for Pan-African economic integration" (Nnoli, 1978:69-70). Indeed, such divisive competition partly accounted for the ineffectiveness of the transfer tax and the investment policies of the EADB. In addition, foreign aid with strings attached divided the partners even further as it influenced intra-community sourcing of imports. Such aid would ordinarily require the recipient state to import some products from the donating state regardless of the entire Community's preferences.

In the East African Community, the influence of multinationals and other external interests led to such decisions as the building of a tyre factory in Kenya that was supposed to be sited in Tanzania, construction of the Tan-Zam railway without due reference to the East African Railway Corporation, establishment of an international laboratory for research in animal diseases in competition with the widely acclaimed East African Veterinary Research Organization and the building of Plywood manufacturing facilities in each member state in competition with the single existing facility (Mazzeo, 1980:104). The multinationals were seen to benefit most because they could afford to establish uneconomic plants that were protected from within the Community by the tax system and from extra-regional rivals by the CET.

4.6 Conclusion

The obvious inequality in the distribution of the gains of cooperation would appear to have been the root cause of the collapse of the East African Community. This inequality became increasingly disruptive over time and most of the other issues of conflict could be traced to it. Kenya continued attracting more foreign investment due to her superior infrastructure and "free market"-driven policies, while Tanzania harboured a negative attitude to multinational companies and institutionally discouraged their investments by implementing socialist policies (Hazlewood,1979:53).

The inequality was perceived to increase over time and led to a loss of interest in cooperation. There was a change in the perceived benefits of continued cooperation and therefore in the costs

of dissolution. Indeed, as Hazlewood (1979:53) sums up, "perceived as a zero or negative-sum game the community had no future even though the perceptions may have been erroneous". However, it is the contention of this study that it was the lack of political will, especially in the Authority, that ultimately allowed a promising integration scheme to collapse.

The collapse of the East African Community led to a re-examination of the efficacy of market integration theory for less developed countries, and especially among countries at unequal levels of development. In East Africa, while trade diversion occurred, there was also remarkable growth in the three countries during the life of the integration scheme, perhaps more than would have been possible for the three partners to achieve individually. The implication is that trade diversion need not necessarily mean that participants would outrightly lose out. This point was emphasised in the theoretical contributions of Cooper and Massell (1965b) and Jaber (1971), considered in Sections 3.3 and 3.4 of this study.

A vital lesson was also learnt with regard to the viability of integration among countries at unequal levels of development, and how disruptive unequal gains can be to an integration scheme. It may be argued that the corrective measures employed to redress the unequal distribution of gains were inadequate. On the other hand, the measures themselves may have been sufficient, while implementation problems inhibited their effectiveness. The latter would suggest that there may indeed be scope for mutually beneficial and sustainable integration among countries at unequal levels of development if corrective measures are properly implemented. For example, it is possible that, had the transfer tax been used to establish complementary rather than competing industries, the resulting conflicts may not have arisen, neither would the EADB industrial specialisation policies have failed as they did. Indeed, as the literature on compensation referred to in Section 3.8 suggests, measures such as the transfer tax and a properly implemented regional industrial policy would probably have sufficed.

In the light of this analysis of the history of the East African Community, subsequent chapters of this study will consider the approach adopted by the new initiative of the East African Cooperation (EAC) to critical issues such as the distribution of the benefits of integration and compensation mechanisms.

CHAPTER 5: AN OVERVIEW OF THE EAST AFRICAN ECONOMIES SINCE 1985

5.1 Introduction

In spite of the acrimonious break-up of the East African Community in 1977, followed by a six year long negotiating process that culminated in the sharing of the Community's assets in late 1984, hope remained that cooperation would be restored at some point in the future. The World Bank-appointed negotiator, Dr Victor Umbricht, conducted the protracted negotiations that resulted in the signing of an agreement under which Kenya was to retain 42%, Tanzania 32 % and Uganda 26% of the assets. During the signing of the agreement, leaders committed themselves to explore areas of renewed cooperation, due to a realization of the disadvantages of the break-up of the Community. Tanzania soon reopened its border with Kenya, which further helped to bridge the erstwhile areas of intense disagreement. It was apparent that room was being created for renewed purposeful engagements between the former partners.

This chapter aims to review trends in economic growth and development and intra-regional trade among the East African states from the time of the division of the assets of the defunct East African Community through to the time of the new initiative of the East African Cooperation (EAC). For the purposes of this study, the period from1985 to the most recent date for which data has been compiled will be considered. Factors that contributed to the renewed efforts towards integration will be analyzed, and recent trends in trade and economic growth will be assessed.

The period between 1977 and 1984 will be omitted for several reasons. Firstly, this was the time when relations between the three East African states were at their worst. Mistrust was rife, the border between Kenya and Tanzania had been closed, while the chaos in Uganda was such that no meaningful engagements with foreign countries were possible[1]. The period was characterized by the smuggling of goods and open hostility at the expense of trade and regional development. Secondly, during the same period, Kenya was undergoing an economic and political transition

[1]Uganda was still in disarray after the fall of the Amin regime. Amin's successor (and predecessor), Milton Obote, who had allegedly rigged his way back to power in 1981, immediately became engaged in a guerilla war with Yoweri Museveni's National Resistance Movement (NRM). Obote was overthrown by General Tito Okello in 1985, who in turn was deposed by Museveni's NRM in 1986. In the face of such political instability, little significant economic activity could be carried out in the country.

that was to affect its overall development for many years to come. The country's impressive growth from the 1960s through to the late 1970s was coming to an end at a time when the international financial institutions, mainly the World Bank and the International Monetary Fund (IMF), were prescribing structural adjustment programmes (SAPs) to many sub-Saharan African countries, including those in East Africa. Thirdly, and perhaps most importantly, it was after 1985 that major changes began to be felt across East Africa, which hastened the urgency for closer cooperation.

In 1985, the President of Tanzania, Julius Nyerere, retired from office and was succeeded by Ali Hassan Mwinyi. By this time, it had become evident that the socialist policies which Tanzania had adhered to for more than two decades were not working. In spite of sustained donor support, mainly from Scandinavian countries, the economy was stagnant and inefficient, with high rates of unemployment. Foreign direct investment was not forthcoming because the socialist government viewed such ventures as nothing short of neo-imperialism. However, donors were also becoming fatigued, and Tanzania inevitably had to respond to growing calls for reform.

In Uganda, the National Resistance Movement under Museveni was closing in on Kampala, and by 1986 demoralized government forces had been defeated and Museveni took control. The years of fighting had left the country badly ravaged, infrastructure had virtually been wiped out, and the economy was in shambles. Inflation was very high and the country's productive capacity had shrunk extensively. In these circumstances, external trade had been rendered almost impossible. It is therefore difficult to come up with credible data on Uganda's external trade for the early 1980s.

In Kenya, the down-turn that had begun in the early 1980s was continuing unabated. High levels of corruption, repression and overall economic mismanagement had seriously eroded any gains that had been made in the preceding two decades. Vital institutions supportive to agriculture, the mainstay of the economy, including the Kenya Farmers' Association (KFA) and the Agricultural Finance Corporation (AFC), had been systematically destroyed. Furthermore, tourism, the other major public revenue earner, was seriously threatened by a spate of poaching that was only

contained by government after an international outcry. Many other factors, including the government's reluctance to effect the urgently required economic reforms, contributed to a deeper slide into stagnation. However, a coffee boom in 1986 helped to stabilize the country's foreign exchange position and rekindled hopes for recovery.

It may be argued, thus, that the upheavals of the pre-1985 period limit the possible acquisition of meaningful data for the purposes of this study. The growth and trade statistics since 1985 will bring out more clearly the overall impact of the changes that followed, including market reforms coupled with sluggish political reforms, as well as overall global changes. In Section 5.2, differences in per capita incomes and economic size between member countries are considered, while Section 5.3 will mainly analyze the growth performance of the East African economies between 1985 and 1996. Section 5.4 examines differences in economic structure among the three countries. Recent developments are considered in Section 5.5, while East African trading relations are the focus of Section 5.6.

5.2 Per capita income and economic size (GDP)

As Table 5.1 shows, Kenya is the largest of the three economies in terms of GDP. In 1995, Kenya's GDP of US $ 8142 million was nearly 50 per cent bigger than that of Tanzania, and more than 60 per cent greater than that of Uganda.

Table 5.1: Summary characteristics of the East African economies, 1995

Country	Area in sq km	Population in millions mid-1995	GNP per capita (US$)	Life expectancy	Adult illiteracy	GDP US$ millions
Kenya	580	26.7	280	58	22	8142
Uganda	236	19.2	240	42	38	5042
Tanzania	945	29.6	120	51	32	5488

Source: World Bank (1997:214).

Kenya's population was 26.7 million by mid-1995. According to World Bank estimates, Kenya's

GNP, measured at average 1993-95 prices, was US $ 7583 million that year, yielding a per capita income of US $ 280 (Table 5.1). GNP per capita in Uganda and Tanzania was US $ 240 and US $120 respectively in 1995. These figures highlight the low and unequal levels of development in the region in terms of per capita income, especially between Kenya and Tanzania. Indeed, for 1995, Tanzania was the poorest country in the world, according to the World Bank figures.

From 1985 to 1995, GNP per head in Kenya increased in real terms at an average annual rate of 0.1 per cent. During the same period, GNP per capita for Tanzania and Uganda grew at 1.0 and 2.7 per cent respectively (World Bank,1997:214). The relatively poorer per capita GNP growth performance for Kenya was partly due to bad weather that affected food production and also a high rate of inflation that had been triggered by a large increase in the money supply in the period preceding the 1992 elections (see Section 5.3). In a period when the food import bill was on the increase, Kenya's export commodities were becoming increasingly uncompetitive in the international market due to the high domestic rate of inflation.

5.3 Growth performance between 1985 and 1996

As the data in Table 5.2 indicates, after the economic stagnation of the early 1980s that saw the standard of living in most African countries deteriorate, many African countries, including the EAC member states, started experiencing an economic upswing at the close of the decade and during the post-1990 period. This upswing has, however, not been strong enough to raise living standards substantially. Nevertheless, a comparative analysis of the growth statistics points to a positive, though unsteady, upward trend. This is partly attributable to the hastened pace of economic liberalization during this period. The economic liberalization programme was prescribed by the Bretton Woods institutions (the World Bank and IMF) as a policy response to low growth and financial crisis in the affected countries. Although the conditions had been prescribed in the early 1980s, it was not until the end of the Cold War that most countries in Africa began to realize the gravity of the crisis caused by their reluctance to liberalize (Financial Times, November 1996:2).

Table 5.2: Real GDP growth rates for the East African countries between 1980 and 1995 (%)

Country/ Year	1980-1990	1991	1992	1993	1994	1995
Kenya	4.2	2.1	0.5	0.2	3.0	4.9
Uganda	3.1	3.1	8.4	5.3	10.6	8.5
Tanzania	3.8	0.7	2.6	4.4	3.5	3.5

Source: EIU (1996a, 1996b, 1996c).

Another significant factor was the impact of global changes at the beginning of the 1990s that seriously and negatively affected the "fortunes" of many countries in sub-Saharan Africa. After the Cold War, the strategic alliances held previously with African countries as bulwarks against rival ideologies became irrelevant and so did the economic support packages that used to accompany such alliances. Western donors started linking their aid to African countries to what has been referred to as market reforms and good governance. Consequently, African countries that had hitherto relied heavily on donor funding as a "reward" for staying in the same ideological camp found themselves under pressure to effect change. Bilateral donors, and even the international financial institutions, started showing their growing preference for Eastern Europe, which was opening up after decades under communism.

The Eastern European countries were viewed as more attractive to direct foreign investment as they were liberalizing at a faster rate, and had a sizeable pool of trained manpower. Another possible reason for their relative attractiveness is perhaps more political than economic, namely that Eastern Europe, being at the doorstep of the more industrialized Western Europe, should not be ignored because any social-political upheaval resulting from economic collapse would certainly affect the latter. It is also natural for a rational business person to try and harness markets according to their proximity and accessibility. Besides, having won Eastern Europe from the control of Russia, the former Western bloc would not have wanted a poverty-driven reversal by such countries, possibly into communism or another alliance with the former Soviet Union.

Thus aid and foreign direct investment continued to diminish in East Africa and Africa in general as a result of the apparent shift of attention by donors and investors to other emerging markets.

Indeed, due to economic mismanagement and the general market instability caused mainly by political upheavals, it was no longer feasible for investment to trickle readily into Africa. Hence, change became inevitable.

The other contributory factor to the economic upswing in the period after 1990 was the occurrence of good weather which made agriculture, the mainstay of the East African economies, perform well. The agricultural sector remains one of the most important contributors to GDP yet it is the most volatile, since its overall performance is generally determined by weather conditions. In 1995, the agricultural sector contributed 29, 50 and 58 per cent of total GDP in Kenya, Uganda and Tanzania respectively (Table 5.3). Water is especially critical as its shortage often leads to a substantial drop in crops yields. Droughts cause huge fluctuations in food prices, especially for a country like Kenya whose proportion of the total land that is arable is a mere 20 percent. Adverse weather conditions always have negative implications for food security and often result in higher import bills and possible balance of payments problems (EAC/ds,1997:8).

Since the late 1970s, the primary products produced in East Africa have been subject to a significant decline in their terms of trade. Farmers' earnings have continually declined, seriously affecting the forward-backward linkage process necessary for economic growth (EAC/ds, 1997:8). In the 1990s, besides the relatively better weather, there has been a substantial diversification which has seen horticulture coming to the fore as a major foreign exchange earner in the region, especially in Kenya.

Turning to the economic performance of the individual EAC member states, in the period between 1980 and 1990 Uganda's real GDP grew at an annual average rate of 3.1 per cent which, by 1992, had dramatically risen to 8.4 per cent (Table 5.2). The positive growth performance, especially in the early 1990s, was mainly attributable to the fact that the political and economic reforms the country had embarked on in 1986 were starting to pay dividends. In the years 1994 and 1995, GDP grew at 10.6 per cent and 8.5 per cent respectively (Table 5.2). These high rates of growth reflect a rapid expansion of the productive sectors in response to the sustained implementation of economic reforms. Gross fixed capital formation also improved tremendously, from US $152 million in 1985 to US $967 million in 1995. With a population growth rate of

around 2.5 per cent per annum, per capita income grew by 8.1 per cent and 6 per cent in 1994 and 1995 respectively (EAC/ds,1997:9).

Although we have identified the 1990s as a period of economic upswing, it is noteworthy that Kenya was experiencing a difficult transition period at about the same time. The struggle for the restoration of a multiparty system of government accelerated at the start of the decade with pro-multiparty agents openly challenging the government to reform. What followed was a costly and violent confrontation and gross human rights violations by an intransigent kleptocracy fearful of change. With the linking of aid from Western donors and the international financial institutions to issues of good governance and respect for human rights, the activities of the Kenyan government led to the freezing of aid to the country in order to increase pressure for change. Left with no option, the government agreed to allow the registration of more parties. This step, however, was not enough to usher in an era of good governance and sound economic management.

In a subsequent general election in December 1992, the Kenyan government imprudently printed paper money for campaign purposes, increasing the money supply by an enormous 35 per cent, which resulted in the highest inflation rate ever recorded in the country (over 46 per cent). The adverse effects of this increase in the money supply, coupled with other financial scandals, including the "Goldenberg case", have continued to be felt in the economy[2].

Initially, therefore, after 1990, the rate of growth of GDP in Kenya continued on a downward slide, falling to a mere 0.2 per cent in 1993, the lowest growth rate since independence in 1963. Besides the economic and political problems that pervaded Kenya at the time, the slowdown was further compounded by a drought which caused the agricultural sector to register negative growth of approximately 4 per cent in 1993.With a population growth rate of 3 per cent annually, per capita income grew negatively between 1990 and 1993. However, the economy has been on an up-turn since then, registering GDP growth rates of 3 per cent and 4.9 per cent in 1994 and 1995

[2] The Goldenberg case involved the alleged collusion of some businessmen and government officials at the Treasury and the Central Bank of Kenya to defraud the government of billions of shillings under the pretext of exporting non-existent gold and diamonds.

respectively (Table 5.2). This can be attributed to good weather and the deepening of the implementation of economic reform policies. However, per capita income is still low, at US $ 280 in 1995.

In the 1973-1978 period, Tanzania's GDP grew at an average rate of 5.5 per cent, but thereafter, through to the early 1980s, the economy only managed to grow at annual rate of around 0.4 per cent (EAC/ds,1997:9). Average GDP growth picked up from the mid-1980s up to 1990 due to the economic reforms that were beginning to yield benefits to the economy. Consequently, in spite of the apparent slump at the beginning of the decade, the overall average growth in GDP between 1980 and 1990 was 3.8 per cent (Table 5.2). However, during the same period, the economy suffered successive balance of payments deficits and shortages of foreign exchange with which to buy inputs for all sectors, while poor rates of tax collection undermined attempts to achieve a balanced budget. In addition, drought, intermittently-depressed commodity prices, and illegal mining and mineral smuggling adversely affected economic development.

As noted earlier, by 1985, Tanzania had started implementing market reforms under the new government of Ali Hassan Mwinyi. The government adopted austerity measures recommended by the IMF, including devaluation of the currency, attempts at stringent budgetary controls and the easing of restrictions on foreign exchange. In the 1990s, Tanzania started reaping the benefits of economic and political change. Indeed, as Table 5.2 shows, the economy experienced a turnaround, and in 1993 grew at 4.4 per cent, followed by 3.5 per cent in 1994 and 1995. Agriculture remains the dominant sector in the economy, accounting for 58 per cent of GDP in 1995 (Table 5.3). With a population growth rate of 2.8 per cent annually, per capita income growth has been positive in the last three years, but not strong enough to raise per capita GNP, estimated at a dismal US $120 in 1995.

5.4 Economic structure

Generally, agriculture remains the dominant sector in the East African economies. It is the main foreign exchange earner and also one of the largest employers. As noted earlier, in 1995, agriculture accounted for 58, 50, and 29 per cent of GDP in Tanzania, Uganda and Kenya

respectively (Table 5.3). It is projected that agriculture will remain one of the major sectors driving economic growth in the region in the medium term.

Table 5.3: Sectoral structure 1995 (percentage contribution to total GDP)[3]

Country	Agriculture		Industry		Manufacturing		Services	
	1980	1995	1980	1995	1980	1995	1980	1995
Kenya	33	29	21	17	13	13.8	47	54
Uganda	72	50	4	14	4	7.4	23	36
Tanzania	46	58	18	17	11	6.5	37	24

Source: World Bank (1997:236).

With 58 per cent of its GDP accruing from agriculture, Tanzania has the highest dependency on this sector among African countries, closely followed by Ethiopia with 57 per cent. The sector employed 83.0 per cent of the labour force in Tanzania in 1996 (Europa Yearbook,1998:3278). The principal cash crops are coffee, cotton, cashew nuts and cloves (Zanzibar's most important export, cultivated on the island of Pemba). Other cash crops include tobacco, tea, sisal, pyrethrum, coconuts, sugar and cardamon. Tanzania's agricultural GDP increased by an average of 5.7 per cent in 1986-1995.

Industry contributed an estimated 17 per cent of GDP in 1995. During 1985-1994, there was an average annual increase of 6.8 per cent in Tanzania's industrial GDP. This is estimated to have declined substantially in 1995, however. Mining provides only a small proportion of the contribution of industry to GDP, estimated at 1.3 per cent in 1996. Diamonds, other gemstones (including rubies and sapphires), gold, phosphates, salt, coal, gypsum, tin, kaolin, limestone, and graphite are mined, and plans are underway to commence the exploitation of natural gas reserves. Other mineral reserves include nickel, silver, cobalt, copper, soda ash, iron ore and uranium, and exploration for petroleum is in progress. The GDP for the mining sector is estimated to have

[3] Agriculture represents value added from forestry, hunting, and fishing as well as cultivation of crops and livestock production, while industry comprises value added in mining, manufacturing (also reported as a separate subgroup), construction, electricity, water and gas. Services include value added in all other branches of economic activity, such as wholesale and retail trade, transport and government, financial, professional and personal services such as healthcare, and real estate services (World Bank, 1997:258).

increased by an annual average of 18.2 per cent in 1986-1995 (Europa Yearbook,1998:3278).

Tanzania's most important manufacturing activities are food processing, textile production, cigarette production and brewing. Pulp and paper, fertilizers, cement, clothing, footwear, tyres, batteries, pharmaceuticals, paint, bricks and tiles, and electrical goods are also produced. Tanzania's manufacturing GDP grew at an estimated annual average of 0.9 percent in 1986-1995. The slower growth in manufacturing meant that the sector's share of GDP declined from 11 per cent in 1980 to an estimated 6.5 per cent towards the end of 1995 (Table 5.3). Energy is derived principally from hydro-electric power, which supplies more than 70 percent of Tanzania's electricity. Imports of petroleum and petroleum products accounted for 11.2 percent of imports in 1996 (Europa Yearbook, 1998: 3279).

Kenya's agriculture sector contributed an estimated 29 per cent of GDP in 1995 and employed about 77 per cent of the total labour force in 1996. Principal cash crops are tea (which contributed 24.1 per cent of total export earnings in 1993) and coffee (which contributed 14 per cent of export earnings in 1993). Horticultural produce (Kenya is the world's fourth largest exporter of cut flowers), pyrethrum, sisal, sugar cane and cotton are also important (Europa Yearbook,1998:1951). Maize is the principal subsistence crop. There is also a significant dairy industry producing for domestic consumption and for export. During 1991-1995, agricultural GDP increased by an average of 0.3 per cent.

Measured by gross value of output, Kenya's principal manufacturing activities in 1993 were food processing, the manufacture of chemicals, petroleum products (using imported crude oil), electrical machinery and transport equipment. Hydro-electric power accounts for 80 per cent of total electricity generated, while geothermal energy supplies about 15 per cent and other sources about 5 per cent of the total. In 1993, imports of mineral fuels (including crude petroleum intended for refining) comprised 15.0 per cent of total imports. Tourism makes an important contribution to Kenya's economy and has been one of the principal earners of foreign exchange for the country since 1987 (EAC/ds, 1997:10). However, civil unrest in the coastal region during 1997 posed a serious threat to the sector. In January 1995, the Nairobi Stock Exchange (NSE) was opened to foreign investors and this has contributed to greater capitalization of the

institution. Generally, the GDP of the services sector increased by an annual average of 3.4 per cent in the period 1991-1995.

In 1994, there was a slump in the share of industrial output to GDP. A possible reason for this apparent decline in industrial output was the rise in costs of industrial inputs as the value of the Kenya shilling depreciated. However, the decline had started in the early 1980s. The sector contributed an estimated 17.0 percent to Kenya's GDP in 1995 compared to 21 per cent in 1980 (Table 5.3). During 1991-1995 industrial GDP increased by an annual average of 1.6 per cent. In 1995 mining contributed an estimated 0.2 per cent of GDP. Soda ash is the principal mineral export. Flouspar, iron ore, salt, limestone, gold, gemstones (including rubies and sapphires), vermiculite and lead are also mined. During 1991-1995, the GDP of the mining sector decreased by an annual average of 0.5 per cent. Kenya has substantial reserves of titanium in the coastal region which have begun to be exploited (EAC/ds, 1997:10).

Uganda's agricultural sector contributed just over 45 percent of GDP in the financial year ending 30 June 1996, down from 50 per cent in 1995, and employed an estimated 83.1 per cent of the labour force in the same year. The principal cash crops are coffee, cotton, tea and maize. Tobacco, sugar cane, cocoa, and horticultural produce are also cultivated. The main subsistence crops are plantains, cassava, sweet potatoes, millet, sorghum, maize, beans, groundnuts and rice. Agricultural GDP increased by an annual average of 4.4 percent in the period between 1986 and 1995, and by 4.2 percent in the 1995/1996 financial year ending 30 June 1996 (Europa Yearbook,1998:3412). Despite this satisfactory growth performance, faster growth in manufacturing (see below) led to the fall in agriculture's contribution to GDP between 1995 and 1996.

In Uganda, mining makes a negligible contribution to GDP (0.3 percent in 1996). Output of copper, formerly an important export, virtually ceased during the late 1970s. The production of cobalt from stockpiled copper pyrites was expected to commence in 1999. Until the 1970s there was a small scale of mining activity. Uganda is believed to possess the world's largest deposit of gold, which began to be exploited again in the mid-1990s (Europa Yearbook, 1998:3412). Indeed, in 1996 gold accounted for 6.9 percent of the value of exports. In manufacturing,

Uganda's most important activities are the processing of agricultural commodities, brewing, vehicle assembly and the production of textiles, cement, soap, fertilizers, metal products, shoes, paints, matches and batteries. Manufacturing GDP increased by an annual average of 12.5 percent in 1986-1995, and by 18.1 percent in the financial year ending in June 1996. This impressive growth performance is reflected in the increased share of manufacturing in GDP from 4 per cent in 1980 to 7.4 per cent in 1995. Uganda's energy is derived mainly from hydro-electric power. The country exports a substantial amount of this to Kenya. In 1996, imports of fuels accounted for an estimated 1.5 percent of the value of Uganda's imports.

The services sector, which includes the public sector, has been one of the fastest growing, and contributes substantially to the region's GDP. In 1995, its contribution to GDP was 24, 36, and 54 per cent for Tanzania, Uganda and Kenya respectively (Table 5.3). It also provides the majority of modern wage employment, although the share of those employed in the public sector has been declining due to retrenchments (EAC/ds, 1997: 7). The EAC Secretariat therefore views the future prosperity of the private service sector as being of vital importance to the regional economy in terms of direct employment and wealth generation. Furthermore, the service sector also provides support to other sectors, particularly manufacturing. Owing to its future potential within the regional economy, development of service-related activities, particularly in tourism and trade, will be necessary to accord it due priority in the medium and long-term.

Although the share of the manufacturing sector has been growing in both Kenya and Uganda, the increase has been relatively sluggish in Kenya compared to Uganda. Between 1980 and 1995, Kenya's manufacturing sector registered marginal growth and the sector's share in GDP only grew by a dismal 0.8 per cent. A poorer performance can be noted in the case of Tanzania where, as noted earlier, the share of manufacturing in GDP actually declined from 11 per cent in 1980 to 6.5 per cent in 1995 (Table 5.3). Consequently, Uganda is the only country showing a significant increase in the share of manufacturing in GDP. The poor performance of the other countries was partly due to the adoption of policies that might not have been conducive for the faster growth of a manufacturing base. Most manufacturing industries in the region are products of import-substituting industrialization which, it has been argued, led to complacency, inefficiency and rising costs (EAC/ds,1997:8). Apart from agricultural and other natural resource-

based industries, manufacturing in the region has remained predominantly an enclave sector. The implications of the region's manufacturing performance, and particularly the rapid growth in Uganda's manufacturing sector, for regional integration in East Africa will be discussed further in Chapter 7.

In spite of the sluggish growth in the manufacturing sector within the region, its labor productivity remains higher than in other sectors. The experiences of the Newly Industrialized Countries (NICs) have shown that a faster expansion of the manufacturing sector is a necessary condition for sustainable GDP growth, and this is likely to apply in East Africa as well (EAC/ds, 1997:8). In order to sustain the EAC's projected annual regional GDP growth rate of at least 6%, the Secretariat suggests in its Development Strategy that it will be vital to continue aggressively with an export-oriented strategy in order to expand manufacturing at a faster rate.

5.5 Recent developments

5.5.1 Kenya

With the 1997 elections over without the anticipated increase in the money supply and social-political upheavals, Kenya appears to be in a relatively better position than expected. However, it is instructive that aid negotiations between the country and the international financial institutions broke up towards the close of 1997 over accusations of official corruption, and had not resumed by the end of 1998. The IMF still maintains that the government has not done enough to contain or stamp out official corruption, and to collect taxes and duties from individuals within its ranks. Consequently, the Kenyan government has been forced to increase taxes in order to make up for the deficit occasioned by the refusal of the IMF to disburse US $205 million in late 1997. This policy has not gone down well with workers who were already overtaxed before the latest fiscal adjustments were considered. Workers in various sectors have thus resorted to work stoppages as they demand salary increments, which has inevitably had a negative effect on an economy already in recession.

Furthermore, the government has had to freeze most of the intended development projects due to lack of funds. However, the reform program is broadly on track and vital indicators such as

the budget deficit appear to be well under control. Estimates by the end of 1996 pointed to a deficit (excluding grants) of 1.3 per cent of GDP compared with a budget target of 1.7 per cent. Growth was forecast at 4.5 per cent - a slackening in momentum largely reflecting the relatively poor rains, continued high real interest rates and an increasingly uncompetitive exchange rate.

After the dramatic success in bringing the average annual inflation rate down in 1995 from 24 per cent in January to 1.6 per cent in December, inflation soon rose again, reaching 7.8 per cent for the year to September 1996 and 10.4 percent year on year. In an effort to raise money, the government had been issuing treasury bills at high interest rates of over 20 per cent for 91 day bills, and bank lending rates had been ranging from 22 to 28 per cent. Real interest rates have been far too high, which is acting as a disincentive to local investors. It has, however, been attracting a lot of short term capital or hot money inflows that are complicating the Central Bank's efforts to maintain a competitive exchange rate (Financial Times, November 1996:2).

The 1996 figures show the balance of payments on the current account looking quite healthy, with the 12 month deficit falling steeply to only US $ 86 million in August from US $ 631 million a year earlier. The main reason for this was a reduction in the trade deficit. The overall balance of payments position was a surplus of US$ 59.2 million in 1996 compared with a deficit of US$ 134 million in 1995. The improvement in the current account stemmed mainly from better performance in exports and moderate increases in services. An improvement in net private and short-term capital inflows resulted in an increase of US$ 379.9 million on the capital account Net official capital inflows declined by US$ 1.8 million, while long-term capital inflows combined with movements in the current account resulted in a surplus in the basic balance of US$ 297.6 million in 1996, compared with a deficit of US$283.7 million in 1995 (Economic Survey, 1997:115).

GDP figures in 1996 were much lower than had been expected. GDP in real terms grew by 4.6 percent, below the projected 5.5 percent. Inadequate rainfall caused a shortfall in food production which necessitated food importation, while the high cost of domestic credit as well as power-rationing in the latter part of the year further affected investment and overall production adversely. This, together with an increasingly competitive trading environment, were the main

causes of the slow down in growth of the economy (Economic Survey,1997:115). The agricultural sector performed poorly as a result of the rain shortage. Most other sectors of the economy recorded meaningful growth, albeit lower than that of 1995.

Given its limited natural resource base (agriculture and tourism), Kenya has become heavily dependent on its geographical position and existing industrial base which make it the logical growth pole for East Africa, and its huge potential in the form of its relatively well educated, easy-going work-force. While the basis for macroeconomic stability may be in place, the other conditions necessary for sustainable growth of 6 percent to 7 percent annually are not (Financial Times, November 1996:3). The possible contribution of East African regional integration to growth will be considered in subsequent chapters.

5.5.2 Uganda

Uganda, as a landlocked country, is concerned about securing efficient outlets to the sea and eliminating the inefficiency and corruption that adds to freight charges and import bills. The restructuring currently under way at the Mombasa and Dar es Salaam ports has benefitted the Ugandan business community in its contribution to what has become one of the most remarkable economic recoveries. The country once synonymous with disaster now boasts one of the highest economic growth rates in sub-Saharan Africa. Just over ten years after President Museveni took office, the revival of a nation devastated by the despotic regime of Idi Amin and the war to overthrow him has continued apace.

Uganda's GDP growth has averaged 6 percent annually since 1987, topped 8 per cent during the year ending June 1996, and appears set to continue performing well. Inflation is in single figures, the currency is freely convertible, and foreign exchange reserves are in sufficient supply. The return of the Asian community expelled by Amin in the 1970s, and the greater general confidence in the economy, has led to the repatriation of flight capital at a rate of almost US $ 300 million per year, according to IMF estimates (Financial Times, November 1996:3).

If Uganda is to sustain high growth and replace aid by foreign investment, it must start expanding

an export base currently reliant on a handful of cash crops, improve an infrastructure in which inadequate power supplies are a big constraint, and make an import substitution manufacturing sector competitive in the region and beyond. Further progress with the difficult task of trade liberalization is part of the price of continuing approval from the Fund and the backing of the World Bank and other donors, worth US $500 million a year (Financial Times, November 1996:3). Tariff reform is also at the heart of the new EAC initiative, but most Ugandan manufacturers, only now reaching the production levels they enjoyed before the years of anarchy and civil war, may need more time to prepare for the competition that reduced trade barriers will bring, from Kenya in particular, as well as from trading partners further afield. This aspect will be considered further in Chapter 6.

Private investment over the past few years has been concentrated on reviving a manufacturing sector dominated by import substitution, and local manufacturers may need more time to consolidate. A huge trade deficit with Kenya is always cited as a supporting argument for more protection for Uganda's manufactures. In 1994, Uganda imported goods worth about US $ 172 million from Kenya, but Kenyan imports from Uganda totalled only US $3.2 million. The government is also concerned about the impact of trade liberalization on state revenue. About half of Ugandan government revenue comes from various duties and taxes on imports. Lower tariff barriers would mean less revenue, hence the efforts to expand the country's tax base by introducing value added tax (VAT).

However, it is argued that Uganda's medium to long-term potential lies not in its modest manufacturing sector, but in food production, agro-processing, tourism and power supplies. Given its fertile land, it could become an important basic food supplier to neighbouring Kenya, where two-thirds of the land is arid or semi-arid. The second area is power, where plans to expand the country's capacity could provide a surplus for sale to Kenya. Uganda's tourism potential, as yet barely tapped, could also be exploited if plans for the joint marketing of the East African region and the easier movement of tourists between the three countries are fulfilled. Furthermore, if existing barriers were lifted, Uganda's companies could raise capital on the Nairobi Stock Exchange (NSE) as economic cooperation takes hold.

Further growth could come from the revival of the country's high quality cotton crop, rehabilitation of the tea estates and the development of non-traditional agricultural exports. However, insecurity continues to be a problem for Uganda. The rebels supported by Sudan and more recently by the Democratic Republic of Congo have been able to exploit ethnic rivalries, especially in the North, historical grievances and a sense of neglect highlighted by the contrast with the buoyant South. This insecurity is likely to absorb the attention of the Ugandan government at the expense of regional cooperation matters.

5.5.3 Tanzania

As noted earlier, Tanzania is the poorest of the three countries, with an average per capita income of only US $120. The country's population of 29 million, roughly the same as Kenya's, offers nothing like the same purchasing power to investors. The country's infrastructure has been set back by the years of former President Julius Nyerere's African socialism, and its lumbering bureaucracy remains a brake on development (Financial Times, November 1996:2). Despite being the slowest of the three nations to lower tariffs in line with COMESA recommendations, the country is running trade deficits with both Kenya and Uganda.

The fear among many local business people is that an embryonic manufacturing sector, already threatened by goods flooding in from the Middle East, China and South Africa, risks being overwhelmed by regional imports once cooperation takes root. However, while the short-term benefits remain unclear for Tanzania, long-term benefits could be significant. Unlike Kenya, Tanzania boasts huge tracts of unsurveyed, unexploited land available for leasing. Gold mining has already attracted many South African, British and Canadian firms. Tanzania is just beginning to recognize its failure to market its extraordinary tourist attractions, ranging from the island of Zanzibar to unspoilt game parks.

Moreover, the development of the Songo Songo natural gas scheme stands to turn the country into an exporter of power to the rest of the region. Opportunities also exist in various other sectors of the economy. Following the successful privatization of Tanzania Breweries and Tanzania Cigarettes, divestiture of the 300 parastatals continues. In spite of the enormous

potential, much remains to be done before it can be exploited. Under President Nyerere's regime, which was marked by de-industrialization and plummeting living standards, it became impossible to thrive legitimately and the seeds of corruption were sown. Liberalization under President Ali Hassan Mwinyi simply opened up new avenues for shady personal enrichment. By 1994, the official practice of granting arbitrary tax exemptions to a few well-connected businessmen had reached outrageous proportions, prompting the IMF and donors, who provide a yearly US $1 billion in aid, to freeze assistance (Financial Times, November1996:2).

The current leadership under President Mkapa has attempted to institute the transparency needed for conventional investment. An anti-corruption commission has been set up, an independent Tanzanian Revenue Authority (TRA) established, and the "Zanzibar loophole", whereby lower duties on the islands lured container ships away from Dar es Salaam and encouraged vigorous smuggling to the mainland, is being addressed. The heads of graft-ridden parastatals have been sacked and a tight rein kept on expenditure. Inflation, which peaked at 42 percent in early 1995, fell to 18 percent in August 1996, and GDP growth was expected to rise to 5 percent for 1996 (Financial Times, November 1996:2). The tax system, however, still remains complicated and burdensome which tends to encourage evasion and acts as a disincentive to investment.

5.6 Intra-regional trade in East Africa (1990- 1996)

As can be expected, trade between the three East African countries is heavily skewed in Kenya's favour. Being relatively more industrialized than the rest of her regional partners, Kenya continues to accumulate trade surpluses against them. The data presented below gives a clear indication of the general trend of trading activities among the three countries.

There is traditionally only a small volume of trade between Uganda and Tanzania, mainly due to the fact that both countries have relatively smaller manufacturing bases which tends to minimise the number of tradable commodities between the two countries. It is, however, noteworthy that, over the past few years, trade has been increasing and is set to rise further as the region becomes more integrated.

Table 5.4: Tanzania's trade (1990-1996)

Value of exports in US $millions					Value of imports in US $ millions			
Year	Uganda	Kenya	Africa	Total exports	Uganda	Kenya	Africa	Total imports
1990	4	12	35	416	1	18	44	1021
1991	4	7	46	426	1	38	88	1231
1992	5	8	80	499	1	49	86	1523
1993	6	8	81	498	1	103	151	1402
1994	7	9	82	558	1	122	242	1414
1995	8	11	104	726	2	150	435	1759
1996	10	13	119	805	2	176	508	1772

Source: IMF (1990-1996).

Table 5.5: Uganda's trade (1990-1996)

Value of exports in US $ millions					Value of imports in US $ millions			
Year	Tanzania	Kenya	Africa	Total exports	Tanzania	Kenya	Africa	Total imports
1990	1	_	9	181	4	209	226	582
1991	1	1	4	175	5	51	61	402
1992	1	4	6	179	5	79	91	399
1993	1	5	8	135	6	127	142	457
1994	1	6	9	377	8	151	174	539
1995	2	7	11	533	9	186	234	740
1996	2	9	13	559	11	217	272	739

Source: IMF (1990-1996).

There are many factors that affect the availability, comparability and reliability of the data in use. It is arguable that statistical systems in many developing economies are still weak, and statistical methods, coverage, practices and definitions differ widely. Moreover, cross-country comparisons involve complex technical and conceptual problems that cannot be unequivocally resolved (World Bank,1997:249). It should therefore be noted that discrepancies will occur in the figures

given by various countries and those collected by other independent agencies. This is why the data in Tables 5.4-5.6 record different figures for, say, Uganda's imports from Kenya and Kenya's exports to Uganda.

Table 5.6: Kenya's trade (1990-1996)

Value of exports in US $ millions					Value of imports in US $ millions			
Year	Tanzania	Uganda	Africa	Total exports	Tanzania	Uganda	Africa	Total imports
1990	22	190	421	1120	10	-	96	2041
1991	34	46	171	1014	8	1	58	2178
1992	44	72	234	1337	9	5	58	1835
1993	93	115	385	1275	8	6	42	1744
1994	111	137	479	1683	10	7	256	2715
1995	137	169	605	1952	12	8	344	3554
1996	161	199	707	2203	14	9	398	3606

Source: IMF(1990-96).

The data presented in Tables 5.4-5.6 show the general direction of trade for the three countries, and particularly intra-regional trade. The columns showing total exports and imports aggregate the total value of international trade for the country in question. In spite of the obvious trade imbalance, a remarkable feature of this data is the steady increase in the value of trade between the East African countries over the last seven years.

Tanzania's exports to Uganda, though still modest, have increased by more than 100 percent from US $4 million in 1990 to US $10 million in 1996. In the same period, the value of its exports to Kenya increased slightly from US $ 12 million in 1990 to US $ 13 million in 1996. The value of the country's imports from Uganda doubled, while those from Kenya grew tenfold between 1990 and 1996. It is notable that while there was relatively large proportionate increase in Tanzania's trade with Uganda, the greatest increase in Tanzania's intra-regional trade was in its imports from Kenya, worsening its trade balance with that country significantly.

In the period 1990-96, Uganda's exports to Kenya increased ninefold. Imports from Kenya, after

a sharp fall in 1991, increased steadily to reach a higher level in 1996 than in 1990, accounting for about 80 per cent of the country's imports from Africa (Table 5.5). Uganda has, over the past few years, been emerging as Kenya's largest trading partner among African countries. This trend appears to be continuing and is likely to intensify when barriers to trade are finally removed. Unfortunately, although Uganda and Tanzania's exports to Kenya have been on the increase, they have not increased fast enough to narrow the existing trade imbalance.

Another discernible feature of the data presented above is the general increase in intra-African trade, at least from the East African countries' perspective. The Kenyan Economic Survey (1997:115-116) indicates that African countries continued to be the major destination of Kenya's exports for three consecutive years. In 1996, the value of Kenya's exports to Africa and the European Union (EU) accounted for 79.7 per cent of total exports, with Africa buying 46.7 per cent of the total as compared to EU's 33 per cent. Within COMESA, Uganda and Tanzania continue to be Kenya's major trading partners, absorbing 42.4 per cent and 33.7 per cent respectively of Kenya's total exports to the region. Major commodities exported to Uganda include fuel and lubricants, cement, wheat and sugar, while important exports to Tanzania are iron products, beer, sugar, soaps and medicaments.

Most of the items traded regionally are manufactured goods. Kenya, being the relatively more industrialized of the three states, has been exporting the largest share of such products since the pre-independence period. Due to their smaller manufacturing base, Uganda and Tanzania have for a long time been unable to increase their volume of exports to Kenya, which has generally resulted in unfavourable trade balances with the more developed partner. However, as observed in Section 5.5, Uganda and Tanzania have been attracting more foreign investment and have experienced faster growth than Kenya in recent years. These developments are likely to alter the pattern of trade within the region and also the composition of such trade as the two countries increase their volume of exports to Kenya. Such a scenario is likely to enhance economic integration in the region, as it implies the possibility of a more equitable development which may ease the tension stemming from the perception of unequal gains within the EAC.

5.7 Conclusion

This chapter discussed the general economic scenario that prevailed in East Africa in the post-1985 period after major economic and political reforms began to be undertaken in the region. The aim was to show the economic background against which the new initiative of the EAC is being established and also to demonstrate the extent of the unequal levels of development in the region, which has a bearing on the possible pattern of distribution of the benefits of economic integration. A notable point is that, in spite of Kenya being the most developed of the three countries, its current poor growth performance at a time when Uganda and Tanzania are experiencing positive trends in economic growth may actually result in a substantial shift in the pattern of distribution of the benefits of integration in the future.

CHAPTER 6: THE NEW INITIATIVE OF THE EAST AFRICAN COOPERATION

6.1 Introduction

The aim of this chapter is to analyze the new initiative of the East African Cooperation (EAC). The introductory section will review the structure of the integration scheme to facilitate an understanding of the decision-making process within the organization. Section 6.2 looks at the guiding principles of the EAC and attempts to demonstrate briefly the differences in approach adopted by the defunct Community and the new initiative. This is followed by a discussion in Section 6.3 of the opportunities offered by the new initiative. Section 6.4 considers the challenges and future prospects of the EAC in the light of both the lessons learnt from the collapse of the East African Community and the theory of economic integration among countries at unequal levels of development discussed in Chapter 3. Section 6.5 concludes.

Besides the conventional justifications that have always been offered for economic integration, East Africa has some unique characteristics that more often than not have demonstrated the shortsightedness of disunity and non-cooperation. The three East African countries share a common historical heritage that pre-dates colonial rule. Indeed, long before monetary exchange was introduced in the region, East Africans had trading relations which operated through a barter exchange system. Those favored by their proximity to the common "borders" have had not only trading relations but also kinship ties. Some families and clans are actually extended across the borders of the three countries[1].

Furthermore, the fact that East Africa was colonized by one colonial power (except for the short period that the Germans had in Tanzania) made it possible for East Africans to learn a second common language. English is used as the official language across East Africa but, even more importantly, the most widely spoken African language, Swahili, has its origins in the region. The Swahili language has spread into the eastern part of the Democratic Republic of Congo, Burundi,

[1] A case in point are the Seibei people around Mount Elgon who occupy both sides of the Kenyan and Ugandan borders, and the Masai people around the Mara region who virtually move in and out of Tanzania regardless of the border, and consider both regions as their rightful homes.

Rwanda and parts of Malawi and Mozambique. The significance of a common language cannot be underscored; it provides an effective medium of communication which is of crucial importance to trade and the enhancement of other forms of cooperation.

As noted in Section 5.1, the mediation agreement signed in 1984 to facilitate the division of the assets and liabilities of the East African Community provided room for serious consideration about future mutually gainful cooperation. In a subsequent meeting held in Nairobi in 1986, the three heads of state of Tanzania, Kenya and Uganda agreed to establish a mechanism aimed at reviving cooperation. On 3 November 1991, the heads of state directed their respective ministers in charge of foreign affairs and international cooperation to work out a programme to reactivate and deepen cooperation among the three states and draw up an appropriate institutional framework for this purpose. This culminated in the establishment of the Permanent Tripartite Commission headed by the ministers responsible for regional cooperation. It is the highest decision-making body of the EAC. Below it is the Coordination Committee which is made up of Permanent or Principal Secretaries in the respective ministries responsible for the agreed areas of cooperation. The Coordination Committee coordinates the activities of the various committees and working groups from which recommendations are made to the Commission for approval.

The Permanent Tripartite Commission is charged with the duty of initiating, planning and implementing cooperation projects aimed at facilitating and promoting faster development of the member states, and for studying the most appropriate form for the cooperation arrangement to adopt. It will therefore also coordinate activities aimed at deepening cooperation in political, economic, social, cultural, legal and security fields. The Commission was also mandated to establish a secretariat to service and coordinate its work. The protocol for establishing the secretariat was signed by the heads of state of the EAC countries in November 1994.

The Secretariat, which is the principal executing organ of the Commission, has a legal personality and has the power to enter into contracts and acquire, own or dispose of movable or immovable property. It was launched on 14 March 1996 at Arusha, Tanzania (EAC/ds, 1997:5). On the other hand, the Commission, which is also the EAC's main coordinating body, has as its prime mission the promotion of a people-centered economic, political, social, and cultural development on the

basis of balance, equity and the mutual benefit between the three states. The areas that have been identified for economic cooperation purposes include: trade and industry, transport and communications, energy, agriculture and animal husbandry, environmental and natural resources, tourism and wildlife conservation, social and cultural activities, and harmonization of fiscal and monetary policies. Other important areas include immigration, political cooperation, legal and judicial cooperation, and cooperation in security matters.

As noted in the Chapter 1, the EAC's core objectives have been broadly defined as follows:

i) to strengthen and consolidate cooperation in the agreed fields with a view to bringing about equitable development among the member states and thereby to uplift the living standards and quality of life of the East African people;
ii) to promote sustainable utilization of the region's natural resources and put into place measures for the effective protection of the environment;
iii) to enhance the role of women in development; and
iv) to promote peace, security and good neighborliness in the region (EAC/ds,1997:2-3).

6.2 The guiding principles of the EAC

It has been noted that regional integration has a chequered history in sub-Saharan Africa where grandiose, unrealistic promises and programs to establish CUs, common markets and single monetary areas have come to nothing, leaving institutions dating from the colonial era, such as SACU and the 14 member CFA Franc zone, as the only arguably successful experiments in the region. However, it is instructive that the EAC promises to be different if only because the three partners have fewer illusions about the difficulties that they face, having attempted to integrate before.

In its development strategy for the period from 1997 to the year 2000, the EAC Secretariat unveils the guiding principles of the cooperation scheme whose careful implementation should be able to place the regional bloc on a firm footing. Unlike the cooperation arrangement for the defunct East African Community, which was mainly based on joint ownership of common services, the new initiative is based on the creation of an enabling environment for the

establishment of a single market and investment area (EAC/ds, 1997:12). Due consideration is also being given to the fact that the reactivation of cooperation is taking place at a time when the processes of globalization and liberalization are taking place. To combat the challenges posed by these two processes, the EAC will be counting on the economic, social and political cooperation of the three states.

Economic liberalization in the global economy has brought about a situation whereby the market mechanism and the private sector are playing a leading role in the development process (EAC/ds, 1997:12). Consequently, the role of government is progressively being focused on the maintenance of law and order, provision of basic infrastructure and the implementation of policies for the development and expansion of the market mechanism and the private sector. This is set to be achieved through the restructuring programs currently under way within the three countries.

The approach adopted to cooperation will therefore rely more on market incentives and automaticity, rather than administrative discretion, which the defunct Community relied on. This will not only be in line with the global trend towards liberalization, reliance on markets and competitiveness, but also with national frameworks being gradually put into place (EAC/ds, 1997:12). One implication of this approach is that public intervention at the regional level should focus only on policy formulation, creation of a regional policy framework, mapping out macro-economic convergence, and the provision of the basic regional infrastructure that will enhance economic integration. Beyond this, the member states will strive to ensure that peace, security, good governance and democracy prevail within the region. These requirements will be needed to implement the programmes set out in the EAC development strategy successfully and to enable the efficient utilization of the region's financial, natural and human resources potential.

The success of the EAC is also being viewed within the framework of broader regional integration schemes such as the Common Market for Eastern and Southern Africa (COMESA). Indeed, recent experiences in regional integration have indicated that the approach to regional integration should allow for flexibility, and incorporate the principle of "variable geometry" (EAC/ds,1997:13). This principle allows the progression of cooperation among sub-group

members in larger schemes in a variety of areas and at different speeds. To be successful, integration in the east, central and southern African region will need to proceed on a multi-speed basis with a variety of focal points. The EAC is set to be one such multi-speed focal point.

Further, the EAC intends adhering to the "principle of subsidiarity". This principle emphasizes the importance of multi-level participation and the involvement of a wide range of stakeholders in the process of integration. The implication is that all actors will be allowed to influence developments in the regional cooperation arrangement, and highlights a sensitivity to the interests of various groups. In this regard, in order to promote the participation of the private sector, women, and civil society in general in regional economic, trade and social cooperation, it will be important that business associations, non-governmental organizations and other actors in the member economies be supported in establishing modalities of cooperation, creating strategic alliances and exchanging information (EAC/ds, 1997:13).

The EAC has taken cognisance of the importance of the role of the private sector in the development of a single market and investment area. The success of most of the policies to be adopted by the member states to this end will depend to a large extent on the response of the private sector. The EAC aims at encouraging the development of private sector institutions at the East African level to encourage cross border investment, joint ventures and increased trade in goods and services. The East African Business Council has already been established, and will be accorded observer status in the meetings of the Commission and its subsidiary bodies. The development strategy favours the view that if the region has to be internationally competitive, such competitiveness will have to come from within individual firms and business organizations (EAC/ds,1997:13-14).

The EAC has also made provision for a prominent role to be played by women. Enhancing the role of women is stated as one of the organisation's prime objectives (EAC/ds,1997:5). Their role in the economic, social and political development of the region as producers of goods and services, keepers of family health, and first teachers of children is given recognition. Consequently, the EAC aims to accord them a high priority as partners in regional development. Deliberate efforts will be made nationally and regionally to reduce the inequality that exists

between men and women. To this end, the EAC aims at forming an apex body for women's organizations in East Africa to enable them to contribute to cooperation efforts effectively.

The EAC development strategy envisages an integration scheme that is people-centred and which therefore provides for the participation of all stakeholders and sections of East African society in cooperation activities. In the medium term, deliberate efforts will be made to encourage the establishment of modalities of cooperation among civil society groups through the formation of regional-based organizations such as youth, women's and professional organizations, and the holding of public lectures, symposia, trade fairs, and cultural activities at the regional level. These activities would all be aimed at creating public awareness and sensitizing civil society on the need for closer and purposeful cooperation (EAC/ds,1997:14). Mechanisms will also be developed to enable the East African people to participate in decision-making at the regional level, in an effort to obtain a wider consensus and successful implementation of decisions.

To facilitate the implementation of development programmes for economic infrastructure and other areas of common economic interest, the EAC recognizes the need for resource mobilization (EAC/ds,1997:19). This will require the creation of incentives to encourage the mobilization of direct investment, both local and foreign. Other sources of funds will include member states, commercial banks, capital markets, national development finance institutions (DFIs), regional and country development institutions, and multilateral and bilateral financing arrangements.

Although member states are currently involved in restructuring their budgets to meet various macro-economic targets which may limit their ability to mobilize public funds for major infrastructural projects, they could become involved in facilitating access to external funding for onward lending to state agencies to co-finance development programmes. Already, possibilities are being explored for co-financing the EAC Digital Telecommunication Transmission Project through such arrangements. Commercial banks could be sources of finance particularly for profit-oriented commercial activities. To facilitate borrowing by private and publicly-owned commercial enterprises from foreign commercial banks, the liberalization of rules governing financial flows into and out of member states will be required.

Capital markets are viewed by the EAC as cheaper sources for venture capital for industrial and commercial activities and the best avenues for ensuring that ownership of privatized enterprises is widespread within the domestic and regional economies (EAC/ds,1997:42). In recognition of this key role, the three member states have established Capital Market and Securities Authorities which are cooperating within the framework of the East African Member States' Regulatory Authorities (EASRA). The ultimate aim is to develop this cooperation into an East African Capital and Securities Market.

National Development Finance Institutions (DFIs) are, depending on their mandates, sources of finance for funding economic activities and private commercial enterprises. The national DFIs can co-finance projects with regional and international financial institutions. They usually have credit lines with foreign development institutions for financing private enterprises (EAC/ds, 1997:42). These DFIs need to be strengthened to enable them to finance commercial transactions, especially in the import-export business within the region.

In 1967, when the EADB was established, its objective was to generate and finance projects of regional significance and redress the imbalance of industrial development in the three member states. As one of the few surviving institutions of the defunct Community, the EADB should play an increasingly active role with a view to strengthening economic cooperation. This will require an increase and a widening of its capital resource base through the additional mobilization of resources regionally and internationally. One way of doing this would be for the bank to sell itself as an intermediary (a medium) for external donor funds, so as to mobilize concessionary resources to strengthen its resource base.

The multilateral sources of funding for regional development programmes include institutions such as the World Bank, African Development Bank (ADB), UN agencies, and regional groupings such as the European Union. Most of these institutions have funds set aside for financing regional-based development programmes. The EAC aims to explore areas where it could make use of such resources. It has further been suggested that where development programmes have portions falling within each member country, such as the upgrading of road networks, the member states may seek bilateral funding for the portions within their areas, if

funding for the whole regional project is not forthcoming (EAC/ds,1997:43).

The EAC treats political cooperation as a distant goal. The highest priority is given to economic cooperation, largely in order to avoid the mistakes of the defunct Community when venturing into matters of political cooperation. However, in order to achieve the objectives of the EAC, political will and vision for the cooperation arrangement will have to be sustained within the summit of the heads of state, the Permanent Tripartite Commission, national parliaments, business organs, professional bodies, the East African network of Non-Governmental Organizations (NGOs) and the informed public (EAC/ds, 1997:43). Thus, in identifying areas where cooperation will be focused, treatment of political, security, legal and judicial matters is a vital precondition for viable and sustainable economic cooperation.

Furthermore, deliberate efforts aimed at enhancing the capacity of the EAC to promote closer integration among the member states will need to be undertaken. The Secretariat is the executing organ of the Commission and is responsible for various activities that include strategic planning, management and monitoring the Commission's programs. In line with the international trend of having small but efficient bureaucracies, the Secretariat is headed by an executive who is supported by two deputy executive secretaries. These in turn are supported by seven professionals in the areas of economics, statistics, information management, administration, finances (accountant and internal auditor) and legal matters. Capacity building is to be undertaken to make the Secretariat more efficient in the implementation of the EAC's development strategy. In an effort to reduce its dependence on contributions from member states, and thus to ensure the financial sustainability of the Secretariat, the EAC aims to identify other reliable and automatic sources of income to fund its operations (EAC/ds,1997:48).

As the outline in this section illustrates, the guiding principles of the EAC appear to be largely focused on the objectives stated in Section 6.1. However, some of the issues raised in this section need further consideration. It is possible that many of the principles expressed above may actually be reflecting the ideals of those who prepared the EAC Development Strategy. Indeed, the political leadership in the region could be engaging in political rhetoric, and the issues revolving around the reactivated EAC may have provided them with the opportunity to do so. However,

if we suppose that there is sufficient political will to work within the outlined principles, then we still need to confront these principles with the provisions of the theory of economic integration discussed in Chapter 3. This will be taken up further in Section 6.4.

One notable point of departure from the defunct East African Community has been the greater role assigned to bodies other than the respective governments in the integration process. There is, in the EAC, a generous consideration of civil society and the private sector as important players. However, it is noteworthy that the relationship between the individual governments and civil societies operating in their respective states has been said to be one of suspicion and even intimidation by the former. Government officials often appear to regard civil societies as allies of opposition forces competing for political power. It may, therefore, prove quite difficult to build enough confidence and trust to allow an effective working relationship between these groups and the governments. It is likely that the latter will remain suspicious of the former and thus inhibit their role in the regional integration process. Neofunctionalist integration attaches a lot of importance to civil society and interest groups in general as crucial players in the integration process (see Chapter 3). For such groups to play a pivotal role in economic integration, they need to be firmly institutionalized in such a way that they are not muzzled by the political establishment.

6.3 Opportunities offered by the EAC

In the EAC's development strategy for 1997-2000 the Secretariat has argued that, since the EAC is among the world's poorest regional economies, with a regional income per head of only US $200 a year and a total population of around 75 million, economic integration makes excellent sense. This is stated in terms of providing a larger regional market and attracting foreign investment in manufacturing, while enabling companies to exploit economies of scale (EAC/ds, 1997:8). Efficiency gains are also expected to result from tariff and tax rationalization and the sharing of some common services, thereby eliminating duplication of effort. In this section, an attempt will be made to ascertain and analyze the opportunities offered by this cooperation and the new initiative.

In its effort to create a strong economic bloc, the EAC Secretariat has embarked on an ambitious agenda which includes the harmonization and rationalization of tariffs, evolving joint fiscal and monetary policies, and exploring the possibilities of a customs union. It is consequently argued that the EAC offers tremendous opportunities to East Africans and to foreign investors willing to venture into various sectors (EAC/ds,1997:8). The determined efforts to harmonize policies will hasten the establishment of a single market and investment area in East Africa. Policy harmonization has included, among other things, the launch of an East African passport in 1997, and the re-introduction of an inter-state pass to ease the movement of people across the borders.

Harmonization of fiscal and monetary policies by the EAC will help to create an enabling environment for the development of trade, industry and investment in the region. It will create a uniform incentive framework that will make it easier for the joint promotion of the region as a single trade and investment area. Cooperation in this area has thus been tailored to include the harmonization of statistical systems to enhance comparability of statistics, sharing of relevant budget information on tax proposals, trade and other economic policies, revision of tariff levels, and the introduction of GATT/WTO valuation agreements. This will ensure that budget proposals and economic policies to be newly introduced do not negate the policy harmonization process (EAC/ds,1997:21).

Transport and communication networks have been identified as another vital area of cooperation. The development of road, rail, water, air transport and telecommunications is regarded as an integral part of the integration of the region (EAC/ds,1997:21). The closer linkages which result between member states through transport and telecommunication networks will facilitate the cross border movement of people, goods and services, and the maintenance of peace and security in the region. This cooperation includes inland water transport, ports and shipping, aviation, postal services, telecommunications and meteorology.

The existence of peace, security and political stability is an important prerequisite for the success of development efforts. In this regard, relevant areas of cooperation have been listed as, *inter alia*, border security, immigration, refugee management, training in security matters, coordination of security operations, disaster management, joint maritime and rescue operations, and mutual

assistance in criminal matters, including the sharing of information regarding drug trafficking in the region. An important role is expected to be played by the East African Defense and Security Committee to enhance cooperation in this area. An improved security situation borne out of closer cooperation will not only help create an investor-friendly atmosphere, but will also reduce the costs of policing for individual states.

Industrial development, a major goal of the EAC, requires a substantial amount of energy. Currently, member states in the region face deficits in the supply of some types of energy, particularly electricity. The need for cooperation in this area cannot be underscored, and is aimed at covering electricity production and supply, including investment in electricity generation, oil and gas pipelines, interconnection of the three national grids, exchange of data and information on fossil fuels exploration, oil distribution and storage, bio-mass research and the development of alternative sources of energy (EAC/ds,1997:22).

Furthermore, industrial development is vital to the promotion of sustainable development and production as well as the creation of more employment opportunities in each economy within the region (EAC/DS, 1997:23). It is argued that industrial development within the EAC will create economies of scale and facilitate competition. Promotion of joint ventures in public and private enterprises, the promotion and development of industries based on competitive and comparative advantage, and consideration of their complementarity within the region are some of the priority activities. It is, however, not explicitly explained how promotion of joint ventures will be undertaken without evoking the same conflicts that led to the collapse of the East African Community. Other goals include the rationalization of investment in core or basic industries, and the development of sustainable industrial and technological capability.

Agriculture, as the mainstay of the EAC economy, also forms a prime area of cooperation. In the immediate future, the sector will have to continue to be the base for sustainable economic growth and development. Indeed, most existing industries are either agro-based or have a strong linkage to the sector. Cooperation in this area will cover food security, the development of regional early warning systems (REWS) and meteorology, utilization of agricultural training and research facilities, joint programmes for combating plant and animal diseases, pest and vector control and

eradication programmes (EAC/ds,1997:23).

The tourism sector is one of the fastest growing sectors in the region, accounting for a substantial amount of total foreign exchange earnings. In the face of increasing competition from other African countries, it is argued that the EAC countries have to market the region as a single destination. A common strategy would ease logistical problems and provide a platform from which to address common conservation issues. The three member states also share borders along some of the world's most famous tourist attractions, such as Lake Victoria. In tourism, cooperation will include dealing with issues such as the preservation and conservation of wildlife, liberalization of the tourism sector, and the joint marketing of the region as a single tourist destination. This arguably offers enormous opportunities for investors interested in venturing into the sector.

In order to ensure that sustainable development is achieved, the EAC aims to undertake an effective management of natural resources and protection of the environment. Cooperation will focus mainly on the environmental management of Lake Victoria, including control and eradication of water hyacinth (see Section 6.4.13), and the management and conservation of aquatic and terrestrial resources and fisheries. Also to be dealt with are the following: management of the coastal and marine environment, control of the illegal trans-boundary movement of hazardous wastes, combating desertification, management and conservation of forestry resources, environmental assessment programmes, harmonization of environmental policies, and joint action preparedness in case of environmental disasters such as oil spills (EAC/ds,1997:24).

With the aim of enhancing social integration for the people of the region, the EAC regards social and cultural activities as vital elements of overall integration. As noted earlier, East Africans share aspects of a common cultural heritage, especially with respect to the English and Swahili languages. Sports, education and professional training, science and research, health, cultural activities, literature, fine art, music, performing arts and the preservation and retention of historical materials and monuments will constitute some of the areas of cooperation. The argument is that this common heritage, if carefully and purposefully harnessed, will contribute

to overall growth and development in the region. The latter is likely to be achieved through increased trade and business relations made possible by closer social integration. In addition, the social interaction will facilitate the formation of interest groups that may lobby for sustainable integration as envisaged by the neofunctionalist model of integration (see Chapter 3).

In the area of legal, judicial and ultimately political cooperation, a common purpose is developing. The East African Lawyers' Society has been formed, which will help members of the legal profession to practice law in all East African countries. Cooperation in legal and judicial matters will include the creation of regional courts, formulation of a regional treaty, and the creation of a regional mechanism for the settlement of business disputes. In addition, closer political cooperation envisaged at a later date is likely to augment economic cooperation, both of which are critical factors in the achievement of regional integration (Financial Times, November 1996:3). Political cooperation will include summit meetings of heads of states, meetings of the foreign affairs ministers of the three countries, ambassadors and high commissioners, meetings of the proposed Joint Committee of National Assemblies, and meetings of administrative authorities at border regions. These activities will serve to cement cooperation in all facets of the regional economy, and should lead to a consolidation of the gains of a fully integrated region.

The EAC has also proposed new areas for joint cooperation which include health, labor and employment, the development of information systems, education and training, and the financing of the Secretariat. The latter is particularly important, because the aim is to improve the effectiveness of the Secretariat in strategic planning, management and the coordination of activities, by ensuring that it has a firm financial base. The EAC is in the process of identifying alternative, realistic and guaranteed sources of funding to reduce the dependence of the Secretariat on contributions from member states.

While the above targets set out by the EAC's Secretariat are useful and positive, they are nevertheless subject to various constraints. Indeed, the programme is arguably highly ambitious and several questions may be raised with regard to the viability of some of its aspects. For example, are the proposed areas for cooperation not too numerous given the fact that the initial

Development Strategy covers only three years? Has the EAC really been able to learn from the mistakes of the defunct East African Community? Are there indications that the EAC has carefully considered the lessons from the theory of economic integration, especially with regard to integration among countries at unequal levels of development? What are the challenges to the stated objectives? Some of these questions will be addressed in the rest of this and the subsequent chapter.

6.4 Challenges and prospects

In the process of forging closer cooperation and integration among the three economies, the EAC faces some enormous challenges. Indeed, for the integration scheme to entrench cooperation effectively and meet its stated objectives, it will have to deal carefully with fundamental problems that would otherwise jeopardize the entire initiative. This section attempts to bring out and discuss some of these challenges.

It is worth noting that some of the benefits of cooperation are already evident. For example, the three currencies are now convertible, the ports are under better management, although political interference is still rife, central bank governors meet regularly, and there is a common passport for East Africans. However, the problems of the past continue to impact negatively on the three economies. For all its remarkable progress, the size of the Ugandan economy, measured by GDP, is roughly half what it was in 1971 before the Idi Amin era. Tanzania still hosts a cumbersome bureaucracy that continues to constrain growth. In Kenya, the deteriorating infrastructure and erratic power supplies are hampering growth, while corruption and lack of transparency continue to strain the country's relationship with donors, much to the detriment of the economy. In late 1997, for example, the IMF had to suspend the disbursement of a loan of US$205 million after negotiations broke down over accusations of official corruption (Daily Nation, August 1997).

The new initiative of the EAC contains elements of both formal economic integration and looser economic cooperation (see Chapter 2). Accordingly, the focus in the first three subsections of Section 6.4 will be on those challenges that affect specific aspects of formal economic integration, while Sections 6.4.4 to 6.4.13 will consider sectoral cooperation.

6.4.1 Trade barriers and industrial development

One of the EAC's most ambitious plans was the intention to remove all tariff barriers between the three countries by the end of 1998 (East African Standard, 26 March 1997:18). However, the date for the completion of the removal of tariffs was later changed to 1 July 1999. Reducing barriers to trade will be a welcome move to the suppliers of goods and services based in Kenya who have seen Uganda and Tanzania become their most important export markets. The Kenyan Economic Survey of 1996 shows that, in 1991, Kenyan exports to Uganda were worth 107.25 million Kenya pounds and those to Tanzania 54.13 million Kenya pounds, while exports to the United Kingdom and Germany were worth 266.88 million and 123.54 million Kenya pounds respectively.

However, by 1995, exports to Uganda and Tanzania had risen to 766.70 million Kenya pounds and 631.02 million Kenya pounds respectively, far surpassing those to the UK and Germany (at 487.73 million and 369.44 million Kenya pounds respectively). This trend is believed to have continued into 1996. This scenario not only reflects the change in the direction and volume of trade from traditional European partners to regional ones, but also brings to the fore the sensitive question of the balance of trade between Kenya and the other members of the EAC. Comparatively, the balance is largely tilted in Kenya's favour. There has, however, been some substantial growth in imports from Uganda and Tanzania. Over the same period considered above, the value of Kenya's imports from Uganda grew from 2.65 million to 8.03 million Kenya pounds, and those from Tanzania grew from 11.29 million to 31.10 million Kenya pounds. This means that, although there continue to be huge trade imbalances with both countries, the gap is narrowing. If this trend is sustained, the EAC may be able to avoid the strains associated with conflicts over trade.

It is, however, likely that the perception of unequal gains from integration will re-emerge, which may have adverse implications for the success of the EAC. It was noted in Chapter 4 that the perception of unequal gains was one of the prime causes of the collapse of the East African Community. Compensatory mechanisms and corrective measures may therefore have to be employed. This raises the question of to what extent Kenya, for example, would be willing to

agree to such measures on one hand, and for how long its partners would be willing to wait for a more equitable balance to be achieved on the other. This constitutes a formidable challenge to the EAC members' commitment and political will. It has already been indicated that, despite the official move to a zero tariff in the region from 1 July 1999, some commodities will still attract a maximum 10 per cent tariff. This measure may help to reduce conflict, but other complementary measures may still be necessary.

Other critical questions that need to be addressed in the face of the removal of trade barriers include whether or not such a measure will cause significant trade diversion. In terms of the orthodox theory, if a higher cost partner within a customs union ends up displacing cheaper imports from the rest of the world, the result is trade diversion which is considered to be welfare-reducing (see Section 3.2). In terms of the orthodox criteria it seems likely that trade diversion will occur. However, the scenario may be slightly different from what it was during the time of the defunct East African Community, because of the rapid growth of the manufacturing sector in Uganda, observed in Section 5.4.

Furthermore, as noted in Sections 3.3 and 3.4, orthodox theory's argument that trade diversion is necessarily welfare worsening has been challenged by theorists such as Jaber (1971) and Cooper and Massell (1965b). For example, Cooper and Massell (1965b:464) conclude that trade diversion could in fact be preferred to trade creation in some circumstances because it does not entail a loss of domestic industrial production. This is particularly relevant in the developing country context.

In the East African Community, it was observed that although trade diversion did occur, there was evidence of substantial economic growth which would perhaps have not been achieved in the absence of the integration scheme (see Section 4.4).This further suggests that the possibility of trade diversion need not be a barrier to economic integration in the region. It would still be possible for each country to expand its industrial production in order to supply the wider regional market, and the potential benefits may be further enhanced by economies of scale. With a larger regional market, there may be cost reduction gains which could enhance the expansion of enterprises and overall production (see Chapter 3).

However, apart from the stresses caused by uneven economic growth within the region, the removal of duties on imports from Kenya would be bound to create severe budgetary problems for the governments of Uganda and Tanzania. These governments are already under severe pressure from the IMF and the World Bank to reduce their budget deficits by increasing revenue collections as well as reducing their current expenditure. Government revenue as a proportion of GDP is far less than that of Kenya, which has achieved a respectable 30 per cent, and the two countries are far more dependent than Kenya on donor aid. In 1994, aid dependence as a percentage of GNP was 11.8, 38.2 and 19.7 per cent for Kenya, Tanzania and Uganda respectively (Financial Times, November 1996:11).

Some special tariff reductions have been negotiated for individual products in the EAC, which will attract a tariff of not more than 10 per cent. The impact of such measures may be similar to that of a partial customs union (see Section 3.4) which allows two or more countries to have a CET but not internal free trade. This, Cooper and Massell (1965b:472) argue, could allow all the members to gain from integration.

Such an arrangement would particularly be beneficial for Ugandan and Tanzanian manufacturing industries, which would continue operating under limited protection from the relatively better established industries in Kenya. It is possible that this may prevent the nascent integration scheme from experiencing some of the problems of its predecessor, the defunct East African Community. In addition, it may be argued that if the rate of import duties and sales tax were substantially reduced there would be far less inducement to smuggle and the tax revenue collected would probably increase.

6.4.2 Cross-border movements

Free movement of the citizens of the three countries has been declared a desired objective by the EAC Secretariat. As noted earlier, a common passport has already been launched. However, the crucial question is when it will become possible for employers to engage citizens of other member countries without having to obtain work permits for them. This would signal a positive move towards the establishment of a formal common market which allows free movement of

labour within the integration scheme. If this happens, the practice for Kenya-based enterprises starting up in Uganda or Tanzania is likely to be to transfer qualified and experienced Kenyan managerial staff rather than much more expensive European, American or Indian expatriates who will continue to need permits. Kenyan companies could also perhaps engage semi-skilled or under-skilled workers from Uganda and Tanzania for lower wages than their counterparts from Kenya which could lead to difficulties with Kenyan trade unions.

6.4.3 Harmonisation of policies

Harmonisation and rationalisation of policies has been identified by the EAC as an important aspect of a closer economic cooperation. Robson (1987:175-176) argues that the economic case for the pursuit of regional policies rests on three principal considerations, namely resource allocation, resource utilisation and stabilisation considerations. Indeed, if an integration scheme is to promote a more efficient use of resources in the presence of diverse national taxes and subsidies, limited measures of harmonisation may be indispensable. Moreover, there are also social and political arguments for harmonisation of regional policies which mainly hinge on the overall maintenance of order within an integration scheme by, among other things, staving off potentially costly and disruptive geographical movements of the population (Robson,1987:176). Quite clearly, harmonisation of policies is a very important aspect of regional economic integration.

Within the EAC, there is a need for the maintenance of macroeconomic stability in member countries and the region. Policies to achieve such stability would include the maintenance of low inflation, balanced budgets and low balance of payments deficits. Balance of payments problems often result in economic instability which finds expression in inflationary pressures, over-valued currencies and low economic growth rates. Such conditions are obviously not conducive to investment and business.

Member countries will therefore need to harmonize their macroeconomic policies and create conditions for economic growth and stability. This will cover both fiscal and monetary policies. It will require efficient and professionally run financial institutions and revenue authorities. A

lot of political will is needed for these objectives to be achieved because such institutions are generally firmly under the control of the respective states. Harmonisation of fiscal and monetary policy differentiates a common market from an economic union, and is arguably one of the more difficult areas to implement in an integration scheme. The EAC may have to learn from the experience of the European Union which, despite its many years of economic integration, is still struggling with the issue of a common currency, especially in the face of British opposition.

The EAC might find it hard to secure firm commitment towards the achievement of policy harmonisation. While the proposed policy appears desirable, it entails a long process of negotiation in order to obtain consensus from all the members. It also requires cooperation from ministries responsible for finance and economic planning, central banks, and revenue and capital market authorities in respective member states (EAC/ds,1997:29).

6.4.4 Road transport

In East Africa, the slow pace and high cost of transport are among the most frequent complaints made by industry across the region. Often, time wasted and vehicle breakdowns push up costs and seriously compromise the competitiveness of final products. In Kenya and Uganda, travellers and businesses face an unenviable choice between a rail network neglected for generations and a road system in which main trunk routes are poorly maintained, sometimes unsafe and often choked with traffic. Regional links are further impeded by lengthy bureaucratic formalities at the border. Transport problems will therefore be one of the most serious challenges that the EAC will have to contend with.

6.4.5 Telecommunications

A further challenge is posed by poor telecommunications. Parastatals charged with the provision of telecommunication services across the three countries have been operating as monopolies for the past three decades, with management often appointed more out of political expediency than considerations of competence (Financial Times, November 1996: 2). Indeed, poor management, political interference and low investment ratios are some of the factors behind the precipitous

decline of telecommunication infrastructure and services across East Africa in recent years. Consequently, for efficient telecommunications to be achieved, there will be a need for a faster restructuring of the sector. Since this may also entail retrenchments, it is a direction that the authorities are reluctant to take because of the possible political costs. Yet, without a properly working telecommunication system, the activities of the EAC Secretariat will be greatly impeded.

6.4.6 Ports

Until very recently, the ports of Mombasa and Dar-es-Salaam, the gateways to the region, were real barriers to trade. Widespread theft, administrative incompetence and official corruption were some of the adverse factors that served to stifle trading activities in the two ports. This affected Uganda particularly badly, due to its dependence on the ports for supplies from abroad and even for exports. They have been a constant focus of complaints from businesses, and a serious concern for the IMF which is determined that the Tanzanian and Kenyan governments should improve revenue collection. For economic integration to work, it is critical that the ports be reorganized and re-orientated. The challenge will be for the Secretariat to persuade the two governments to move faster to address the problem.

For both authorities, improving performance and administration can only be part of the solution. Until containers can be evacuated more quickly by rail and road, major expansions remain problematic. At the time of this study, the Mombasa to Nairobi highway had virtually been rendered impassable partly by neglect over time and partly due to El Nino floods. Further inland, numerous bridges have been washed away and roads have been destroyed, the repair cost of which may run into billions of Kenya shillings.

A future target with regard to the ports is the establishment of a unit train which would take containers from Mombasa to Kampala (Financial Times, November 1996:5). There is constant apprehension that if the ports are not improved, some trade will go elsewhere, geography notwithstanding. Dar-es-Salaam has already seen cheaper ports in South Africa and Mozambique take up much of the trade that, in the apartheid era, went via Tanzania to Zambia and Malawi. Uganda, which brings more than one million tonnes of goods a year through Mombasa, has on

various occasions warned that it is willing to shift to the longer route through Tanzania if Dar-es-Salaam offers a better deal.

6.4.7 Energy

A further challenging issue relates to power problems, especially in Kenya. When President Museveni threatened, in late 1996, to cut off power supplies from Uganda to Kenya, he drew attention to a dispute which reveals both the problems and opportunities presented by regional cooperation in the energy sector. It is not that the region no longer produces sufficient power for its needs. At the signing of an agreement in 1954 for Uganda to supply power to Kenya, the supply far exceeded the needs of the three countries.

The Owen Falls Scheme, which is the source of power, was itself the product of an earlier era of cooperation when the East Africa Power and Lighting Corporation planned and provided for the region's collective power requirements. Uganda's complaint is that the existing contracts oblige the country to supply power at a third of what the market rates are. Across the region, supply has been falling, despite increasing demand. Kenya's 50 megawatts shortfall, which is around 8 per cent of its requirements, has prompted the authorities to adopt an energy rationing programme. Load shedding and blackouts are also familiar in Uganda and Tanzania (Financial Times, November 1996: 7). As factories operate below capacity, industrial growth is also compromised. It is thus imperative for the EAC to deal with this problem urgently to ensure a steady, stable and reliable power supply.

6.4.8 Stock exchange markets

Establishing and strengthening the capacity of stock markets will also constitute a difficult task for the EAC. Kenya, Uganda and Tanzania may have undertaken economic restructuring over the past decade, but progress in developing their financial markets has been hampered by outdated regulations, false starts and continued hostility towards foreign investors, especially in Tanzania (Financial Times, November 1996:7). By 1996, the region's biggest economy, Kenya, was the only country with a fully fledged stock market. The Nairobi Stock Exchange (NSE), founded in

1954, was Africa's fourth largest at the end of 1996, with a market capitalization of around US$ 2.33 billion. The market registered the biggest gains in the emerging markets sector in 1994 as local investors bought stocks ahead of the relaxation of rules for foreign investors (Financial Times, November 1996:3). The EAC's challenge will be that of encouraging the establishment of strong stock markets in both Uganda and Tanzania, and the adoption of rules that are investor- friendly.

6.4.9 The tourism sector

Tourism is a prime sector in the three East African countries. It is not only a major foreign exchange earner, but also an employer of thousands who work in hotels, tour companies and tourism-related activities such as curios trading. For the EAC to exploit the full potential of the region, there is the need, noted earlier, to offer East Africa as a single tourist destination. Tourism was one of the conflict areas that contributed to the collapse of the East African Community. As noted in Chapter 4, at that time, just as it is now, Tanzania was opposed to the idea of tourists landing and lodging in Kenya and only visiting Tanzanian tourist attractions by day. The implication then was that Kenya, which had better infrastructure and facilities, was always the main beneficiary, gaining well over 50 per cent of a tourist's total expenditure.

Tanzania arguably has a wide range of attractions that rival the best that Kenya can offer. Consequently, the EAC will inevitably have to develop an acceptable formula for how a single destination could ensure an equitable distribution of the gains arising from tourism. Competition is likely to be the path to adopt for the three countries, which puts Kenya in a relatively advantaged position vis-à-vis its partners. It is hard to predict the likely response that this will elicit from Uganda and Tanzania. This issue highlights once again the problem of the distribution of benefits in an integration scheme among countries at different levels of economic development.

6.4.10 Human resources development

The experience of the Newly Industrialized Countries has shown that development of a minimum

technological capacity is a prerequisite for sustained economic growth and development (EAC/ds,1997:30). Technological improvement not only enhances productivity but also the international competitiveness of goods produced locally. The East African region is therefore faced by the challenge of developing a substantial literate workforce that can easily adopt new production techniques. Experience in other regions has shown that such a workforce must have the minimum of secondary school level education. However, enrolment in this category and even at the primary level has been on the decline, especially in Kenya. This has partly been attributed to an increase in the cost of education as a result of structural adjustment programmes (SAPs) in member states (EAC/ds, 1997:30). Even more important is the need for both technical and industrial education which would produce a work force with the appropriate skills for rapid industrialization. At a time when government expenditure is being reduced, and universities can only enrol 30 per cent of the total eligible students (such as in Kenya in 1997), such objectives may prove quite hard to achieve.

6.4.11 The need for joint research

The defunct East African Community had a research and social council and other research institutions that carried out joint research in areas of common interest to the region, such as agriculture, industry and the medical field. The new initiative of the EAC aims to encourage joint scientific research and joint utilization of research findings in order to find solutions to various challenges that have emerged, particularly in the medical and related fields (EAC/ds,1997:32). The main obstacle to this objective will certainly be availability of funds . Like many other sub-Saharan countries, research and development endeavors quite often get minimal funding from state coffers. Indeed, most existing research institutions are joint ventures between the respective states and foreign donors.

6.4.12 Democratisation

For economic and social development to thrive, and for democracy and the rule of law to be upheld, an enabling institutional, legal and judicial framework will be necessary. Promotion of trade and investment within the region will require the building of confidence among potential

investors and business persons with regard to the safety of their businesses and property. This can only happen if their perception of the region is one of a place where the rule of law is upheld and court decisions are respected and enforced. National constitutions in the three countries have been found wanting in various respects by proponents of political liberalization. It is felt that there is a need to expand the democratic space in order to enhance the popular participation necessary for overall growth in the region (EAC/ds,1997:14). However, the intransigence of some of the current leadership and the hardened resolve by proponents for change continue to cause violent confrontations which damage the macro-economic objectives of the region. A peaceful transition will be the best option, especially for the nascent integration scheme.

6.4.13 The conservation of Lake Victoria

The EAC is also faced by the challenge of preventing Lake Victoria, the second largest fresh water lake in the world, from being completely choked by the hyacinth weed. Indeed, the exploitation of Lake Victoria's resources and the management of its environment are crucial, since it serves as a unique unifying factor for the three member states. It will thus be necessary for concerted efforts to be made to eradicate the weed, which threatens fishing and trading activities in the Lake. In spite of the problem having existed for over three years, the response by the respective governments has been slow and, while they delay, ports on the Lake are being rendered inaccessible. The Lake is not only a source of food for millions of people around it, but is also a mainstay of the fisheries industry, and a source of foreign exchange earnings and thousands of jobs. Further, it is an important trade route for vessels calling at various ports in the three countries.

6.4.14 Summary

This section has attempted to enumerate the most important challenges facing the new EAC initiative in the light of the collapse of the East African Community and the theory of economic integration among developing countries, especially those at unequal levels of development. It has been argued that overcoming the difficulties involved in achieving a genuine single market in East Africa depends largely on the political will of the participants in the EAC (EAC/ds,

1997:14). This is particularly the case since it is felt that the short-term benefits are likely to accrue mainly to Kenya, with its larger and more diversified economy and its strategic central position. However, it may be argued that, in the longer term, real growth and economies of scale will spread throughout the region if the political will for integration remains intact.

6.5 Conclusion

This chapter attempted a discussion of the new initiative of the EAC with regard to the opportunities it offers, the challenges facing it and the prospects for the future. Most of the challenges cited above are development-related and a lot may depend on how successful the region will be in attracting investment. Besides expending determined efforts to meet these challenges, the situation also demands a serious confidence-building endeavor from the respective member states in terms of security and general political stability. There must be purposeful policies aimed at building up sufficient confidence in order to improve the business environment for both local and foreign investors.

This confidence-building will not, however, be easy to achieve. All three economies are in the process of both political and economic transition. Further, the countries have suffered devastating climatic conditions under El Nino, which swept across the region from mid-1997 to early 1998 leaving huge destruction in its wake. Road networks that were already in a state of disrepair have been further damaged, making transport of goods very expensive. Moreover, there is a very real threat of famine. The propensity to import is set to increase, which will adversely affect the balance of payments position of the economies.

Other issues include serious industrial relations problems in Kenya, which are worsening the state of the already ailing economy. Beyond the borders of East Africa, international relations between Uganda and the Democratic Republic of Congo (DRC) are at their lowest ebb, as Kabila's government faces a rebellion supposedly sponsored by Uganda. The conflict in Southern Sudan continues and the tension between Eritrea and Ethiopia does not seem to ease. Somalia remains a chaotic, stateless society where hardly any economic activity can be registered in current circumstances.

These conflicts are all a threat to the overall stability of the East African region. The potential for internal conflicts to escalate and spill-over to neighboring countries should not be underscored. The refugee crisis, illegal arms and the general disruption of trade all have an adverse effect on the entire region. Such conflicts clearly need to be resolved at the earliest opportunity. The EAC should concertedly act as an honest and impartial arbiter in these conflicts with the aim of achieving peaceful solutions for each of them.

In spite of the various challenges that face the EAC, it is clear that there are positive prospects for the future. The economic and political reforms under way are already having a positive impact on governance in the region in general. There is more commitment by the leaders to involve more stakeholders in the process of economic integration in East Africa. This is particularly exemplified in the current public debate over the treaty set to turn the EAC into an East African Community for the purpose of establishing a stronger base on which integration will be built. The treaty was set to be ratified in November 1998, but the EAC Secretariat heeded a request by interest groups and civil societies to extend the debate in order to arrive at a more broad-based consensus over its various provisions.

With the implementation of the liberalisation policy framework deepening within the region, there are indications that the general upturn in the economies may be sustainable, particularly given the potential benefits accruing from a larger regional market. Although the effects of the newly-found cooperation may not be felt in the very short-run, it is noteworthy that cross-border trade activities have already started to increase with the easing of travel formalities and the convertibility of national currencies. Further entrenchment of cooperation is likely to bring more benefits to the regional economy, particularly in the fields of trade and investment. However, the issue of trade imbalances, and possible discontent stemming from the loss of customs revenue as trade barriers are eliminated, will remain potentially disruptive and require careful consideration by the EAC Secretariat.

CHAPTER 7: RECOMMENDATIONS AND CONCLUSIONS

7.1 Introduction

The numerous challenges facing the new initiative of the EAC, considered in the previous chapter, and the history of failure of such arrangements in Africa in the past, may cast serious doubts over the future prospects of the integration scheme. It is not easy to make accurate predictions concerning the future due to the rapid dynamism exhibited by the contemporary international system. However, by observing past and current trends, it is possible to make worthwhile projections and give viable proposals on the way forward. The aim of this chapter, therefore, is to provide some recommendations in the light of the discussion in preceding chapters and to draw some conclusions on the scheme's future prospects.

Sections 7.2 through to 7.9 discuss various recommendations ranging from the need for the EAC to lay more emphasis on policy harmonisation to the crucial importance of the political will and commitment of participants to the goals of the integration scheme. The analysis in these sections is not intended to be a detailed blueprint for future action on East African cooperation. Rather, an attempt will be made to highlight some key ideas towards a broad but realistic framework for the integration scheme in the light of past experience. The remainder of the chapter provides some conclusions and suggestions for future research.

It may be argued that, to facilitate a meaningful integration of the East African economies, realistic short and medium-term measures need to be clearly articulated. The initial focus should be on short-term objectives such as the rationalisation of existing organizations for cooperation. In the second stage, the thrust should be on harmonising the national development plans of member countries as a step towards fully integrating the regional economy in a gradual manner (see Section 7.2 below). This harmonisation process, Aly (1994:92) suggests, should take advantage of the IMF/World Bank-sponsored structural reform policies currently being implemented in almost all African countries (see Section 7.4). Particular emphasis should be placed on privatisation programs and debt /equity swaps, considered in Sections 7.5 and 7.6 respectively.

The proposed scenario needs to be supported by three main pillars in order to function effectively. These include an efficient payments mechanism, a more active role for the East African Development Bank (EADB) and other donors in the integration process, and the firm political will of East African leaders. These aspects are considered in Sections 7.7 to 7.9.

7.2 An emphasis on policy harmonisation

While the classical model relies on market forces in the integration process, and the interventionist approach stresses comprehensive regional planning, the strategy suggested by the EAC proposes the harmonisation of national development plans of member states. This has a close semblance to the approach used within the SADC, but the main difference is that SADC allocates the responsibility of harmonising different sectors to different partner countries, whereas the EAC would take responsibility for the harmonisation of all sectors itself (Aly,1994:96). It is argued that this would help circumvent the shortcomings of SADC's approach, notably the multiplicity of small and weak sectoral secretariats, complicated bureaucracies and the absence of a strong central coordinator.

Ideally, member countries should submit their national development plans to the EAC Secretariat for harmonisation and setting up the relevant framework for implementation. It may be difficult to persuade member states to make such submissions, however, and even if this is achieved, the work load involved in the harmonization process may be quite daunting. The alternative would be for the Secretariat to undertake appropriate research and then provide each member country with a set of guidelines and criteria to take into account in the preparation of national development plans. For follow up purposes, the Secretariat should be given observer status in each country's project implementation committees and its officials should be able to inspect projects that are agreed upon. A step in this direction has been the establishment in the three countries of fully fledged ministries to deal with matters of economic cooperation. The EAC Secretariat, in collaboration with the relevant ministerial coordinating committees, would be responsible for monitoring the implementation of harmonized plans.

Contrary to past approaches that focus on a specific sector as a spearhead for regional

development, the harmonisation process should involve concerted action "on a wide front" (Aly,1994:96). The Secretariat must insist on a parallel harmonisation of national development plans with respect to markets, the productive base and infrastructure. This would speed up integration through the large network of interrelationships among various sectors. For example, integration of infrastructure would help to integrate the region's productive base and markets by providing necessary facilities and services. Integration of production structures would push forward the integration of infrastructure and markets by making material and financial requirements available. Furthermore, liberalisation of intra-regional trade would in turn accelerate integration measures in the other two sectors.

7.3 Infrastructural development and the integration of production

In view of the challenges discussed in Chapter 6, notably the poor state of infrastructure in the region, it would be imperative for multilateral infrastructural projects to be implemented as a prerequisite for regional development. At the time of this study, the EAC Secretariat had already identified and estimated the cost of constructing various road networks. On the whole, transport and communications, energy and institutional infrastructure will need rapid improvement in order to enhance the integration of production and overall industrial growth in the region.

Integration of production could yield veritable benefits for the region in terms of economies of scale, as discussed in Chapter 3. This would help to alleviate persistent financial and material constraints, as it would enable member countries to pool resources and establish regional programmes in areas such as iron and steel and the development of lakes and river basins. Certain production areas should be given priority because of their obvious importance in the region. One such area will be food production, with a view to the attainment of self-sufficiency which is considered to be an urgent objective of economic policy in the region. Other important priority areas would be the production of intermediate and capital goods such as iron and steel, machine tools, fertilizers, chemicals, pharmaceuticals and building materials, as well as agricultural, transport and construction equipment (Aly,1994:97).

Special attention needs to be given to the harmonization of regional projects. Two categories of

regional projects are suggested by Aly (1994:98), in line with the criteria set by the agreement establishing the African Development Bank (ADB): those that jointly concern two or three countries and thus constitute truly multinational projects, and those that increase economic complementarity among countries, such as national projects with regional implications. The first category includes joint projects that form part of a common investment program and projects physically situated in one or more countries but involving joint investments undertaken and guaranteed by different countries. The second category comprises national projects that are situated in one country but utilize the goods and services from two or more countries as inputs, and projects established in one country with a view to achieving a balanced distribution of investment among participating states. The envisaged harmonization of regional projects should be enhanced by reform policies already under way. These include structural adjustment programmes (SAPs), privatisation and debt / equity swaps (considered below) which can be used to alter sectoral priorities on a regional basis.

7.4 Structural adjustment programmes

From the early 1980s, most sub-Saharan African countries, including those in East Africa, embarked on IMF and World Bank designed structural adjustment programmes (SAPs). The thrust of the SAPs has been directed to financial liberalisation and the deregulation of markets, with the aim of redressing financial imbalances and enhancing economic growth. Specific measures have invariably included, among other things, liberalisation of all prices including exchange and interest rates and prices of goods and services, the reduction of incentives offered to producers and exporters, trade liberalisation, rationalisation of public expenditures, and the restructuring of the public sector. They have also included recommendations for phasing out government subsidies for ailing industries and, in some cases, plans to rationalise production by closing down plants and factories whose demand for foreign exchange can no longer be justified in terms of their contribution to the national economy and the welfare of the general population.

Most of these measures could be implemented on a regional basis, thereby enhancing the possibility of the success of SAPs on one hand and furthering the process of regional integration on the other. For example, special incentives could be offered to exports destined for other

member countries and to producers who procure their production inputs from other partner states. Rationalisation of parastatals on a regional basis could help the Secretariat and member states to identify those concerns that are unviable and those which can be maintained for the benefit of the entire region. As noted in Chapter 6, the three currencies have become convertible, and a harmonious liberalisation of exchange rates would facilitate, *inter alia*, intra-regional trade. Fiscal harmonisation which is under way may further contribute to the establishment of a single investment area.

7.5 Privatisation

It could be argued that privatisation on a regional basis would give a powerful impetus to the integration process. Public ownership of the means of production has in the past been hailed in socialist countries as the means to social justice and equity, an inherent part of the Marxist strategy, while the Western industrialised societies, especially in the post-Great Depression period, came to view the public sector as crucial in the maintenance of stable economic activity over the course of business cycles (Aly,1994:99). This confidence in the public sector inevitably spilled over to the developing countries through colonial influence. At independence, this view was reinforced by a fear of multinational corporations, and the fact that, by and large, most indigenous entrepreneurs did not have the capital to start up big businesses. The latter was often a result of colonial economic policies that prevented the accumulation of private capital by the indigenous people. For example, as noted in Chapter 4, the local population in Kenya was not allowed to partake in cash crop farming which was confined to the white settlers only.

However, the performance of public sector enterprises has largely been disappointing. Most have led to an inefficient use of scarce resources and represent a drain on public funds, giving rise to large budget deficits, high inflation rates and external imbalances. Low prices ostensibly set to benefit consumers have discouraged producers, creating scarcities and an increasing reliance on imports. Credit allocation and subsidised interest rates have resulted in a bias towards capital-intensive industries. Low-yielding public investments and inefficient public enterprises have slowed growth and contributed to expanding public debt. Neglect of maintenance has led to a rapid deterioration of public assets. Excessive and poorly designed and implemented regulations

have contributed to growth in the underground economy, especially in the period before 1996. Many developed and less developed countries have embraced privatization as a consequence. Aly (1994:100) avers that even socialist countries have strikingly sacrificed ideology to pragmatism and begun a de-stating process.

It is likely, therefore, to be of great benefit if the process of financial liberalisation and market deregulation currently being undertaken within the framework of SAPs was speeded up. This would create the enabling environment to promote the private sector, encourage new private investments and eliminate public monopolies. It is further recommended that the possibilities of divestitures from various concerns be explored. Privatization may take the form of outright de-nationalization of state-owned enterprises through new share systems, particularly since East African capital markets have become more active. Another form of divestiture may occur through contracting out or franchising the production of state-financed goods and services to private firms.

A third form is concerned with deregulation or the introduction of competition into statutory monopolies, a kind of market-loosening that allows private enterprises to compete with parastatals in the supply of goods and services (Aly, 1994:100). Finally, privatisation may also take the form of the "hiving-off" of state firms into cooperatives owned and managed by their respective workforces. This presupposes an adequate level of technical and managerial expertise on the part of the workforce, as well as sufficient working capital and supporting services.

To make privatization relevant to the integration process, the outright selling of parastatals can be made to interested nationals of EAC member countries. This strategy could enhance the promotion and establishment of a strong and reliable regional private sector, as well as the expansion of regional capital markets. Public corporations may also be contracted out on a regional basis without discriminating against private firms that may wish to enter into such contracts.

7.6 Debt / equity swaps

External debt as a percentage of GNP for the three countries stood at 80 per cent, 167 per cent and 48 per cent for Kenya, Tanzania and Uganda respectively in 1994 (Financial Times, November 1996:2). Debt conversion schemes currently under consideration worldwide to alleviate mounting debt burdens could be boosted and could have positive effects on regional integration if handled on a regional basis (Aly, 1994:102). Since the debt problem came to the fore in the mid-1970s, various options have been proposed to deal with it. These include debt/ equity swaps, debt/quasi-equity swaps and debt securitization. Debt /equity swaps require the conversion (either directly or indirectly) of old fixed debts owed to commercial banks into direct foreign investments. A lending bank cancels part of its loan to an institution in a debtor country in exchange for an equity stake in that institution. In an indirect conversion, a creditor bank sells its loans at a discount to a foreign investor, who may be able (i) to exchange his or her claims for local currency at its full face value or at a lower discount than the one obtained at the time of purchase, and (ii) to use the proceeds to finance the local costs of the investment.

Debt /quasi-equity swaps involve the conversion of a fixed debt into shares in a country's export earnings. Export participation notes (EPNs) were originally used to accomplish this. However, a more narrowly focused approach was later initiated, linking debt payments to the price of exportables rather than export earnings, and was limited to particular export commodities with special marketing characteristics and price prospects. The instrument for the new scheme is called a commodity bond, which is a security whose returns (as either interest or redemption value or both) vary with the price of a commodity or a specified basket of commodities.

Debt /equity swaps could arguably boost the process of regional integration. Their merit lies in the fact that they create no financial obligations for the debtor country if the project fails (contrary to the original debt, which involves such obligations). Foreign exchange costs would only be incurred when the investment is profitable and the investor remits dividends abroad. Moreover, by selling old debts at a discount, debt conversion has the effect of reducing the debt burden. It may also reduce capital flight, because as long as the premium on the parallel market for foreign exchange is lower than the discount on the traded debt, residents would find it advantageous to

repatriate assets held abroad through debt conversion. Finally, because the proceeds of the conversion are used to finance new investments, debt conversion may have such indirect benefits as disseminating technical and management skills and promoting local capital markets (Aly,1994:102).

Among the drawbacks of debt/equity swaps is the fact that the process is applicable only to debt owed to commercial banks and not debt owed to governments or other official creditors. Unfortunately, most of the debt owed by EAC members is owed to official creditors, which limits the potential for conversion in individual member states. Secondly, most of the external debt to commercial banks is estimated to be much larger than the stock of foreign direct investment in the region, which means that tradable debts under these schemes cannot easily be accommodated in a given East African country. Third, conversion on a massive scale may imply a radical shift in the ownership of enterprises in East African countries, which may not be acceptable to national governments. Moreover, even if these swaps could in one way or another be accommodated in and acceptable to East African countries, foreign investors might be reluctant to invest in the region for other reasons. In spite of these limitations, the envisaged policy may partly help in addressing the debt crisis if co-ordinated regionally within the EAC. Indeed, a regional strategy for combating the debt problem could ensure that no EAC member country is constrained by debt-related problems, especially when it comes to the implementation of regional projects.

7.7 Payments mechanisms

Efficient payments mechanisms are of crucial importance within the EAC. Many countries in Africa suffer from intractable payments problems, notably a scarcity of foreign exchange, a lack of adequate credit facilities at the regional level, and the insufficiency of other payments arrangements, which have all combined to hamper trade among African countries. The only notable success on this front has been the Common Market for Eastern and Southern Africa (COMESA) clearing house, whose clearing system has allowed businesses to invoice their exports in their national currencies or in the Unit of Account of the Preferential Trade Area (UAPTA) (*http://www.comesa.int*).

Thus, for the EAC, whose members are also members of COMESA, appropriate measures need to be carefully devised in the short, medium and long term to deal with the payments problem. As noted in Chapter 4, one of the causes of the collapse of the East African Community was disagreement over the payments mechanism, worsened by the 1973 oil shock which caused a shortage of foreign currency in the region. In this section, the viability of a number of payments arrangements, including clearing systems, payments unions, reserve pooling schemes, limited convertibility arrangements, regional credit facilities and regional export credit will be discussed.

7.7.1 Reserve pooling schemes

These form one of the best payments mechanisms. They are also known as full monetary unions and sometimes as single currency areas (Aly,1994:106). A common central bank representing the monetary authority for a group of independent countries is established. The main tasks of this institution would be holding and managing the foreign exchange reserves of member countries, issuing a common currency and managing the monetary aspects (as well as some fiscal policies) of member countries. If other obstacles unrelated to payments are simultaneously dealt with, a reserve pooling arrangement would be likely to lead to the expansion of intra-group trade.

The EAC has stated its desire to commence the use of a single currency in the year 2000. Such a common currency (when and if it becomes a reality) would help to turn trade among the member countries into "domestic" trade by resolving all payments-related problems, notably the scarcity of international reserves, the complexity of foreign exchange controls and the multiplicity of foreign exchange regimes, and possible overvaluation of currencies.

7.7.2 Limited convertibility

This arrangement has many variants. The less rigorous involves the establishment of a convertibility arrangement among participating countries to permit the exchange and unrestricted use of national currencies in regional transactions. This is the scheme in operation within the EAC at the time of this study. Member countries maintain their separate currencies and exchange arrangements, but the tradability of the currencies is guaranteed in regional transactions. Against

the benefits that arise from this arrangement, some regional development problems may be triggered, arising from the loss of wealth in countries that previously had overvalued exchange rates.

In a more advanced arrangement, in addition to the tradability of currencies, an agreement is also reached to adhere to the same exchange rate regime and to set fixed exchange rates between member countries. This would reinforce the benefits expected under the basic arrangement by reducing exchange risks, but would call for further ceding of policy independence for individual countries. It may also accentuate regional development problems (Aly,1994:107). In addition, conflict may arise regarding the exchange rate regime to be used, as the same type of regime might not equally suit all partners. The practical difficulties of implementation require a strong political resolve from the leaders of member countries, just as in the case of a full monetary union. It is unlikely that firm preconditions for this arrangement exist in the EAC.

7.7.3 Regional credit facilities

These are mainly designed to provide short or medium term loans to resolve external balance of payments problems of member states. Such facilities vary in structure, terms and conditions, type of credit and sources of financing. They are to be resorted to in exceptional circumstances, especially when the cash cycle is temporarily interrupted or proves too weak to generate adequate foreign exchange reserves. Thus a regional credit facility would perform efficiently when balance of payments deficits are cyclical, but hardly operates in the case of perpetual structural deficits. In the first case, Aly (1994:109) suggests that there are always surplus countries supporting the deficit ones, who in turn will eventually be able to repay loans from surpluses accumulated throughout the peak phase. In the second case, the deficit country would have insufficient international reserves to cover the deficit, let alone repayment of old debts. Although such a mechanism has not been proposed in the EAC, it may be necessary for the Secretariat to consider it in the event of a development-stagnating balance of payments problem in any of the three countries.

7.7.4 Regional export credit

Financing foreign trade has traditionally been one of the major businesses of commercial and merchant banks. Aly (1994:112) points out that recently the idea of export financing has been considered at the regional level as a means of promoting intra-regional trade. He cites the example of Latin American countries which, in 1977, established the only existing regional arrangement of this kind, the Banco Latinamericano de Exportaciones (Bladex), to finance Latin American exports without conditioning such financing to economic policy reforms of member countries.

Finances were secured from subscriptions by members' financial institutions, investment in various financial markets and borrowing from the Eurodollar market. This scheme would appear less feasible in East Africa, given the problems of the acute shortage of foreign exchange and resource mobilisation. However, such credit facilities could be established with the assistance of the ADB. Alternatively, the private sector should be encouraged to set up regional financial institutions specializing in export credit. This could greatly enhance the export capacity of the region.

7.7.5 Clearing systems

These constitute a simple mechanism for financing intra-group trade. They are multilateral payments arrangements among the central banks of participating countries for the purposes of clearing all or some intra-group transactions. The main objective is to facilitate intra-group payments primarily through encouraging the use of national currencies in multilateral transactions, thereby economizing on the use of scarce foreign exchange reserves (Aly,1994:113). The main feature of these mechanisms is the use of a common unit of account for clearing transactions, with exchange guarantees to maintain the value of creditors' claims.

The other fundamental element of clearing mechanisms is a built-in, very short term credit facility of one to three months, a settlement period at the end of which a debtor bank must pay its balance in an agreed currency. Provisions are also made with regard to the setting of debit and

credit lines. In addition, all current commercial transactions that relate to products originating from within member countries, often including intra-government grants and loans, are usually eligible for clearing through this arrangement (Aly,1994:113). This mechanism has been widely adopted by various developing countries. Besides the COMESA clearing system, another example of a successful clearing mechanism is that adopted by the Latin American Integration Association (LAIA). The value of transactions settled in convertible currency in 1986 represented only 16 percent of total transactions, while those cleared through the scheme amounted to $6.2 billion or 85 percent of intra-group trade in that year, and a total of $77.6 billion for the period since 1961.

However, the performance of some clearing systems in Africa has been dismal. Several factors have been identified to account for the underutilisation of these clearing houses (Aly,1994:113). Prime among these are the structural imbalances in intra-group trade due, *inter alia*, to the polarization of growth in the more advanced member countries. The reduction of such imbalances can hopefully be attained in the long run within a comprehensive programme of regional development. In the short term, Aly (1994:114) suggests that the key to increasing the efficiency of the clearing mechanisms is to reform the existing clearing houses to resolve, as far as possible, the problem of structural imbalances in intra-group trade. Such reforms may include the creation of built-in, short and medium-term credit facilities. Currently, credit is generally restricted only to the settlement period and does not cover outstanding debit balances. The LAIA adopted this approach and established a credit mechanism within its clearing scheme to settle outstanding debit balances of member countries. The term of repayment is limited to four months, which can be extended to one year. By the end of 1986, LAIA member countries had made 62 drawings from the facility, which partly explains the more effective use of their clearing scheme. However, problems in the case of East Africa might be the temporary nature of credit mechanisms and the critical financial position of the region.

Harmonizing relevant practices and legislation to improve the performance of existing clearing mechanisms would be recommended as a priority in the short run. Particular attention will need to be paid to areas such as the rules and regulations governing payments and trade, the procedures relating to transfer operations, exchange control and exchange rate regimes, bilateral clearing

arrangements, relevant monetary policies, and other incentives to encourage the use of the clearing mechanism.

7.7.6 Payments unions

These are a modified and more developed version of clearing systems that provide, in addition to a clearing mechanism proper, a medium-term credit facility to help settle outstanding debit balances of participating countries. Credit might either be extended on a mutual basis among member countries or provided partly by outside contributors (Aly,1994:116). The European Union initially used such a mixed arrangement, with the US contributing $100 million but not participating in the scheme in any other way. Holding other things constant, the provision of credit would render the clearing mechanism more efficient in enhancing intra-group trade in East Africa. The suggestion of a payments union based on mutual credit is more feasible when trade balance reversals take place periodically, which may not be the case in the EAC given past trends in intra-regional trade.

As a result of growth polarization, less developed countries may be persistent debtors and the relatively well-off countries invariably creditors. This would put the payments union in an awkward position. Creditor countries may lose interest in participating in the arrangement, especially when they experience external balance of payments deficits necessitating the use of their credit balances. Further, unless they experience trade balance reversals, debtor countries would have no chance of settling their outstanding balances, particularly when they in turn suffer from persistent external balance of payments deficits. Nevertheless, this policy may be worth attempting, especially as Uganda and Tanzania continue to close the development disparity that exists between themselves and Kenya.

7.7.7 Summary

A critical review of six possible financing mechanisms suggests that the best mechanism for the EAC is the reserve pooling scheme already applied in the African Franc zone. Regional credit facilities are a tempting option, but face two intractable problems: persistent balance of payments

deficits in the participating countries and poor resource endowments. These two problems deprive the mechanism of its self-financing property and make it less applicable in the East African context. The same applies to the regional export credit approach which can be handled relatively efficiently by national commercial banks.

Clearing systems appear to be the simplest of all mechanisms, but are unfortunately rendered almost ineffective by structural imbalances in intra-group trade. In this context, complementary measures would have to be implemented, including an expansion of the list of goods and services passing through the clearing houses so as to include all key exportables, and the harmonization of relevant practices and legislation.

Payments unions provide both a simple clearing mechanism and short and medium-term credit facilities. They therefore face the same obstacles noted above concerning structural imbalances in intra-group trade, persistent balance of payments deficits, and inadequate resources. Two options have been proposed to resolve some of these problems. The ADB could be approached to finance the proposed credit facilities, or the African Monetary Fund, when it is fully established.

It would appear from the analysis above that the EAC countries have no other option in the short run but to strengthen the existing clearing mechanism as proposed above. In the medium term, the development of the clearing authority into a regional payments union, as explained earlier, is the most appropriate option. A regional monetary union should remain the ultimate aim for the future. As noted earlier, the development strategy of the EAC has proposed the year 2000 for the establishment of a single currency for the region (EAC/ds, 1997:Appendix). This is probably not a realistic projection especially in the light of the fact that it has taken the European Union over four decades to achieve a similar objective, and even then without succeeding to convince one of its major players, Britain, to join. COMESA has a more realistic timetable for the commencement of the use of a single currency, which they project could not be a reality before the year 2020 (*http://www.comesa.int*). However, the EAC member countries have had a common currency in the past and a common central bank. They could possibly build on the experience of the pre-1966 period when the regional central bank was still in operation.

7.8 The role of donors

The ADB has an important role to play in supporting economic integration in East Africa. The twenty-five years from 1967 to 1992 witnessed a substantial expansion in the activities of the Bank. As at the end of 1992, the Bank had committed a sum of $25.3 billion for over 1,760 projects to about fifty member countries (Aly,1994:120). However, there are some aspects of the Bank's functions that seem to conflict with the goal of regional integration. An inconsistency is evident in the Bank's terms of reference. Although committed to financing regional projects that strengthen intra-African cooperation, the statutes of the Bank and its affiliates put legal constraints on lending directly to regional organizations compared with loans guaranteed by governments. Further, when lending for multinational projects, the statutes require member countries to use their individual country allocations, although they have generally been reluctant to do so. The apparent lack of enthusiasm with regard to multinational projects could be because they are politically, juridically, administratively and technically complex. The Bank has consequently not promoted effective mechanisms for their identification.

Of the total cumulative Bank group lending to member countries of $25.3 billion as at December 1992, only $83.8 million or 0.4 per cent represented a commitment to multilateral projects. A sectoral analysis of loans disbursed for multilateral projects reveals that agriculture accounted for 25.6 per cent of total commitments, public utilities 23.0 per cent, transport 16.3 per cent, industry 14.7 per cent, social services 10.3 per cent and multi-sector projects 11.2 per cent. Geographically, the West African region received 28.2 per cent of all loans, followed by North Africa at 26.9 per cent, Central Africa at 16.7 per cent, Southern Africa at 14.8 per cent and East Africa at 13 per cent (Aly, 1994:121).

The EAC should, besides using EADB resources, approach the ADB for multilateral project financing. In addition, the ADB should play a more effective role in such ventures. Firstly, a trade window should be created within the ADB to provide short and medium-term credit facilities to the regional payments union that is to be established in due course. The possibility of extending these credit facilities to existing regional clearing houses can be explored, pending the establishment of the proposed payments unions. However, since the African Export and Import

Bank has already been established, it could carry out the latter function (Aly,1994:121).

Another important area is the financing of structural reform policies which are to be implemented at the regional level, particularly privatisation programmes. It is reported that the ADB committed about $1.3 billion in 1987 and 1988 to sectoral and structural adjustment loans. However, such reform programs should be coordinated by the economic grouping at the regional level. The ADB could increase the share of its loans allocated for multinational projects in an effort to enhance economic integration. If the ADB is able to undertake such adjustments, the EAC and, indeed, other regional groupings could in turn negotiate for more funds for their respective projects.

In the past, especially before the collapse of the East African Community, the involvement of external donors was rather controversial. Skeptics of external aid argue that it reinforces dependence on donors, who consequently enjoy firm control of the selection of development projects. There is also the possibility that donors might suspend their aid during the implementation of the project. Opponents further argue that the repatriation of profits could eventually result in net outflows from developing countries. Liberals, however, contend that, despite these risks, external aid is nonetheless indispensable, particularly in Africa where economies are too poor to generate financing requirements from within.

The experience of SADC may be beneficial to the EAC. SADC prepares a list of projects to be financed by donors both by sector and by country. For this purpose, it invites donors to annual fora to discuss proposed projects in an environment of mutual respect (Aly,1994:123). In this case, donor dictation is minimised. A similar arrangement could be attempted by the EAC. On the basis of studies carried out jointly by the EAC countries, the Secretariat could liaise with the donors in directing external aid to priority areas. For example, a recent road network study and cost estimation should be implemented through such an arrangement. More emphasis should be placed on program and sector aid.

7.9 Political will

The EAC's ability to implement the preceding recommendations depends critically on the political will of the East African leaders. Despite the failures of the past, economic cooperation appears to be an inevitable consequence of the current global economic environment. As noted in Chapter 5, with the end of the Cold War, the attention of foreign aid donors has shifted away from Africa to more investor-friendly countries where returns are expected to be substantial. Furthermore, the emergence of regionalism on a large scale suggests that individual states outside economic and political blocs may be marginalised.

The process of integration is a long and difficult one, often fraught with problems requiring determined and concerted action by all parties involved. The EU has taken several decades to attain its current cohesiveness, and a grouping like the EAC is likely to take even longer owing to its peculiar problems. Fortunately, the EAC has a past to learn from. However, the process will be costly in terms of financial, material and human resources.

It is important, therefore, that a strong commitment to regional integration is demonstrated by member governments which transcends changes of regime, for example. Intergovernmental agreements arising from the arrangement should remain binding regardless of any changes in government. Financial obligations should be met on time to enable the EAC organs to operate smoothly. Qualified personnel and chief executives who fully comprehend the intricacies of integration and have relevant expertise and proven leadership capabilities should be made available to the organization. The recommendations of the EAC Secretariat should be implemented in a timely manner, and there should be serious communication with the Secretariat as agreed.

Democratization will be an essential ingredient of the integration process. The process should involve all stakeholders, including business, professionals and the general populace. The involvement of business is crucial, particularly in the context of privatisation, debt/equity swaps and structural adjustment programmes. Furthermore, the general public must be educated about the merits of integration. The respective EAC governments should seriously consider holding

referendums in order to ascertain public support for regional initiatives. This could facilitate strong grassroots support from civil societies and the general public which could in turn help to diffuse potential personal differences among their leaders in the event of an international conflict. A bottom-up approach is to be preferred for the EAC.

7.10 Conclusions

From the analysis in preceding chapters, it may be argued that one of the major factors responsible for the poor performance of cooperation efforts in Africa in general over the past three decades appears to be the integration strategy adopted by various regional groupings (Aly,1994:35). This strategy was modelled on the classical European Economic Community (EEC) prototype, which is more appropriate in a developed country context. The underlying assumptions of the model may be said to have little relevance in the African context.

Nearly all African countries produce raw materials that seldom have regional markets or tariff problems on international markets. Furthermore, the manufacturing sector is very small in most countries and almost non-existent in some of them. In addition, it is often dominated by multinationals, which makes it extremely difficult for domestically-produced manufactures to qualify for community treatment, given rules of origin. This has rendered regional trade liberalisation programmes virtually ineffective. Even those products that can satisfy rules of origin requirements cannot be traded duty-free in the light of the inability of most African countries to find alternative sources of revenue, as well as the distributional problems associated with trade liberalisation.

Scarcity of foreign exchange aggravates the situation. Many African countries are unable to pay for their tiny intra-regional imports let alone honor their other obligations, nor have they been able to develop adequate credit facilities at the regional level to help alleviate difficulties with payments.

The remainder of this chapter will focus on conclusions drawn from the analysis in preceding chapters and sections. Sections 7.10.1 and 7.10.2 briefly outline what the study considers to be

two of the major problems that face most regional integration schemes in Africa. Section 7.10.3 focuses on specific conclusions with regard to the EAC, while the closing section (7.11) outlines some of the limitations of the study and offers suggestions for future research.

7.10.1 The indispensability of customs revenue

Assuming that some locally-produced manufactures could meet rules of origin requirements and therefore become admissible as locally-produced goods, a liberalization of trade in these products would, as noted above, be further frustrated by the inability of most African governments to do without the associated customs revenue. Given the financial crisis of various economies and the high share of customs duties in total revenue, member states may find it difficult to abolish tariffs altogether. There is a reluctance even to reduce tariffs for this reason, and other charges are often levied that have an equivalent effect, thus rendering liberalisation programmes for intra-group trade practically ineffective.

7.10.2 Foreign exchange problems

The pervasive chronic shortage of foreign exchange has been a major impediment to intra-African trade. It is, therefore, a major problem affecting regional integration and the operations of regional clearing houses. Scarcity of foreign exchange has also made it difficult for adequate credit facilities to be developed at the regional level, a necessary condition for expanding trade among the countries of the continent.

7.10.3 A rational strategy

The strategy adopted by the EAC to effect economic integration would appear to be a convenient blend of the market, development and neofunctionalist approaches outlined in Sections 3.2, 3.8 and 3.9 respectively. Various aspects of these models, carefully selected to suit the special circumstances of the region, appear to be quite evident in the guiding principles of the integration scheme, set out in its development strategy for the period 1997 to 2000. While there is an obvious intention to reap the benefits of an integrated regional market, there is also a strong indication

that this will go hand in hand with policy harmonisation aimed at establishing a single investment area. Furthermore, a crucial aspect of the neofunctionalist model, namely that a vital role is played by interest and professional groups in enhancing economic integration, is also envisaged within the EAC. The EAC's strategy appears to be more purposeful than that of the previous Community, which gave more emphasis to market integration and the joint ownership of assets by the three countries. The approach adopted suggests that lessons have been learnt from the failure of previous integration efforts.

Unfortunately, as things stand, the three economies complement each other to a limited extent. As noted in Section 5.6, on the export side, only Kenya conducts sizeable volumes of trade with its neighbours. Tanzania and Uganda are locked into commodity-dominated South-North trade patterns in their export trade while becoming increasingly reliant on imports from Kenya. The regional industrial base is similarly heavily skewed in Kenya's favour. As much as 75 per cent of manufacturing production within the EAC is located in Kenya. Tanzania's share of EAC industrial output is only 8 percent (Financial Times, November 1996: 2). These figures illustrate the polarization problem noted in Chapter 4, which was partly to blame for the break-up of the East African Community.

It was argued in Chapter 3 that complex formulae to redress this situation have little appeal given their track record elsewhere. One option could be an interventionist policy which would entail industrial planners allocating manufacturing projects on the basis of assessed comparative advantage. However, this policy would risk reversing the region-wide trend towards market-driven reforms, while simultaneously discouraging foreign investors who, understandably, dislike having their location decisions made for them by bureaucrats.

Possibly the most attractive solution, though one that might not commend itself to Kenyan industrialists, is to ensure that the region has a relatively low common external tariff (CET) of between 15 and 20 percent (Financial Times, November 1996:2). This would not only facilitate the flow of new industrial investment into competitive activities, but would also lower trade diversion, so that Uganda and Tanzania would not feel that their participation in the EAC involved buying high cost, indifferent quality imports from Kenya rather than sourcing from

cheaper suppliers in Asia and elsewhere. Clearly, Kenyan industrialists, already losing market share to South African and Asian imports, would be reluctant to see any reduction in their tariff protection, but may consider it worthwhile for eventual duty-free access to the Ugandan and Tanzanian markets.

It was noted in Chapter 5 that, due to economic mismanagement and the political instability that Kenya has been experiencing over the years, relatively more investments have been flowing into Uganda and Tanzania. This partly helps to lessen the polarization problem. Kenya's relative share of the US $14.2 billion regional market in GDP terms has also shrunk, because of the rapid growth of Uganda's economy, noted in Section 5.3. As a result, Kenya's GDP now accounts for 48 per cent of the total, down from 53 per cent in 1991, while Tanzania's has fallen to 24 per cent from 28 percent. Uganda's share of regional GDP increased from less than a fifth to 28 per cent over the same period (Financial Times, November 1996: 2).

The free movement of labour in the EAC could be a partial counter to polarisation to the extent that Ugandan and Tanzanian nationals are able to compete for jobs in Kenya. However, free mobility will be difficult to achieve given the high levels of unemployment across the region. More feasible in the medium term is the free movement of capital within the grouping. Given the scarcity of savings throughout the region, returns from investment could be enhanced by greater capital mobility, through the banks and capital markets, enabling Ugandan and Tanzanian companies to benefit from the Kenyan Stock Market. Further, the harmonisation of tax rates that are already broadly similar, and of investment regimes including export processing zone arrangements, would put an end to the zero-sum game competition between the region's investment centers, which often compete among themselves for the same projects.

As noted in Chapter 6, there could be cost and scale advantages from marketing East Africa as a regional tourist destination. As a single market, the EAC has a greater diversity of tourist attractions than any one of its parts. Further, a cohesive regional solution to the run down infrastructure in all three countries could attract greater donor and private sector support than existing piecemeal approaches. The US $ 1 billion extended to the EAC by the World Bank in 1998 for regional road network rehabilitation reinforces this notion.

Finally, it may be argued that there are still prospects for mutually beneficial integration between countries at unequal levels of development. This was suggested in the analysis of the defunct East African Community in Chapter 4 where, in spite of the resultant trade diversion, there appeared to be a substantial gain in terms of GDP growth in all three countries. This contrasts with the orthodox argument that a trade-diverting arrangement will necessarily be detrimental to the welfare of some of its participants.

In the new EAC, Uganda and Tanzania's disadvantages on the trade front could be offset by enhanced cooperation in services. Uganda could supply hydropower to Kenya, while Tanzania's Songo Songo gas project could also be developed as a regional resource providing power to Kenya. Although industrialists believe that Uganda would find it enormously difficult to compete with manufactured imports from Kenya, there is scope for Uganda to develop exports of food and agricultural materials (maize, sugar and cotton) alongside processed agro-products.

As noted in Chapters 3 and 4, corrective and compensatory mechanisms may be required to redress the possible imbalances that may arise. However, no regional arrangement can be wholly equitable. There will always be one or more members that benefit more than the others. It may be argued that policy-makers need to focus less on how the benefits might be shared and more on boosting economic growth in the region as a whole, primarily by implementing outward-looking trade and investment strategies. Leaders should consider whether any of the three countries would be better off outside the revived EAC than within it. Given the current strength of the reform movement in the region, cooperation may be seen as a vehicle for opening up and globalising the three economies. It may be argued that the reactivated integration scheme has the capacity to become a game in which there are winners all round.

7.11 Suggestions for future research

This study faced a number of limitations, some of which are mentioned below. It was initially intended to carry out interviews with diplomatic officials representing the three countries, officials of the EAC Secretariat at the headquarters in Arusha, Tanzania, and various trade associations and personalities directly involved in the new initiative of the EAC. However,

funding difficulties prevented this research from being carried out, which denied the study vital first-hand information which would have facilitated appropriate policy recommendations.

The fact that the study was carried out at a time when the EAC was still in its nascent stages also placed some limitations on data availability. The integration arrangement was barely two years old at the commencement of this study and therefore not much literature had been generated on the scheme. Moreover, due to the frequent changes occurring within the EAC regarding, for example, the implementation of various agreed policies, it was sometimes very difficult to keep abreast with developments, and continual adjustments were necessary to accommodate new information on a regular basis.

It would thus be useful to evaluate the progress and achievements of the EAC with respect to its stated objectives in, say, the year 2001. This would be five years after the inauguration of the new initiative. It would also be the end of the implementation period of the current development strategy, which is supposed to lapse in the year 2000. The effectiveness of the development strategy could therefore also be specifically assessed.

In addition, there is a need for a specific study on intra-regional trade, especially after the elimination of barriers to trade among the three countries. Along with this, research could also be carried out in order to assess the effectiveness and success of the approach to integration adopted by the EAC.

The possibility of expanding the EAC to cover countries that have already indicated their desire to be admitted to the regional grouping should also be examined. One such country whose membership is still under consideration is Rwanda. Such a study should look into the implications and viability of such expansion, particularly where potential new members are at a greatly differing levels of development.

APPENDIX I: LIST OF ACRONYMS

ADB	African Development Bank
AFC	Agricultural Finance Corporation
APPER	Africa's Priority Programme for Economic Recovery
CEPGL	Economic Community of the Great Lakes Countries
CEAO	(French speaking) West African Economic Community
CEMAC	Economic and Monetary Union of Central Africa
CET	common external tariff
COMESA	Common Market for Eastern and Southern Africa
CU	customs union
DFIs	development finance institutions
DRC	Democratic Republic of Congo
EAC	East African Cooperation
EAC/ds	East African Cooperation Development Strategy
EACM	East African Common Market
EADB	East African Development Bank
EAHC	East African High Commission
EACSO	East African Common Services Organisation
EASRA	East African Member States Regulatory Authority
EC	European Community
ECA	United Nations Economic Commission for Africa
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
EU	European Union
FTA	free trade area
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
ILO	International Labour Organisation
IMF	International Monetary Fund
KFA	Kenya Farmers' Association

LDCs	less developed countries
LEGCO	East African Legislative Council
LPA	Lagos Plan of Action
MNCs	multinational corporations
NGOs	non-governmental organisations
NSE	Nairobi Stock Exchange
PTA	Preferential Trade Area
PTC	Permanent Tripartite Commission
REWS	Regional Early Warning Systems
SACU	Southern African Customs Union
SADCC	Southern African Development Coordination Conference
SADC	Southern African Development Community
SAPs	structural adjustment programmes
TNCs	transnational corporations
TRA	Tanzania Revenue Authority
UDEAC	Customs and Economic Union of Central Africa
UEMOA	(French speaking) West African Economic and Monetary Union
UMA	Arab Maghreb Union
UNESCO	United Nations Educational, Scientific and Cultural Organisation
UN-NADAF	The United Nations New Agenda for the Development of Africa
UN-PAAERD	The United Nations Programme of Action for African Economic Recovery and Development

APPENDIX II: STATISTICAL DATA FOR CHAPTER 4

Table A-1: Area and population, 1961

	Kenya	Tanganyika	Uganda
Area, 1000 sq.km			
Land	569	884	197
Water	13	53	39
Total	583	937	237
Population per sq.km of land area	14.7	10.7	34.7
Population ('000)			
Africans	8,082	9,281	6,751
Europeans	59	23	12
Asians & others	211	117	82
Total	8,352	9,421	6,845
Approximate proportion of total population living in towns, per cent	7	3	2

Source: (Hazlewood, 1975:4).

Table A-2: Estimated population, 1973

	Thousands
Kenya	12,482
Tanzania (mainland)	13,974
Uganda	10,810

Source: EASD (1973) cited in Hazlewood (1975:4).

Table A-3: Gross domestic product and sectoral structure

Years	Average 1961-3			1971		
Country	Kenya	Tanganyika	Uganda	Kenya	Tanganyika	Uganda
Total GDP, $m. Of which per cent:	243	212	163	576	442	469
Primary production	42	62	65	32	41	55
Manufacturing	10	4	4	13	10	8
Construction	3	3	2	5	5	2
Services	46	32	29	51	44	35

Source: (Robson and Lury, 1969:321) cited in Hazlewood (1975:5).

Table A-4: Gross domestic product, 1971

	Kenya	Tanzania	Uganda
Non-monetary			
Total GDP shs.m. Of which per cent:	2,538	2,573	3,159
Primary production	80	74	91
Manufacturing	8	3	1
Services	12	23	8
Monetary			
Total GDP shs. M. Of which per cent:	8,978	6,273	3,159
Primary production	18	27	37
Manufacturing	16	14	13
Construction	4	7	2
Services	62	52	48

Source:(Hazlewood,1975:6).

Table A-5: Income per capita, 1962 (in pound sterling)

	Kenya	Tanganyika	Uganda
African, monetary	7	8	10
African, total	15	16	17
Non- African	400	371	291

Source: (Hazlewood: 1975:6).

Table A-6: Share of small farms in monetary agriculture (per cent)

Kenya		Tanzania		Uganda	
1960	20	1960-2 av.	58	1960	80
1962	52	1968	74	1970	77

Source: (Hazlewood,1975:6).

Table A-7: Exports as a percentage of GDP

	1962	1971
Kenya	21	16
Tanzania	37	28
Uganda	35	27

Source: Hazlewood,1975:6).

Table A-8: Source of main tax revenues (per cent of East African total)

Country	Kenya		Tanzania		Uganda	
Year	1960	1970	1960	1970	1960	1970
Import duties	45	48	31	30	24	22
Excise duties	42	43	29	30	29	27
Income tax	60	58	20	25	20	17

Source:Hazlewood (1975:7).

Table A-9: External and inter-territorial trade (in millions of pound sterling)

	Kenya	Tanzania	Uganda
1961			
External			
Exports	41.7	50.6	41.3
Imports	68.9	39.7	26.5
Balance	-27.2	+10.9	+14.8
Inter-territorial			
Exports	15.9	2.2	6.9
Imports	7.0	10.6	7.4
Balance	+9.0	-8.4	-0.5
Total			
Balance	-18.2	+2.5	+14.3
1971			
External			
Exports	78.4	89.6	84.0
Imports	184.1	120.7	68.1
Balance	-105.7	-31.1	+15.9
Inter-territorial			
Exports	33.9	9.9	8.9
Imports	16.0	15.6	21.1
Balance	+17.9	-5.7	-12.2
Total			
Balance	-87.8	-36.8	+3.7

Note: Exports = domestic exports + re-exports

Source: Annual Trade Reports (1961 and 1971) cited in Hazlewood (1975:7).

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