Introduction

The foregoing chapters argue strongly the ease for a common market for countries of South Asia in order to accelerate their economic growth. But an integration scheme even in its simple form is beset with a whole host of problems. Such problems may relate to the agreement of the scheme, its chances of survival and its eventual success. The countries joining the market should believe the benefits accruing to them to be greater than could be achieved by not forming the common market. They should be prepared to adopt certain policies required by the integration process and have the necessary will to overcome the obstacles.

The present chapter deals with the problems in broad outline in an attempt to identify the principal issues and seek possible solutions. The likely problems
with which the formation and eventual success of the South Asian common market may be confronted are enumerated as follows:

1. Problems arising out of the Generalised System of Preferences (GSP) and other barriers;
2. Problems arising out of different economic systems;
3. Difficulties of plan harmonisation;
4. The question of distribution of benefits and costs.

The Generalised System of Preferences and other Barriers

The adoption of GSP under the auspices of GATT in 1970 may well be regarded as a major breakthrough in the trade relations between the developed and the developing countries of the world. It led to the replacement of the principle of reciprocity in trade relations between these two sets of countries by the principle of non-reciprocal tariff preferences for the manufactures and semi-manufactures of the developing countries in the markets of the developed countries.¹

¹ The system was to apply to all the developing countries without discrimination and covered 18 developed countries as well as 5 socialist countries of Eastern Europe.
During the time that has elapsed since the coming into operation of the scheme, it has been found that it is the larger, better endowed and more industrialised among the developing countries which are deriving the greatest benefits from the schemes while the smaller countries have not been able to reap these advantages owing to the small productive capacity, their narrow resource base and their technological backwardness.

In fact, least developed countries of the South Asian region, for the instance, Nepal and Bangladesh, may thus be largely unaffected by the granting of tariff preferences under the GSP, as their physical and human infrastructures are too narrow and their production methods too rudimentary to allow them to make any use of the opportunities offered, unless they join the neighbour in an effort to overcome their common problems within the framework of economic integration. Only under such circumstances are they likely to move forward towards the creation of modern industrial capacity geared to

1. Thus ability to benefit in turn, depends on the developing country's size and level of infrastructure and technological development as also on the ability to satisfy the conditions attached to the scheme of preference granting countries. Indeed, in developing countries, at an early stage of industrialisation, manufacturing activity is mostly confined to processing of imported semi-finished goods, the import content of which is generally too high for the goods to qualify for preferential treatment under the GSP. Thus, in the long run, this particular restriction is less of an obstacle to the relatively more industrialised countries than it is for the least developed and the intermediate group of developing countries, which are only able to carry out smaller transformation processes or add a modest share of the total value to the imported input.
the needs of the regional market in the first instance and to the GSP markets of the preference-giving countries at a later stage.¹

South Asian common market may thus act as a major instrument for the small developing countries of the group to overcome the handicaps described above, if these countries base their industrialisation programmes on the combination of import substitution and export-oriented industries. Although the immediate objective of most economic integration movements tends to be import substitution on a regional scale, limits to this process will sooner or later appear just as they do in the national context. It is at this point that the extra-regional exports become essential if the process of raising productivity level is to continue.

This latter process not only involves the establishment of units with large production capacities in order to take advantage of the economies of scale and more advanced techniques of production but also lead to

¹ Project studies carried out recently in South-East Asia on the cost curves of some of the basic industries, such as chemicals and petrochemicals, machinery, glass, and newsprint, show that the unit cost of production can be reduced by as much as 25 per cent, or in some cases, even more, if capacities are doubled or trebled to cater to an integrated market of three or five countries.
specialization within the industrial sectors as well as in particular skills both manual and managerial. As specialization on a regional or sub-regional scale is likely to be accompanied by appropriate measures for intra-regional trade liberalization, the increase in trade among the members of the grouping should also result in the acquisition of experience in exporting techniques in the relatively less competitive regional market. Such experience may subsequently help exporters exploit the opportunities offered by GSP in the market of the developed countries, where competition is keener.¹

The GSP schemes currently in operation consider all beneficiary countries as separate units, so that each of them must comply with the original criteria on the basis of its own natural resources i.e. unaided by any transformation or value-added in another developing country even a partner in the same economic grouping.² These 'rules of origin' tend to restrict the benefits of GSP to a smaller group of countries than would be the case if they were so amended at least to treat the

¹ In this way the small countries of the proposed group can aspire to a fair share in the common effort to expand export of manufactures and semi-manufactures to the third countries with the help of GSP.

organised grouping as one economic unit. Moreover, they constitute a centrifugal force tending to undo the progress already achieved in the field of economic cooperation and integration among the beneficiary countries.

In order to counteract those features of GSP which may tend to operate to the detriment of the members of the proposed regional grouping, it may be suggested that the developed market economy countries should examine the possibility of permitting developing countries belonging to sub-regional or regional groupings to utilise the cumulative treatment principle. This principle has come to be known as 'cumulative treatment principle' as opposed to the principle of a 'single-country treatment'. In the case of preference schemes, using the value-added criterion, imports from the developing countries which enter into the production of a particular commodity would be reckoned along with the value-added by the exporting country itself to determine whether the accepted level for local content (40 to 50%) has been met. In schemes using the process criterion, goods should be eligible for preferential treatment, resulting from combining the manufacturing process in more than one developing country within the region.

1. Cumulative treatment principle, however, is approved by GATT under article XXIV, See GATT, Basic Instruments and Selected Documents, Geneva, 1969; Vol. IV, p. 41.
The present situation in which the countries of the region restrict their imports from other countries of the region is more of a by-product of the general control system than the result of conscious effort to keep the regional goods out of the market. Generally speaking, these countries have made no real efforts to take into consideration the interests of other countries of the region when framing their import regulations. On the contrary, since many of the products made by countries of the region are not considered essential to their development programmes, there has been no incentives for governments deliberately to favour regional suppliers. This has led to a general apathy among the countries of the region towards the potential of intra-regional trade.

The ECAFE Working Group of 1963 suggested the following classification of barriers to intra-regional trade: (a) Barriers which are the result of deliberate government action to restrict trade, whether directed at trade in general or specifically at intra-regional trade. Such barriers take primarily the form of quantitative restrictions (quotas) and of tariffs and measures of equivalent effect. (b) Barriers which are the result of government action (or inaction) but of which the effect on intra-regional trade is incidental or secondary. One example would be if businessmen found difficulty in obtaining visas to other countries of the region in
search of opportunities for trade. (c) Barriers which are not the result of governmental action but which are implicit in the geographical and economic structure of the region. ¹

However, the impeding effect of such arrangements may be easily over-estimated. As the ECAFE Working Group of 1963 observed, "It does not seem likely that the existence of these extra-regional preferential arrangements would be a serious handicap to the establishment of a kind of limited preference area that might be established between some countries of the ECAFE region. They could present an obstacle to the establishment of a complete customs union, because the interests of the extra-regional countries benefiting from the preferential agreement might be significantly affected. But there are a number of ECAFE countries among which it would be possible to establish a preferential area limited to goods produced in these countries without any real difficulty arising from the existence of extra-regional preferences." ²

1. Barriers result from preferential association of some regional countries with extra-regional trade partners. Extra-regional preferences have ceased to be important only very recently. Until a few years ago, India, Bangladesh and Sri Lanka participated in the Commonwealth Preference System with the United Kingdom. These arrangements secured a preference for the products of the participating countries in the markets of the British Commonwealth. At the same time extra-regional preferential benefits inevitably discourage the growth of the intra-regional trade.

In Sri Lanka, government agencies play a dominant role in imports, particularly in the imports of essential goods. Commodities classified as essential are rice, sugar, cement, caustic soda, cotton yarn, newsprint, petroleum products, textiles and manufactures of textiles material. These are largely handled by government agencies. Import duties on these commodities are low in relation to duties levied by other developing countries in the region. The duties levied are a mixture of ad valorem and specific rates. The government regulates imports by quantitative import restrictions and commercial importers are required to import at the government fixed foreign exchange rates. As a result, tariffs are not a chief deterrent to imports.

Imports are grouped in three categories: essential, less essential and non-essential. Non-essential commodities and goods that can be produced locally are subject to very high tariffs and/or quantitative restrictions. This encourages domestic industries and reduces the consumption of luxury articles. The availability of import licences differs according to whether goods will be imported by actual users for manufacturing purposes, for their own use or for trading in domestic markets.¹

Tariffs are used to raise revenue, control the balance of payments and for protection. Exemptions and

low rates are applicable to essential goods and higher rates are levied to protect the domestic industries and restrict the import of luxury articles. Preferential treatment was granted to the imports from other commonwealth countries.

India can be cited as another example of a country which uses strict import control measures when in balance of payments difficulties. India adopted reasonably liberal import policies before its second five-year plan was initiated but an import quota system was introduced in 1957 and this has been gradually tightened as foreign exchange became increasingly scarce. Attempts were made for sometime to overcome economic problems without devaluating the domestic currency but rupee was devalued in 1966. Some import quotas were relaxed at that time but no great increase of imports resulted. Duties are levied on nearly all commodities and the rates are high.1

Taking these barriers into account, the economic integration scheme in this region may not envisage general trade liberalisation to begin with but only the freeing of trade in items produced by common enterprises. Progress in this direction of trade liberalisation may however, have to encounter a number of difficulties. Firstly, item by item negotiation on tariff reductions

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faces considerable difficulties because of the power of special interests. Secondly, the differences in the level of industrial development may make agreement on trade liberalisation difficult. Thirdly, in view of the distortions in relative prices due to protection, it would be difficult to determine the benefits to be derived from integration.

However, the use of free market prices reflecting resource scarcities will clarify the available choices and reduce uncertainty with regard to possible gains and losses from liberalisation. As a result, there will be less resistance to the elimination of barriers on intra-group trade.

Different Economic Systems: The Problems of State Trading

Countries of the proposed region also differ from the developed countries in so many other respects. First, these countries are more likely to be characterized by monopolistic and oligopolistic structures in the organised sector of their economies than the developed countries. Secondly, these countries have a more vital and extensive public sector than the industrialized countries forming the economic integration schemes. Finally, these countries are more regulated by the non-price measures of one type or the other than most of developed economies. For all these differences the behaviour pattern of South Asian
countries, whether of the free market type like that of Nepal or the centrally planned type like that of Burma, is likely to differ significantly from their counterpart developed countries.

As such, economic integration among the South Asian countries cannot be the prototype copies of those prevailing among the developed countries whether market or centrally planned. The importance of models such as EEC and EFTA is further reduced when account is taken of the fact that integration arrangements among South Asian countries typically involve countries with significant differences in their economic systems.¹

In this group, Burma is committed to moving in the direction of a centrally planned economy while Sri Lanka, Nepal and Bangladesh remain more or less private enterprise economies.² Another difficulty may

1. Nepal is more near to the free market type of economy though recently state has tightened its control over the foreign trade with some effective measures, while Burma thought not exactly a centrally planned economy but is akin to it.

2. The juxtaposition of countries with different economic systems within the same regional grouping gives rise to a variety of problems which may be absent in groupings of countries with more homogeneous systems. These problems may arise on account of differences in development objectives, strategies and policies, and differences in the principles and practices of the organisation of the economies. An example of the kind of problems that arise in such situations is provided by the role of foreign capital in the enlarged market. Countries with centrally planned economies are generally opposed to the unimpeded inflow of foreign private investment. Burma, for instance, till recently had closed its doors to the inflow of foreign capital. As a rule, they will have evolved elaborate criteria setting out the conditions under which private foreign capital may invest in these countries.

(Cont'd.)
be faced in the matter of industrialisation policies. The countries attempting to move in the direction of centrally planned economies may press for the regional planning of industrialisation and the agreements for the allocation of specific industry to member countries. Private enterprise economy countries may, on the other hand, prefer to rely on the free play of market forces.

Most of the difficulties, however, centre round commercial policy, where differences in economic systems and institutions may significantly affect the patterns and processes of trade expansion.1

**Impact of State Trading Enterprises**

When regional trade agreements among countries with different economic systems are considered as is typically the case with the group of countries under consideration, the existence of state trading enterprises creates difficulties in the way of its expansion.2 If the emphasis in the regional trade arrangement is placed on trade liberalisation through the abolition of trade barriers and reliance on market forces, state trading enterprises may hinder the objective in several ways:

Protection of Domestic Products:— State trading enterprises may follow a discriminatory purchasing policy which has the object of providing protection to domestic products against imports from member countries in contravention to the agreement on economic integration. There are many ways of varying degrees of subtlety through which the discriminatory purchasing policy may be practised. Either acting under instructions or on its own initiative, a state trading enterprise with monopoly in importation may decide not to import a product from the member states, even though on grounds of price, quality or terms of payment or delivery, the imported product may be considered superior to the local product. A slightly more subtle way of pursuing a discriminatory policy is by adding high mark-ups to imports or of charging high commissions to wholesalers so that imports are put at a price disadvantage in the domestic market. The possibilities of discriminating against imports by this means obviously increase with the number of state controlled stages of distribution of imports.

The administrative procedures for obtaining imports whether by the state trading enterprise or by agents appointed by them could be so burdensome and lengthy as to constitute a serious barrier to trade.

There are a number of other ways through which imports from the partner country may be discriminated.
have been intended. The cumbersome procedures relating to imports may stand in the way. In addition, state trading enterprises may contribute to inefficiency and confer unintended benefits on local producers.

**Discrimination against Partner States Vis-a-Vis Third Countries:** A state trading enterprise may also discriminate against imports from member countries in favour of imports from third countries. This may happen for instance if the country has trade, aid or payment agreement with another country outside the trading bloc, under which it enters into a commitment or finds it advantageous to purchase specified quantities or values of certain products from it. Even in the absence of such an agreement, state trading enterprises acting under instructions or on their own initiative may pursue a policy of buying from the cheapest source in disregard of the tariff schedule in existence. If their decisions are based on c.i.f. values on imports, then the tariff discrimination in favour of suppliers in the regional bloc, which is the basic incentive of a free trade scheme is eliminated and member countries are treated at par with suppliers from third countries. While such a policy is rational from the short term national point of view of the country, it is incompatible with the schemes of regional economic integration.

State Trading Enterprises and their impact on the distribution of gains and losses: The presence of state trading could constitute an impediment to the objectives of integration; whether in a particular case it does so or not will depend on the nature of the framework within which state trading in a member country operates, and the commercial policy pursued by the country in the group.¹ Lack of common code in decision making is likely to result in purchases being made on a commercial basis rather than being influenced by political considerations or the wider economic policy of the government. If the policies of the state training enterprises are largely determined by the government, as generally tends to be the case, the issue is settled by the instructions received by the enterprises. If there is a genuine commitment to the idea of regional integration or the desire to make it work, the state trading enterprise is expected to follow a non-discriminatory purchasing policy fully reflecting tariff differentials. On the other hand, in situations of domestic excess capacity, unemployment and balance of payments difficulties, state trading enterprises are more likely to be under pressure to buy domestic products than profit maximising private traders. Similarly,

if the structure of the state trading enterprises permits a degree of competition among them, the enterprises are more likely to follow a policy of buying from the cheapest source in the region than if they are granted monopoly power.

The Potential Benefits: Whereas state trading is a handicap in the integration schemes of countries with different economic systems, it may be turned into an instrument to promote regional economic integration. State trading enterprises would appear to be particularly suitable means of trade expansion in at least three situations: In the first place, as is well known, trade among developing countries is hampered not only by the high cost and low quality of the many of the manufactured products but also by the failure to develop adequate commercial and financial links, by lack of information about product availability and the prejudices of importers and distributors in favour of the well-known brands originating in developed countries. State trading enterprises are well suited to counter some of these obstacles to trade expansion among member countries by forging new commercial and financial links, by introduction of new products and brands and generally by improving the knowledge about the product availability and the marketing possibilities in the member countries.
Secondly, in situations where intra-regional trade is hampered by an overall lack of foreign exchange as reflected in quantitative and other restrictions or in detailed regulation by direct controls in countries practicing some sort of central planning, state trading can play a positive role in trade creation through agreements to expand trade annually among member countries, by specified amounts or proportions. State trading enterprises may be better able than private traders to fulfill trade commitments embodied in such bilateral or multilateral agreements.

Thirdly, where the emphasis in a particular integration scheme is on trade expansion through the coordinated development of new industries on a region-wide basis as is very much the case in South Asia, state trading may be better suited than the private traders to fulfill commitments with respect to exchange of particular products. This is so because it is easier for the government to control the policies and plans of state trading, to ensure compliance with such undertakings, especially when some of the transactions may not be fully justified by private commercial considerations. This point is particularly relevant in situations when the existence of an integration scheme may be threatened by large imbalances in trade among the member countries. Corrections of such imbalances may require purchases from the deficit countries even when these may be
justified on purely commercial grounds. Private traders interested mainly in profit maximisation cannot be expected to take such considerations into account when making purchasing decisions.

**Difficulties in Plan Harmonisation**

The countries of the region would perhaps face the greatest difficulty in harmonization of their plans. Indeed, complete plan harmonization is even theoretically a very difficult task; partial plan harmonization or for that matter, commodity to commodity agreements would require greater effort for their fulfilment.

Firstly, these countries have embarked upon national plans of self-sufficiency and regional compromise would require readjustments. Secondly, harmonization would require the participating countries to relinquish their freedom of action over progressively wider areas of economic and social policy much against their will.

Again, plan harmonization cannot be carried out in a comprehensive way. It may be possible to harmonize new or basic industries, but the centralisation of existing industries in one country will be allowed to proceed and

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1. India and Bangladesh are under a balanced trade agreement and the imbalances in the Bangladesh's exports have been met by the export of raw jute to India.
often the introduction of new consumer good industry may not be considered the subject of control. Thus there will be some industries which will be considered wholly "new" and thus the scope of plan harmonization may be very much reduced.

The inclusion of infrastructure projects, establishment of regional institutes of technical training etc., in a common plan implies the existence of a common fund for this purpose. Member countries may of course subscribe part of their investment funds, but such schemes would meet with greater acceptance if partly financed by institutions like ADB or some other international organisations.

Again, the decision on the location of new plants or industries may not receive the consent of all the partners. The best way to ensure this probably is to evolve a package deal that is seen not to ask for undue sacrifices from any of the partners and to have the agreement publically endorsed by the governments that are parties to the scheme.

While harmonizing their plans at the regional level, partner countries aim at a balance in matters of benefits in these areas. But this over-emphasis on complete balance will make regional planning impossible. This is accountable to the fact that it is not possible to predict precisely the effects that plants or industries
etc., will have over time on the important policy objectives of national governments like employment, foreign exchange, savings etc. If partner governments place excessive emphasis on reciprocity of benefits in these areas, the scheme will never be negotiated. This means plan harmonization policy must be handled flexibly.

If the partner countries retain their sovereignty in economic policy, uncertainty about the prospects of the common market will continue. Therefore the benefits may not be realised or may only be realised very slowly. However, the desire to overcome the uncertainty may create a momentum to proceed to greater interdependence. At every stage the process may reverse itself if necessary measures are not taken unanimously by all partners. Continuous renunciation of national control over economic policy is the price that countries must pay to achieve successful integration.

**Distribution of Benefits and Costs**

The need to promote some sort of economic integration schemes for the countries of South Asia has been widely accepted. But in the process of integration emerges the problem of distributing the benefits and costs among the participating countries. This problem has been at the root of the major crises that have
occurred and are still occurring in several integration schemes notably the Central American Common Market (CACM) and East African Community (EAC).\footnote{1} It has become so to speak, the Achille's heel of the process of integrating developing countries.

It is quite conceivable that the potential plan for the South Asian Common Market cannot be put into practice unless satisfactory arrangements for the distribution of benefits and costs among the members are looked out successfully. Furthermore, this problem assumes additional importance in the light of the existing commitments to grant special treatment to the relatively less-developed countries (e.g. the landlocked country Nepal), since it is precisely these which will be least able to make a significant contribution to the costs of integration and, at the same time, are to derive most benefits from it.

The elimination of intra-regional obstacles to trade will inevitably alter the pattern of trade among the partner countries. These changes in the flow of trade will give rise to benefits and costs, the extent and

the distribution of which will depend upon the precise character of the trade liberalisation and the economic structure of the countries. The benefits and costs of integration will be governed basically by the extent to which the markets for the particular goods produced by each country expand and the protection affecting other products is reduced as a result of the elimination of the intra-regional obstacles to trade.\(^1\)

Of these factors, following merit special attention:

(a) the linkage effects of goods in which trade is facilitated. Trade in various goods will have different effects on the production of other items, depending on whether raw materials intermediate goods or finished goods are involved. The stronger these linkage effects, the greater the potential benefits to be derived from an increase in intra-regional trade.

(b) The opportunity cost of factors of production: To the extent that a country can increase the production of certain goods through the use of unemployed factors of production, that country can profit more speedily from the enlargement of the market achieved through the creation of trade liberalisation.

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Reduction of uneconomic productive barriers: Another way in which common market can yield benefits for partner countries is through the creation of trade. Such benefits result from the lowering of excessively high barriers which had caused distortion in the allocation of resources before the creation of the common market.

Besides, the common market will be involved with the benefits and costs of determining the pre-existing national tariffs and the common external tariffs of the group, since it would be this factor which would determine the relative possibilities of trade expansion of the different countries and which could be the major influence on the distribution of any costs of trade diversion. Moreover the existence of common external tariffs requires negotiation with the third countries before changes in such a tariff can be carried out on the joint basis, thereby increasing the bargaining power of each of the partner countries as compared with their bargaining power in separate negotiations.

There tends to be a movement of factors in the direction of more advanced areas and some measure of control is necessary here too. The movement of labour and capital may here be distinguished. An organised movement of labour can be useful both for the recipient country and for the country of origin. The organised
movement here implies, the existence of a mutually agreed programme among the countries concerned and possibly also certain harmonization or convergence of wage structures and social security policies. Because of rather generalized unemployment and underemployment prevailing in these countries, labour does not move from an unemployment economy to a full employment one, but rather from one in which labour opportunities are scarce to another where there are more work possibilities owing to the availability of land and other resources.¹

Movements of capital are intimately connected with integration programmes providing for an equitable geographic distribution of economic activities. Free movement of capital within a regional grouping will necessarily require all member countries to adopt a common policy of foreign exchange controls in relation to the third countries; without such a policy a country applying most liberal regulations could be used as a transit point for capital exports for its partner countries.²

1. Of course, labour movements between countries may well compensate for an unfavourable trade balance in that a trade deficit can be financed for a while through the remittances etc.

2. To avoid this risk, either the internal exchange rates would have to be "irreversibly" frozen or finally a common currency would mean that the integrated area would have to proceed to an economic or perhaps a political union. This would of course mean that sovereignty over economic policy would not only be relinquished de facto but also de jure.
Similarly a common policy in relation to the investment inflows from these countries is required. Again fiscal incentives can serve as an instrument to influence the geographical allocation of activities. In customs unions, the problem of landlocked countries is particularly important, because in many instances, the transit country derives advantages from the fact that it collects the import taxes in the first instance.

As regards agreements on sectoral cooperation for the purpose of distributing geographically the location of certain activities, "package deals" consisting of several projects are probably more acceptable than the project by project approach, because in this way, most if not all the countries can receive certain benefits. The expansion of the existing or the establishment of the new activities in a country creates benefits in the form of increased production and exports and reduced costs as well as greater employment opportunities. To the extent it is so, when integration is accompanied by import substitution behind a common external tariff, although the direct burden of any higher costs of production due to trade diversion will be borne by all member countries in proportion to the consumption of the product in question, the benefits consisting of industrial development or of a growth of real income will accrue largely to the country in which the development is concentrated. Myrdal
refers to these forces as the "backwash effects" whereas Hirschman terms them "polarisation effects".\(^1\) Polarisation effect is a process by which after the formation of customs unions, the growth of income, industry and employment tend to concentrate in one country. But this may not be true. The operation of the forces of polarisation between countries may be limited by the variety of factors which may produce growth centres in each country. These include the existence of several concentrations of fixed natural resources which may serve as strong points of industrial and commercial complexes; limits to the mobility of population; distribution of costs and finally, of course, policy integration. Besides, the dissemination of the economic benefits of economic and industrial development in a common market beyond the countries which enjoy the initial growth centres will depend on what Myrdal and Hirschman respectively term "spread effects" or "trickle down" effects.\(^2\)

As such, among developing countries, the impact of costs of economic integration are shared by members in proportion to their consumption of these local


2. Ibid.
products whose market prices exceed the cost of comparable imports, whereas the benefits from integration accrue in proportion to each member's share in integration-induced industries. A divergence in costs and benefits will be reflected in the induced intra-group trade of each member with its partner and in the net trade balance of each member with the rest of the group. In regional integration arrangements among less developed countries, substantial integration-induced trade imbalances are likely to be found.¹

If economic integration scheme in South Asia is to make its potential contribution to economic development, ways shall have to be devised simultaneously of ensuring that any inequities are overcome and that arrangements afford net benefits to all of their members. Some possible corrective measures are suggested here.

**Corrective Measures**

It should certainly be possible to adopt several measures which could help correct imbalances in the distribution of benefits and costs. Such measures can be taken at the beginning (ex ante) of the process of integration, while other measures of the ex post nature may be taken at the end of the previously specified review period.

However, no single measure would suffice in and by itself to achieve the broad objective of an acceptable distribution of costs and benefits; this objective can only be achieved by a judicious combination of several policy instruments appropriate to the severity of the problems faced, institutional particularities of the countries involved and the practical political possibilities at the time such measures are taken. Below may be mentioned some suitable forms of compensating action.

A. Trade Measures

The less developed partners of a grouping can obtain preferential trade treatment in one or several of the following ways: (a) By longer transitional periods for the opening up of their markets to trade; and the faced application of common external tariffs to them in the event of a common market. (b) By giving priority to the liberalisation of trade in commodities of special export interest to the less developed partners, e.g. processed goods based on natural resources found in these countries and items in respect of which these countries have unutilized capacities; (c) by excluding products already produced for local consumption in the less-developed partner countries from across-the-board tariff and non-tariff cuts, to the extent that in the home market these countries would be at a disadvantage in competing
with their more developed partners. (d) By imposing less stringent rules of origin for transitional periods with respect to exports from the less-developed partners; in this connexion, an even more far-reaching measure might consist of the requirement that a minimum portion of the inputs of certain processed products exported by the more advanced members of the group, such as processed food, must originate in the less developed partners in order to qualify for intra-group trade liberalisation.

(e) Less-developed countries of the group should be granted a certain degree of preference with respect to exports outside the integrated area.¹ For example, for products subject to quantitative restrictions (tea, jute, sugar etc) on the world market or in developed countries, the more developed countries in the group might, when distributing export quotas, yield part of their quota to less favoured countries. The reason for this is that the former derive greater benefits from integration, since they can take better advantage of the new benefits arising from integration e.g. new opportunities of wider market, whereas the less-developed countries find it harder. This would lead to a degree of balance wherein the more advanced countries of the area would benefit from the intra-area trade but would

have to make some concessions with regard to traditional exports to points outside the integrated area, while the less developed countries would make a sacrifice by buying in the more developed countries in the region, but would benefit by being able to increase their traditional exports.

B. Monetary and Payment Measures

Compensation can be provided to less developed countries within the framework of payments arrangements by granting more liberal credit to the less developed partners incurring deficits in trade with the rest of the group. But such a measure would be too narrow for correcting the structural imbalances of countries not deriving their fair share of the benefits of integration. Chronic deficits in the intra-area trade pose a problem which must be solved since if it is not, the country affected may take steps which may limit free trade within the area and endanger the integration scheme. In order to deal with this problem it has been suggested that a system of partial inconvertibility might be set up so as to force a country in surplus to buy more in a country in deficit, or else grant it larger loans.¹ The purpose

¹ Under the balanced trade agreement between India and Bangladesh, a trade turnover of Rs.61 crores was envisaged for the year ending 31st December, 1974. But actual performance was lower because of various impediments and an adverse balance of Rs.5 crores at the end of the year was converted by India into a credit in Bangladesh's favour to balance the trade.
of this system is to assist countries which are experiencing payments difficulties as a result of the development in intra-area trade. However, it should be applied in such a way that it does not encourage some countries to have chronic deficits in their trade with other member countries. Thus, for instance, thought might be given to the possibility of granting deficit country a credit for the total amount of the deficit in the first year, but in subsequent years the proportion of the deficit which would be financed would decrease so that the deficit country would have to pay an increasing proportion of each deficit in its intra-area trade in convertible currencies.

It may be further suggested to do "compelling" business in countries exporting to the less-developed countries to invest a proportion of the value of its exports in them. The basic idea is that the less-developed countries need not only obtain additional financial resources but also to improve their entrepreneurial capacity. This suggestion would oblige businessmen in the exporting countries to seek and develop new investment opportunities in the less developed countries.

C. Measures in the Field of Factor Movements

The free movement of skilled and unskilled labour across borders of countries participating in the integration

scheme has both negative and positive effects. The movement of labour thus can act as a useful balancing mechanism if subjected to proper control and agreed in advance by the various countries concerned. Similar considerations apply to an even greater extent when labour movements involve scarce entrepreneurial and managerial skills. The loss of such skills by the less developed partners might call for special measures of compensation and technical assistance.

Free movement of capital should depend on (a) a common regional investment policy and (b) a coordinated banking system which can redirect autonomously moving funds to those areas in greatest need of loanable funds. Thus capital movements both within the group and from third countries can be used as a balancing mechanism by applying mutually agreed incentives in favour of the less developed partners.

D. Fiscal Measures

Fiscal measures would take two directions as a corrective device (1) fiscal transfers as a mechanism for compensating the less developed partners and (2) harmonization of fiscal systems. Fiscal transfers may be linked with productive investments in less developed partners and may be for projects which are designed to reduce the social inequalities in the less developed
partners to seize the opportunities offered by integration schemes.

So far as fiscal harmonization is concerned, lack of harmony of fiscal systems may hinder intra-group trade and direct such trade to illegal channels and lead to undesirable influences on the distribution of opportunities for productive investment. Fiscal harmonization need not necessarily imply the equality of tax rates. Indeed since the less developed partners often rely on indirect taxes as important source of fiscal income, they might be permitted to introduce substitute revenue duties on a non-discriminatory basis (i.e., levied equally on domestic production, imports from partner countries and imports from third countries) even within the context of common markets. Income tax rebates might be granted to investors within the more advanced countries for the purchase of the stock of firms located within the less developed partners.

E. Measures in the Field of Common Services

Common services provide a particularly useful mechanism for reallocating costs and benefits of integration through appropriate policies in the following areas: (1) setting of rates and service fees, (2) employment, (3) the location of administrative offices, (4) purchasing and (5) investment. Such common services as scientific and technological research and development, administrative and high level training institutions, joint export promotion etc., also
provide the opportunity of yielding special benefits for the less developed countries of the grouping by giving high priority to their technological problems, training needs, export commodities etc.

F. Financial Measures

The more advanced partners can give import credits and import credit guarantees to exports from the less advanced partners to compensate for the general absence of export credits and export credit guarantee facilities in the less developed partner countries. Alternatively a regional scheme of export credits and export credit guarantees can be established which would provide such credits to finance extra-regional as well as intra-group exports. Such a scheme could give more favourable terms and provide for more liberal product coverage in respect of exports from the less advanced countries in the group. This is an area in which international assistance could be of particular value.

Common policies with respect to foreign investment could play an important role in influencing the volume and the terms of entry of such investments as might be appropriate to the development needs of the less advanced members of the grouping. Such common policies are also desirable as a safeguard against the danger that competition among partner countries for foreign investment might lead to the granting of excessive concessions.
G. Direct Assignment of Economic Activities

In the direct assignment of economic activities, industrial enterprises would have to be given highest priority at least in the long run, but the assignment of enterprises in other fields, e.g., agro-industry, natural resource development and tourism might be equally effective. The location of enterprises in the less developed partner countries regardless of their net benefits may not always be helpful, however, since certain enterprises involve costs not commensurate with the benefits to be derived by the host country. Therefore, the assignment of enterprises should be preceded by the detailed studies of the distribution of costs and benefits involved for all partner states.

Decision on the location of productive enterprises should in general be determined by means of indirect instruments relying on market forces. However, direct measures of allocation of productive enterprises may also be necessary. Particular attention should be paid to the assignment of projects located on border areas, based on local natural resources and relying on multinational labour force and/or market for their full utilisation, with a view to making such areas poles of growth and integration, thereby creating vested interests for continued cooperation on both sides of the border. In this
context, national development institutions and national
development plans should be formally geared to specific
integration objectives, including the attainment of
equatable benefits for less-developed partners.

In order to overcome the problems consequent upon
polarization, but none the less to attain greater efficiency
in production, it has been proposed that all member countries
should share the ownership of certain undertakings which
need the regional market in order to operate efficiently.
In this way a country which is not receiving the benefits
resulting from the location of an undertaking in its
territory (employment, value-added and so on) would at least
participate in the undertakings profits as a shareholder.
Again, to counter the trend towards polarization, it
has been proposed that trade among the member countries
should be kept strictly in balance with regard to various
classes of goods so that a country may export certain
goods to another only if it imports from it an equal amount
of goods in the same class. A pre-requisite for the
existence of trade, therefore, is the development of similar
productive activities in all the countries.

1. Little, I.M.D., "Regional International Companies
   as an Approach to Economic Integration", Journal of
   p. 181.

2. Elkan, P.G., "How to Beat Backwash - The Case for the
   Drawback of Customs Union", The Economic Journal,
   March, 1965, p. 44.
As such it seems realistic to assume that some form of compensation agreement will be required. Its object will be to provide that certainly no country should fare worse within the scheme than it would outside and that as far as possible, a fair distribution of benefits should be assured. Compensation will tantamount to granting privileged treatment and otherwise transferring resources to the countries gaining least (or nothing) from those gaining most by integration— to the extent that this can be assessed. Its immediate aim may range from a restructuring of the recipients economy to the transitional easing of financial difficulties.¹

Compensation arrangements will, therefore, take a wide variety of forms and will usually entail some kind of "package deal" as a condition for weaker countries entering or remaining in the common market. Since integration will bring a large number of new problems simultaneously, compensation will probably have to cover several aspects of economic activity at once.

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